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**MECHANISMS AND ARRANGEMENTS FOR ALLOCATING FISCAL
TRANSFERS TO SELF-GOVERNING ABORIGINAL GROUPS:
Evolving the Fiscal Relations**

Evren J. F. DeSousa

MPA Candidate

School of Public Administration

University of Victoria

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Policy Development and Coordination Branch
Treaties and Aboriginal Government
Indigenous and Northern Affairs Canada
Government of Canada

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by

Evren J. F. DeSousa

Master of Public Administration Candidate

School of Public Administration

University of Victoria

Examining Committee:

- Client:** Alan Greer
Manager, Operational and Fiscal Policy
Treaties and Aboriginal Government
Indigenous Affairs and Northern Development Canada
- Supervisor:** Dr. Rebecca Warburton
Associate Professor
School of Public Administration
University of Victoria
- Second Reader:** Dr. Thea Vakil
Associate Professor and Associate Director
School of Public Administration
University of Victoria
- Chair:** Dr. J. Barton Cunningham
Professor
School of Public Administration
University of Victoria
- Date Defended:** July 13, 2016

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NOTE TO THE READER

This paper is presented in the spirit of fostering a new understanding of fiscal arrangements in support of Aboriginal self-government. The opinions expressed in this capstone research paper are solely those of the author and interviewed participants, and do not necessarily reflect the opinions or positions of the Department of Indigenous and Northern Affairs, the Government of Canada, the University of Victoria, or any other specific party. The findings and opinions expressed in this paper do not constitute a representation of federal policy or position on self-government fiscal negotiations.

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On a personal note:

To my ever-supportive dad, mum and sister - a heartfelt thank you.

EPIGRAPH

“Indigenous peoples from across the country are at an important juncture in our history as they seek to deconstruct their colonial legacy and rebuild their communities. We all have a role to play. [However], even with political will, support and resources, only the colonized can decolonize themselves.”

Hon. Jody Wilson-Raybould, Attorney General of Canada (2016)

“Once you have an idea of the type of political institutions that you need it also becomes apparent that you don’t want to live on a handout, and that free housing and free education and free government does not exist anywhere in the world. It does not lead to independent, self-reliant individuals and families and communities. So I mean a government by itself, an agreement for self-government by itself doesn’t do anything.. Governments need to be financed, they have to be economical and affordable and they have to be workable. And the people that want to govern themselves have to accept that responsibility.”

Stephen Kakfwi, Dene Nation and former NWT Premier (2000)

“The vast majority of transfers received from the other two orders of government should be devoted as much as possible to supporting actual services, rather than to the high costs of constantly negotiating and renegotiating annual financial agreements. Formula funding such as that found in the fiscal arrangements for the territorial governments is based on a set of indicators and is usually reviewed every five years. This allows for better planning and greater predictability and autonomy.”

Royal Commission on Aboriginal Peoples (1996, p. 273)

“The rapid growth of the First Nation population will ensure that the status quo becomes steadily more costly both in fiscal and social terms. However, given the immense political difficulties these issues present and the importance of developing national position on them, a national table on fiscal relationships is a vital next step for Canada.”

Fiscal Realities (1998, p. 70)

EXECUTIVE SUMMARY

INTRODUCTION

Fiscal transfers to self-governing Aboriginal groups provide financial support for a number of areas: governance activities, treaty implementation, administrative and operational functions, and for programs and services. Indigenous and Northern Affairs Canada (INAC) notes that self-governing Aboriginal groups often face significant challenges such as geographic barriers, diseconomies of scale, poor socio-economic conditions, overlapping government responsibilities; and limited fiscal capacity and higher fiscal need. Effective federal funding mechanisms and fiscal arrangements help address many of these unique challenges faced by Aboriginal governments. With the projected number of self-governing groups to increase in the next decade, it is imperative that implemented fiscal arrangements are stable, workable, predictable and flexible and equitable.

The purpose of this research study is to explore possible mechanisms and arrangements for allocating fiscal transfers in support of Aboriginal self-government. Potential funding mechanisms and fiscal arrangements have been examined and analysed through a comprehensive literature review. Perspectives from key informant interviews have been used to supplement the research. Recommendations to improve upon the current fiscal arrangements are proposed and help wrap up the discussion and analysis. The findings from this research study will further the understanding of how to design appropriate fiscal arrangements in support of Aboriginal self-government.

The primary research questions to be addressed are:

- What are the barriers and challenges to successful Aboriginal self-government fiscal arrangements?
- How could the allocation of funding be modified in order to be more effective?
- What mechanisms or design options can be adopted to improve fiscal arrangements in providing appropriate support for Aboriginal self-government?

In achieving the objectives, this paper will: provide an analysis of issues with current fiscal arrangements; obtain views and perspectives from key informant interviews; identify and analyze potential funding mechanisms and models for the provision of transfers; and provide suitable recommendations for policymakers to consider.

METHODS

A qualitative approach was taken to best achieve the objectives of this study. A comprehensive literature review and document analysis was performed on available academic sources and government documents including relevant legislation, agreements pertaining to self-government fiscal arrangements, fiscal side agreements, and taxation agreements. Interviews were conducted with federal officials, academics and Aboriginal group representatives. Data gathered from the interviews

was interpreted using thematic analysis. The findings from the literature review, key document analysis and key informant interviews were analyzed using an analytical policy framework (adapted from work of David Hawkes and Allan Maslove), and all findings were integrated in order to identify potential funding models and promising practices to help inform the recommendations for policymakers within the sector to consider.

FINDINGS

After more than thirty years of experience with various models of self-government—that range from legislative, stand-alone, sectoral, and modern treaties—INAC has noted several issues with the current approach of allocating fiscal transfers to self-governing Aboriginal groups:

- Time consuming and costly negotiations – Fiscal negotiations can be time-consuming and expensive, often requiring prolonged and contentious discussions. Often resources allocated to fiscal negotiations are disproportionately high compared to the dollar values at stake.
- Varying in provisions– Current arrangements across Canada have key provisions, conditions and funding amounts that vary by agreements and over time as federal mandates and policies evolve.
- Risk and inflexibility – Aboriginal communities are often subjected to increased fiscal risk if local service needs change substantially between agreement renewals. The current method of allocating funding through fixed block amounts is not directly responsive to changes in program demands.
- Lack of clarity and loss of information – The underlying basis on which block funding is allocated can be obscure, leading to contention over time over which programs and services received funding and at what levels.
- Timing of fiscal negotiations – Details of fiscal arrangements (including funding levels and terms and conditions) are not clearly delineated until the final stages of treaty and self-government negotiations.

To help inform the recommendations to improve upon the current system of fiscal arrangements, promising practices from the international context have been identified. Research conducted predominantly by Anwar Shah, Robin Boadway, Richard M. Bird and Michael Smart suggest that the design of intergovernmental fiscal transfers should:

- Address situations where a sub-national government’s level of revenues do not match with the expenditure responsibilities as measured between different orders of government (vertical fiscal imbalance), and where fiscal disparity occurs between the same order of governments (horizontal fiscal imbalance);
- Account for the spillover of benefits from public programs to neighboring jurisdictions when providing funding through matching grants for regional governments.

- Preserve national equity objectives by implementing minimum standards in public areas (such as health, education and social development), as they provide in-kind transfers to residents in communities regardless of region; and
- Improve economic productivity in depressed regions. Often the tool of choice is matching grants, but their use should be monitored to ensure effectiveness in capital infrastructure projects or job creation strategies.

Data gathered from interviews was synthesized using thematic analysis. Findings include:

- The problems that manifest within self-government fiscal arrangements stem inherently from issues within the *Indian Act*. The establishment of the *Indian Act*, resulting in a small patchwork of reserves often situated in areas of low economic potential, has not only contributed to broader socio-economic issues plaguing Aboriginal communities across Canada, but also to the issues that arise in self-government—in particular, the stagnant economic development opportunities and the lack of Indian band governance and financial management capacity building. The reserve system also created a concept of land management vastly different from the conventional approach. A shift towards private fee simple ownership of reserve land and exercising property tax are promising ways to spur economic development and self-reliance.
- Current federal policy should move away from its stance of ‘policy neutrality’ regarding encouraging First Nation groups to enter treaty negotiations as an aggregate, rather than separate groups and nations. Currently in the treaty negotiation process, the majority of the 65 groups have population of less than a 1000 people—7 groups have populations of less than 300 with one even having a population of 66 people. Some minimum population is needed for efficient governance and service delivery but firm estimates remain the subject of debate.
- Fiscal arrangements should not solely be about funding but also should improve governance and financial management capacity within the community. As Indian bands transition to self-governments, the corresponding fiscal arrangements should enable good governance and financial management practices. Some Aboriginal groups lack ‘in-house’ governance and financial management resources and often have to contract outside experts to fulfill the need. Continued dependence on extra-community resources erodes the aspect of self-reliance Aboriginal governments strive for.
- Fiscal arrangements should be constructed on a multilateral policy framework built on shared principles, priorities, and methodologies for determining and allocating fiscal transfers. This approach would lead to collaborative development of funding methodologies and a shared understanding of outstanding issues and potentially reduce the likelihood of protracted negotiations.
- There is a pressing need for institution-building within the current system of fiscal arrangements. Until the recent release of the Fiscal Approach, a national forum for formal policy review has not been a part of Canada-Aboriginal fiscal relations. Policy development has thus far occurred on an ad-hoc basis of consultations and engagement with various Aboriginal communities.

There is a need for accurate, reliable and up-to-date data and statistics on Aboriginal communities and the services they receive to be collected.

- Aboriginal-Canada fiscal arrangements should be based on transparent terms that reflect coordinated federal approaches that help achieve the guiding principles. Over time the fiscal transfer systems has become unmanageable, dysfunctional, and most importantly inequitable for Aboriginal groups. Within the federal bureaucracy, the internal mandating process also needs to be streamlined and coordinated to ensure equitable outcomes for negotiating Aboriginal groups. It is also unclear of whether the funding methodologies stated in the Fiscal Approach in fact help achieve the principle of equalization that is alluded to within 10.2 of the principles of the policy. Furthermore, it is not explicit if the funding methodologies or fiscal arrangements do encourage principle 10.6 of efficiency and cost-effectiveness, as there are no aspects of performance measurement in place in any existing agreements or federal policy.
- Fiscal transfers should provide incentives both at the individual level and at the community's governance level. Some interviewees noted that program funding provided by INAC to some First Nation communities has been stalled at the band governance level and not filtered down to community members. Education, for example has been a problematic program to fund. In some cases, education funding transferred to a First Nations has not been spent accordingly. Thus, some interviewees suggested that federal funding provided to a particular sector should be designed to provide financial support for the individual. Performance-oriented transfers could create such incentives; however, interviewees noted that implementing this approach in an Aboriginal self-government context could be unsupportive, as self-governing communities argue that performance-oriented transfers limit perceived autonomy and by nature contravene the nature of self-government.

Findings from the international context and synthesis of interview data were applied to a policy framework (which was adapted from the work of David Hawkes and Alan Maslove) that produced six strategic objectives that Canada-Aboriginal fiscal arrangements should seek to achieve:

1. Fiscal arrangements should reside in a common Canada-wide framework, including policies about both self-governing Aboriginal groups and Indian bands operating under the *Indian Act*.
2. Fiscal arrangements should appropriately support and complement the respective self-government model they fall under.
3. Fiscal arrangements should be attuned to the economic and sociopolitical circumstances of Aboriginal government and community
4. Fiscal arrangements should encourage, enable and incentivize the Aboriginal government to become more self-reliant on own-source revenue generation.
5. Fiscal arrangements should not only work towards reducing funding disparities between Aboriginal and non-Aboriginal communities but also between Aboriginal governments themselves.
6. The design of fiscal transfer components should encourage the spillover of benefits that arise from the provision of public programs and services by Aboriginal governments.

RECOMMENDATIONS

Based on all of the research conducted, this paper provides nine recommendations to improve upon the current system of fiscal arrangements with self-governing Aboriginal groups.

Recommendation 1

It is recommended that the federal government along with the provinces, territories and Aboriginal governments develop and establish through negotiations a shared Canada-wide fiscal relations umbrella framework that sets the strategic and principled foundation for fiscal arrangements with all Aboriginal communities, including:

- Indian bands currently operating under the *Indian Act* (or replacement legislation¹);
- Aboriginal governments that are party to modern treaties, comprehensive land claims with a self-government component, or stand-alone self-government agreements.

Recommendation 2

It is recommended that the AANDC prioritizes institution-building in support of Aboriginal self-government and along with the provinces, territories and Aboriginal governments fully establishes an advisory body with a statutory mandate that includes:

- Commitment by the parties to include the involvement of senior management and decision makers;
- Commitment by the parties to review fiscal matters in a good faith manner that respects the positions of each of the parties;
- Operation in a manner that is transparent and open and is in concert to sound public administration practices;
- Commitment by the parties to practice reciprocal transparency in fiscal matters; and
- Recognition by the parties that the advisory body is not a decision making body and its recommendations are non-binding.

Recommendation 3

It is recommended that the AANDC prioritizes institution building and works with Statistics Canada to:

- Institute resources mandated to provide statistical information and analysis specifically about Aboriginal peoples and communities to inform, develop and evaluate funding mechanisms and arrangements that provide fiscal support for Aboriginal governments and communities; and
- Improves on the efficiency of data collection and statistical methods.

¹ Jody Wilson-Raybould, Attorney General of Canada has recently expressed abandoning the *Indian Act*, in favor of a reconciliation framework (Gilmore, 2016).

Recommendation 4

INAC should move away from the “status Indian” criteria generally used in measuring an Aboriginal government’s population and either adopt a:

- True service population that explicitly ensures individuals are not being funded by INAC for any services provided by another level of government; or a
- Broader citizen-based approach including the consideration of financially reconciling, in whole or partially, the additional costs of public service provision borne by provinces and territories to citizens residing off-Aboriginal government lands.

Recommendation 5

It is recommended that TAG revise the Fiscal Approach to foster efficiency in governance and service provision by encouraging Aboriginal groups to aggregate either prior to the treaty or self-government negotiation process or in the delivery of programs and services.

Recommendation 6

It is recommended that Canada, the provinces/territories and Aboriginal governments share responsibility for the financing of Aboriginal self-government. This represents a major shift from the *Indian Act*, which makes the federal government solely responsible, and would require agreement from provinces/territories and Aboriginal governments.

Recommendation 7

It is recommended that TAG work with the Department of Finance to:

- Amend the federal corporate income tax to apply the small business tax rate to all businesses operating on Aboriginal government lands for some transitional period (such as five to ten years), including creating federal tax credits for those eligible businesses that provide employment for community members;
- Revise the current Fiscal Approach that pertains to the treatment of business entity profits to transfer a portion of tax revenues to the Aboriginal government instead of (as at present) crediting them entirely to the federal government.

Recommendation 8

It is recommended that INAC work on a province-by-province basis to develop a natural resource revenue sharing strategy to provide Aboriginal communities with a portion of government revenues that arise from natural resources. This portion could equate to the percentage of Aboriginal population within the province.

Recommendation 9

TAG, when designing fiscal transfers to Aboriginal governments should:

- Take into account not only the fiscal capacity of the Aboriginal government but also explicitly account for the differential expenditure needs and the fiscal effort² of the Aboriginal governments;
- Fully incorporate mechanisms that are formula-based, responsive and redistributive; and
- Ensure that fiscal transfer arrangements are based on transparency and encourage public accountability.

² The amount of total revenue that is generated by the Aboriginal government—often represented as a proportion of fiscal capacity.

LIST OF ACRONYMS

AANDC	Aboriginal Affairs and Northern Development Canada was the name of the department from 2011 to 2015
AV	Adequacy Variant
CHST	Canada Health and Social Transfers
DIAND	Department of Indian Affairs and Northern Development is the legal title under the Federal Identity Program established in 1966, and is derived from the department's enabling legislation, the <i>Department of Indian Affairs and Northern Development Act</i> [RSC. 1985, c. I-6]
FFTA	Fiscal Financing/Transfer Agreement
FIDDIPI	Final Domestic Demand Implicit Price Index
FRA	Fiscal Relationship Agreement
GAAP	Generally Accepted Accounting Principles
GEB	General Expenditure Base
INAC	Indigenous and Northern Affairs Canada is the applied title currently used under the Federal Identity Program for the departments. Past titles also include Indian and Northern Affairs Canada
OSR	Own-Source Revenues
OSRA	Own Source Revenue Agreement
PDC	Policy Development and Coordination Branch
RCAP	Royal Commission on Aboriginal Peoples
RSV	Relative Standard Variant
SGA	Self-Government Agreement
SGFAA	Self-Government Fiscal Arrangements Act
SGYFN	Self-Governing Yukon First Nation
TAG	Treaties and Aboriginal Government
TFF	Territorial Formula Financing
TRR	Transfer Reduction Rate

GLOSSARY OF TERMS

Aboriginal government	Defined as the government with which Canada has established a direct fiscal relationship through a comprehensive land claim agreement which includes a comprehensive self-government component constitutionally protected as treaty rights under section 35 of the <i>Constitution Act, 1982</i> ; a comprehensive agreement on self-government; a sectoral self-government agreement; or a legislated comprehensive self-government arrangement, notwithstanding the recognition that there are band council and traditional forms of governance that are practiced by Indian bands.
Aboriginal government lands	Means lands, which the particular Aboriginal government has general governance jurisdiction over.
Central Agencies	Refers to the Privy Council Office, the Treasury Board Secretariat and the Department of Finance who play a key role in the decision-making process and administration of the federal government.
Comprehensive Land Claims	Refers to claims negotiated with Aboriginal groups in areas to Aboriginal title have not been addressed by treaty or through other legal means.
Executive Federalism	Means the system of meetings and negotiations between federal Ministers and officials and their provincial and territorial counterparts.
Fiscal chapter	Refers to the chapter in a final agreement that deals with fiscal relations.
Sectoral self-government	Refers to self-government over a sector or jurisdiction, for example, education.
Self-Government Financial Transfer Agreements	Refers to 5-8 year funding arrangements that INAC enters into with Aboriginal groups that have a self-government arrangement with Canada.
Side agreements	Refers to intergovernmental agreements signed between Aboriginal governments, Canada and the province (in some cases) that support self-government agreements or treaties.

Mechanisms and Arrangements for Allocating Fiscal Transfers to Self-Governing Aboriginal Groups: Evolving the Fiscal Relations

1.0 INTRODUCTION

This research paper reviews the legal, economic and public finance literature to refine promising policy practices³ that could be adopted to improve the current fiscal arrangements between self-governing Aboriginal groups (used interchangeably with Aboriginal government) and the Government of Canada. It covers new ground as it distills practices from international jurisdictions, reshapes and applies it to the Aboriginal self-government context and the Canadian intergovernmental fiscal system. The discussion and analysis contained in this paper is intended to advance the current thinking and understanding about how to design effective fiscal transfers and arrangements that support Aboriginal self-government.

This research paper was prepared for the client, Alan Greer, Manager of Operational and Fiscal Policy in the Policy Development and Coordination Branch (PDC) of Indigenous and Northern Affairs Canada (INAC). The author has worked with the client to establish the focus and scope of this research paper. PDC provides strategic, fiscal and operational policy support regarding the negotiation of self-government and land claims for the Treaties and Aboriginal Government (TAG) sector on behalf of the Government of Canada.

DEFINING THE PROBLEM

In providing programs and services to its communities, self-governing Aboriginal groups (used interchangeably with Aboriginal governments in this paper) often face significant challenges such as geographic barriers, diseconomies of scale for service provision, poor socio-economic conditions, competing/overlapping government responsibilities; and limited fiscal capacity relative to need. Effective federal funding mechanisms and fiscal arrangements help address many of these challenges faced by Aboriginal governments. With the number of self-governing groups projected to increase in the next decade, AANDC is committed to ensuring that implemented fiscal arrangements are stable, predictable and flexible (AANDC, 2012).

After more than thirty years of experience with self-government, AANDC has noted several issues with the current approach in allocating fiscal transfers to Aboriginal governments. Funding mechanisms and methodologies often lack clarity, responsiveness, and flexibility; vary in provisions; and in some cases the underlying rationale for program and service funding is no longer clear. In addition, negotiating fiscal arrangements is time-consuming

³ This paper uses the term “promising” as opposed to “smart or best” when referring to policy practices, as the latter assume universal application while the former does not.

and expensive (AANDC, 2012). These issues reduce the efficacy of federal transfers to Aboriginal governments.

STUDY OBJECTIVES

The purpose of this research paper is to explore mechanisms and arrangements for allocating fiscal transfers in support of Aboriginal self-government, in order to make recommendations for improvement.

The primary research questions to be addressed are:

- What are the barriers and challenges to successful Aboriginal self-government fiscal arrangements?
- How could the allocation of funding be modified in order to be more effective?
- What mechanisms or design options can be adopted to improve fiscal arrangements in providing appropriate support for Aboriginal self-government?

To achieve the objectives, this paper will: provide an analysis of issues with current fiscal arrangements; obtain views and perspectives from key informant interviews; identify and analyze potential funding mechanisms and models for the provision of transfers; and provide suitable recommendations for policymakers to consider.

SCOPE

While there are a number of different models that could be applied to Aboriginal self-government, to ensure feasibility in achieving this paper's objectives, the focus of this paper will be on the modern treaty model, which consists of Aboriginal groups having a comprehensive land claim with a self-government component. However, where appropriate, discussions may include other Aboriginal groups who are either operating under a non-treaty model of self-government or are under the *Indian Act*.

Similarly, there are some instances where the discussion and analysis of policy issues is outside the scope of the modern treaty model of self-government fiscal arrangements and thus, excluded from the scope of this paper. Such issues, for example, are detailed analysis of the *Indian Act*, and the lack of fee simple land ownership in reserves. However, policy issues such as 'status Indian' verses 'true service population', and aggregation of Aboriginal groups in treaty negotiations have been deemed within the scope of this paper, and therefore, included in the discussion as they directly affect funding levels for governance.

During the research and analysis of this paper a number of policy issues materialized that were peripheral to the objectives and research questions of this paper. Therefore, they were out of the scope of this paper. However, these policy issues could benefit from further research and could potentially enhance the effectiveness of self-government fiscal arrangements. The author has noted these peripheral policy areas in the concluding section of this paper.

The goal of this research paper is not to detail an all-encompassing review of every fiscal aspect concerning arrangements with Aboriginal governments, but rather to feature important principles, mechanisms and fiscal arrangements that have helped influence the evolution of Canada-Aboriginal fiscal relations. Similarly, in the international context this paper does not attempt to examine every intergovernmental fiscal transfer system, but rather to draw upon promising practices that have already been identified by substantial contributors to the field—such as Anwar Shah, Robin Boadway, Michael Smart and Richard M. Bird among others—and reshape and apply them to the Aboriginal self-government context.

Ultimately, the focus of this paper is on: a) identifying promising practices regarding the technical and design mechanisms of fiscal arrangements as learned from the international context; and b) examining the unique contextual aspects, together with the Aboriginal self-government context, within which federal-Aboriginal fiscal arrangements reside.

Recommendations to improve upon current fiscal arrangements with Aboriginal governments flow from the discussion and analysis. The findings from this research paper will further the understanding of how to design appropriate fiscal arrangements in support of Aboriginal self-government.

ORGANIZATION OF THIS RESEARCH PAPER

This paper is divided into nine sections, each composed of a number of sub-sections. Section 1 introduces the topic of study, defines the problem to be examined, states the research questions and objectives of this paper, and summarizes the methods to be used.

Section 2 provides background and contextual information for the reader.

Section 3 describes the methodology employed to investigate the research questions, including the analytical framework utilized. This research paper adopts a qualitative approach to investigating the research questions, which includes a literature review, document analysis and thematic analysis of key informant interviews. Caveats are placed around certain concepts in order to ensure feasibility of this research paper's objectives. Limitations of the research study are also identified.

Section 4 provides an overview of fiscal arrangements with Aboriginal governments through a document analysis of key legislation, federal policies and fiscal side agreements. It commences by recounting how federal policy on Aboriginal governance has evolved from early prejudicial colonist perspectives to the inherent right of self-government. In the second section principal features of existing fiscal arrangements are briefly analyzed. The third sub-section compares current Canada-Aboriginal fiscal relations to that of federal-provincial/territorial relations. Several similarities and differences emerge from this comparison and their implications are discussed. Section 4 closes with an overview of recent developments in federal/Aboriginal fiscal arrangements.

Section 5 summarizes the results of the literature review, illuminating promising practices drawn from the work of Anwar Shah, Robin Boadway, Michael Smart and Richard M. Bird on intergovernmental fiscal transfer systems around the world. Principles essential for successful intergovernmental fiscal relations are also identified.

Section 6 provides an overview of the themes that emerged from interviews with key informants and subject area experts. These themes help situate self-governing fiscal transfer arrangements within the broader Aboriginal policy climate and identify factors that inhibit the effectiveness of existing fiscal arrangements.

In Section 7 findings from the literature review, document analysis, and interviews are discussed and analyzed through the lens of an analytical policy framework that was developed from the literature review and has been revised and adapted from the work of David Hawkes and Allan Maslove in the late 1980s. Applying the adapted policy framework produces six objectives that fiscal arrangements should address and work towards.

Section 8 provides recommendations to policymakers within PDC of Treaties and Aboriginal Government in order to improve both the technical and design aspects of fiscal arrangements in place across Canada today. These recommendations can be considered incrementally, exclusive of each or as a whole to restructure and revitalize fiscal arrangements. In the latter half of Section 8, a novel way forward to reforming Canada-Aboriginal fiscal relations is articulated. This approach is differentiated from the preceding recommendations as it necessitates a complete restructuring of the current framework that operationalizes fiscal relations.

Section 9 concludes the paper. During this research a number of peripheral issues surfaced, which were out of the project scope. These policy issues could benefit from further research and have been noted by the author in this final section.

2.0 BACKGROUND

Aboriginal peoples in Canada comprise three groups: First Nations, Inuit and Metis. Together, Aboriginal peoples represent 4.3% of the Canadian population, with First Nations representing 61% of the total Aboriginal population (Statistics Canada, 2011). Social and economic inequality remains pervasive between Aboriginal and non-Aboriginal communities. Significant disparity has led to marginalization, discrimination, socioeconomic stratification and adverse health outcomes amongst Aboriginal individuals (White, Beavon & Spence, 2007). Aboriginal peoples—especially those who have to experience such inequality frequently first hand or reside in communities where social problems are prevalent—have been calling out for changes in how Aboriginal communities are funded (Kirkup, 2016).

Contrary to public perception, federal funding has been made available in part to address the socioeconomic and health disparities. Since 1946 the federal government has responded, and continues to respond, by providing more funding through AANDC and Health Canada that approximates \$256 billion over the past 70 years (Bains & Ishkanian, 2016). Annual spending on Aboriginal peoples rose from \$82 million in the early 1940s to \$8 billion in 2014. Although, this in part was due to a surge in the growth of the Aboriginal population over the same period, the dollar amounts are significant. Furthermore, there are numerous Aboriginal communities across Canada have been thriving and continue to generate a substantial amount of revenues. Over the span of 2014 alone, First Nations brought in an estimated \$3.3 billion in own-source revenues, the majority of which exceeded their individual federal transfers (Bains & Ishkanian, 2016).

Questions and concerns inevitably arise concerning the efficacy and effectiveness of federal funding. Aboriginal people themselves want a brighter future—they want their communities to succeed. Uncovering the underlying causes of persistent socioeconomic ills continues to be elusive. The federal government has mandated self-government (through the 1995 Inherent Right Policy) as an approach to empower Aboriginal communities towards self-reliance and autonomy. Fiscal arrangements have evolved over time and continue to evolve in order to better support self-governance. This evolution, however, has not resulted in a perfectly designed and constructed system of allocating fiscal transfers to Aboriginal self-governing groups. The current fiscal arrangements between Canada and Aboriginal governments are fraught with a multitude of systemic issues.

ABORIGINAL SELF-GOVERNMENT

Section 35 of the *Constitution Act, 1982* recognizes the inherent right of self-government and therefore, self-governing Aboriginal groups can be effectively viewed as a new and

legitimate level of government⁴ (AANDC, 1995, 2010; Hurley & Wherrett, 2000). Through self-government agreements, Aboriginal groups govern their internal affairs and have a greater control over the decision-making that directly affects their communities. Self-government agreements address: the structure and accountability of Aboriginal governments, their law-making powers, financial arrangements, and their responsibilities for providing programs and services to their members (AANDC, 2010).

Prior to entering into self-government, Aboriginal groups govern and operate under the severely restrictive *Indian Act*, which is the principal federal legislation through which INAC administers Indian status, band council governance structures, and federal reserve land and monies (Henderson, 2006). Self-government is intended to promote sound governance and intuitional and financial capacity building in order to empower communities to be more self-reliant, shifting responsibility and accountability from INAC to the local community. As a group, self-governing First Nations have better education, employment and labour force outcomes in comparison to registered Indians living on reserves managed by Bands operating under the *Indian Act*, in part attributed to a renewed sense of pride in their newly established governments, new relationships that spurred socio-economic growth in their communities (AANDC, 2011)

Across Canada there are more than 600 Aboriginal communities, most of which are not self-governing and operate under the *Indian Act* (AANDC, 2015a). However, to date, the Government of Canada has entered into more than 25 self-government fiscal arrangements with individual Aboriginal governments as part of the self-government and comprehensive land claims negotiation process (see Appendix A for a complete list). Self-government has been operationalized through a variety of models: legislated (i.e. Sechelt Indian Band); separate self-government agreements that are associated to a land claim (Yukon First Nations); as a stand-alone agreement (Westbank), as a sectoral agreement (e.g. Mi'kmaq education), or as part of a comprehensive land claim (modern treaty) (such as Tlicho, Nunatsiavut, Nisga'a, Tsawwassen, and Tla'amin⁵). Figure 1 below displays the numerous self-governing Aboriginal groups across Canada.

⁴ Rustand (2010) and Gibson (2009) contest the view that there is a third order of government within the Canadian federation that consists of self-governing Aboriginal groups, purporting that Aboriginal self-government can only be achieved through delegating federal legislation rather than recognizing an inherent Aboriginal self-government power that is not derived from Crown sovereignty.

⁵ Tla'amin is also referred to as "Sliammon".

FIGURE 1: SELF-GOVERNMENT AGREEMENTS IN EFFECT ACROSS CANADA



(Source: modified from AANDC, 2014 by author)

Aboriginal governments can, however, face significant challenges, which include (but are not limited to):

- Geographic barriers – The remote locations of many Aboriginal communities limit access to economic and employment opportunities, and government services (see Figure 1 above and Figure 2 below).
- Small populations – Many Aboriginal communities have populations of a few hundred or less (see Table 1 below). As a result, Aboriginal governments face high fixed costs and are particularly susceptible to funding and program delivery problems associated with diseconomies of scale.
- Service delivery difficulty due to remoteness of communities – As Figure 2 depicts, nearly 75% of Aboriginal governments are located north of the 60th parallel, and only four Aboriginal governments (Sechelt, Tsawwassen, Westbank, and some Mi'kmaq communities) are located within 50km of a major urban centre. Some Aboriginal governments have no year-round road access to a nearby service centre, or year-round road access to all of their communities, making delivery of services difficult and costly.
- Socio-economic conditions – Compared to the rest of the Canadian population, Aboriginal communities have higher rates of unemployment, lower educational attainment and worse health outcomes.
- Overlapping government responsibilities – the federal, provincial/territorial or municipal governments may have intersecting roles in the provision of programs and services to Aboriginal communities that result in diffusion of responsibility.

- Limited fiscal capacity relative to need – The ability of Aboriginal governments to generate revenue is often limited. Costs of delivering programs and services are also typically greater due to diseconomies of scale and geographic remoteness resulting in prolonged fiscal dependency. Under the *Indian Act*, Indian bands rely heavily on federal transfers to fund their operations and program delivery. While the transition to self-government is expected to improve socio-economic conditions, most self-governing Aboriginal communities will continue to be dependent on federal fiscal transfers for the majority of their funding. This is a result of their limited ability to raise revenues (small tax bases) and relatively high per capita expenditure need, arising from the diseconomies of serving small and often isolated communities, many of which have limited economic opportunities, ongoing social challenges and associated program demands (AANDC, 2012).

FIGURE 2: ABORIGINAL GOVERNMENTS BY REMOTENESS

LATITUDE (Environmental Classification)	DISTANCE TO SERVICE CENTRE (Geographic Zone)			No Road Access	
	< 50km by road	50-350km by road	> 350km by road	< 240km	> 240km
North of 60°	• Yukon (2)	• Yukon (6) • Tlicho (1)	• Yukon (2)	• Yukon (1) • Tlicho (3)	
55-60°		• Nisga'a (4)		• Nunatsiavut (2) • Nunatsiavut (1)	
50-55°	• Westbank			• Nunatsiavut (2) • Maa-nulth (1)	
South of 50°	• Sechelt • Tsawwassen • Mi'kmaq (7)*	• Maa-nulth (3) • Mi'kmaq (4)**		• Maa-nulth (1)	

* Acadia, Annapolis Valley, Bear River, Membertou, Paqtnkek, Pictou Landing, Shubenacadie (Indian Brook)

** Chapel Island (Potlotek), Eskasoni, Wagmatcook, Waycobah (Whycocomagh/We'koqma'q)

(Source: AANDC, 2014. Data derived from the Band Classification Manual, 2005)

TABLE 1: ABORIGINAL GOVERNMENTS IN CANADA

Aboriginal Group	Location	Effective	On-Lands Pop.	Tot. Pop.*
<i>Legislated (stand-alone)</i>				
Sechelt	BC	1986	638	1384
<i>Self-Government Agreement (as part of a comprehensive claim)</i>				
Champagne & Aishihik	Yukon	1995	352	900
Nacho Nyak Dun	Yukon	1995	167	555
Teslin Tlingit	Yukon	1995	268	601
Vuntut Gwitchin	Yukon	1995	259	547
Little Salmon/Carmacks	Yukon	1997	310	657
Selkirk	Yukon	1997	336	637
Tr'ondëk Hwëch'in	Yukon	1998	191	825
Ta'an Kwäch'an	Yukon	2002	103	270
Kluane	Yukon	2004	78	168
Kwanlin Dün	Yukon	2005	617	989
Carcross/Tagish	Yukon	2006	244	668
<i>Self-Government Agreement (stand-alone)</i>				
Westbank	BC	2005	438	855
Sioux Valley Dakota	MB	2014	1457	2568
Deline	NWT	2016	521	970
<i>Sectoral Self-Government Agreement</i>				
Mi'kmaq Education	NS	1997	2400**	13,517
<i>Modern Treaty</i>				
Nisga'a (4)	BC	2000	2046	6036
Tsawwassen	BC	2009	183	365
Maa-nulth First Nations (5)	BC	2011	516	2322
Tlicho (4)	NWT	2003	3023	3952
Nunatsiavut (5)	NFL	2005	2361	7206***
Tla'amin	BC	2016	588	1017
<i>Ratified, Not Effective</i>				
Yale First Nation	BC	TBD	67	159

* 2016 data from the Indian Registry.

** There are also an additional 500 Mi'kmaq students benefiting from post-secondary program funding.

*** Total population numbers not available for Nunatsiavut.

(Source: adapted from AANDC, 2014 by author)

AANDC has recognized that there are several issues with the current fiscal arrangements:

- Negotiation time and cost – Fiscal negotiations can be time-consuming and expensive, often requiring prolonged and contentious discussions. Often resources allocated to fiscal negotiations are disproportionately high compared to the dollar values at stake.
- Varying in provisions– Current arrangements have key terms, conditions and funding amounts that vary by agreements across Canada and over time as mandates and policies evolve.
- Risk and inflexibility – Aboriginal communities are often subjected to increased fiscal risk if local service needs change substantially between agreement renewals. The current method of allocating funding through fixed block amounts is not directly responsive to changes in program demands.

- Lack of clarity and loss of information – The underlying basis on which block funding is allocated can be obscure, leading to contention over time over which programs and services received funding and at what levels.
- Timing of fiscal negotiations – Details of fiscal arrangements (including funding levels and terms and conditions) are not clearly delineated until the final stages of treaty and self-government negotiations (AANDC, 2012).

Issues with Population Measures in Existing Agreements

Population of an Aboriginal community is a key determinant of the amount of funding to be provided to the respective Aboriginal government in support of program and service delivery. In identifying the specific population figure to be used, first involves determining ‘who is eligible to be counted’ and then, ‘what data should be used’. AANDC (2014) notes that there are at least three different measures of a First Nation group’s population that can be used when determining funding:

- *On-lands or on-reserve population* - the number of registered Status Indian group members residing on lands belonging to the Aboriginal government.
- *Regional population* - the number of group members living in the region (i.e., the relevant territory) but not necessarily on their own lands. Exclusive to the Yukon.
- *Total population* - the total number of Status Indians registered as group members, regardless of where they reside (p. 4).

The use of Indian Status and Indian Registry population numbers to determine the actual population of the group is problematic, as granting of Indian Status is not automatic and requires the individuals to register themselves, so not all eligible group members are necessarily registered as Status Indians. Furthermore, Inuit peoples are not Status Indians, and their communities (such as Nunatsiavut) cannot be quantified according to “Status” population. There is no central population database similar to the Indian Registry for Inuit peoples, making data collection, and thus funding allocation, difficult (AANDC, 2014).

An Aboriginal group’s self-government final agreement or other related foundational documents could be a source for determining funding eligibility. They, however, illustrate a wide mandate for program and service delivery and often differ from funding agreements, which stipulate a more restrictive service-based population value. In some instances, there is also ambiguity as to who Aboriginal governments actually serve (i.e. are individuals citizens or non-citizens, and do they reside on or off the Aboriginal government lands).

This lack of clarity has contributed to employing varying methodologies when determining population figures. For instance, Yukon First Nations generally do not have reserves and do not differentiate between Status and non-Status members, preferring to count their population in terms of “citizens”. Program funding for Yukon First Nations is based on the regional population of citizens, which is the number of citizens living in the Yukon

Territory. For BC First Nations, the population figure used is generally the Status Indian on-land population. For the Mi'kmaq sectoral education agreement, funding is based on the number of school-aged children (K-Grade 12), as well as the number of students in post-secondary studies (AANDC, 2014).

In short, although self-governing aboriginal groups are relatively autonomous and govern themselves, they still rely substantially on federal financing. The current consensus (from federal officials, aboriginal communities and political pundits) on the state of fiscal arrangements that support Aboriginal self-government is that it is largely inadequate, constraining, and promotes continued dependency (Brunet-Jailly, 2008; Sniderman & Ferbey, 2012). AANDC, through Treaties and Aboriginal Government, is responsible for negotiating and implementing funding and fiscal arrangements with self-governing Aboriginal groups and wishes to address these challenges.

3.0 METHODOLOGY

A qualitative approach was taken to best achieve the objectives of this study. A comprehensive literature review was performed on available academic sources and internal government documents. A document analysis was performed on relevant legislation and agreements pertaining to self-government fiscal arrangements, including fiscal side agreements and taxation agreements.

The literature review was performed using a number of different databases and internet search engines: UVIC Library's Summons 2.0 TM, Google Scholar, Hansard (Parliament of Canada), Canadian Legal Information Institute (CANLII), as well as internal INAC databases. Search terms used included various keywords and subject areas paired together by Boolean operators, for example: "Aboriginal self-government," "fiscal arrangements," "intergovernmental fiscal transfers," "fiscal transfer agreements," "self-governing Aboriginal groups," "financial arrangements," "own-source revenue agreements" and "funding arrangements." Due to the confidentiality and potential sensitivity of internal government documents, only information that is publically available was used in producing this paper.

To supplement the literature review, interviews were sought from three participant groups, which were predominantly subject area experts who have considerable experience in fiscal policy, Aboriginal governance and the financing of Aboriginal self-government:

- Group 1 – Subject area experts: Government, Aboriginal Affairs and Northern Development Canada (AANDC) Area of expertise within government e.g. federal fiscal negotiators, senior analysts, federal officials,
- Group 2 - Subject area experts: Academia e.g., University Professors, lecturers, researchers
- Group 3 – Subject area experts: current or former representatives of Aboriginal groups e.g. fiscal consultants, lawyers, academics and Aboriginal group representatives.

Potential interviewees from Group 1 were sourced from business contacts and colleagues from within INAC, while Group 2 and 3 were sourced from publically available contact information obtained from Internet searches. In-person, snowball sampling was used on only public and business contact information. The purpose of utilizing key informant interviews was to garner a better understanding of the current state of fiscal arrangements, the issues and obstacles within them, and to aid in the development of recommendations.

Twelve potential interviewees were sourced and contacted, of which five agreed to participate (Appendix B). Most interviews lasted about one hour, but some were longer. The interviews were semi-structured and aided by questions, including some open-ended questions, developed beforehand by the researcher (see Appendix C). Interviewees were encouraged to express their views (both professional and personal) in their own terms. No recordings or transcripts were taken. The researcher took only handwritten notes. Confidentiality and anonymity of the interviewees have been maintained and preserved to

allow for a forthcoming and fruitful discussion. In total 5.5 hours of interview data was gathered.

Data gathered from the interviews was interpreted using thematic analysis, which is method widely used in qualitative research analysis. Data is first reviewed, coded and labelled, and then sorted into categories. This allows patterns and themes to emerge from the data. Although thematic analysis is not strongly linked with a particular epistemology or discipline (Harvard, 2008), it is considered to be compatible with both the essentialist and constructionist paradigms (Braun & Clarke, 2006).

The focus of the interviews was to delve into the experiences of subject area experts to identify factors that hinder the success and effectiveness of self-government fiscal arrangements. By utilizing thematic analysis, a number of commonalities in the interviewees' responses surfaced, producing various themes. This paper first separates the findings obtained the literature review and interviews into discrete elements, and then fuses the findings into an analytical policy framework that was developed from the literature review. This methodological approach allows for rigorous discussion and analysis to occur, ultimately producing more purposeful evidence-based recommendations than would otherwise be possible.

4.0 DOCUMENT REVIEW: FISCAL ARRANGEMENTS WITH ABORIGINAL GOVERNMENTS

The issues and problems that are inherent to current fiscal arrangements with Aboriginal governments are central to not only the success of treaty negotiations across Canada, but also have two critical political implications: the first being the fiduciary obligation of the Crown to Aboriginal peoples; and the second being AANDC's mandate to support the building of healthy, economically sustainable and self-sufficient Aboriginal communities. This chapter comprises three distinct sections. The first section focuses on how federal policy on Aboriginal self-government has evolved. The second sections summaries notable fiscal arrangements in place today, keeping in mind the strong linkage between approaches of self-government and its accompanying arrangements for fiscal transfers. The third section focuses on how Canada-Aboriginal fiscal relations compares to federal-provincial/territorial relations.

4.1 EVOLUTION OF FEDERAL POLICY ON SELF-GOVERNMENT

Federal policy on self-government was not fully realized and articulated until the 1995 Inherent Right policy. The evolution of federal policy has been gradual and dates back to the dawn of the Canadian constitution, where the federal government's jurisdiction for Aboriginal peoples is derived from a single line. Section 91(24) of the *Constitution Act, 1867* states:

91. ...[T]he exclusive Legislative Authority of the Parliament of Canada extends to all matters...[regarding]:
 - (24) Indians and the Lands reserved for the Indians.

Section 91(24), places Indians exclusively within the purview of the federal government. In 1876, the *Indian Act* was first introduced consolidating existing colonial laws (including the *Royal Proclamation of 1763*) regarding Indians, status of Indians and reserves for Indians (Wherrett, 1999). Decades since saw the *Indian Act* amended several times to remove discriminatory sections, with the most recent one in 1985. Indians under the *Indian Act* were considered to be “wards” of the federal government (Campbell, Menzies & Peacock, 2003 p. 92).

In 1939, a Supreme Court decision (*Re Eskimo*) also included the Inuit as part of the section 91(24), definition “Indian” (S.C.R. 104). Historically, Metis were not subject to federal legislation—the exception was the Metis settlements in Alberta (Wherrett, 1999). However, a recent Supreme Court decision in *Daniels v. Canada* [2016 SCC 12] deemed Metis and non-status Indians to be included in the definition of Indians under section 91(24).

From the late 19th century until the mid-20th century, the federal government policies focused on the assimilation of Aboriginal peoples in to the larger Euro-Canadian society. Indian

band councils had their autonomy severely limited. Federally delegated power to govern reserves and decision-making power resided with the Minister of Indian Affairs and Northern Development or with the appointed Indian Agent with the Department of Indian Affairs (DIAND) (Wherrett, 1999).

Then in the 1950s, DIAND services and programs were gradually transferred to the respective Indian bands and other federal agencies. This devolution of programs to Aboriginal groups has continued to this day. In 1969, the Trudeau government released the Statement of the Government of Canada on Indian Policy (colloquially known as the White Paper), which proposed the abolishment of the *Indian Act*, and subsequent status Indian in favor of equality and complete devolution of services and programs to the provinces (INAC, 1969). Even though the White Paper proposed dismantling the prejudicial *Indian Act*, Aboriginal leaders were not in favor of federal government's position stated in the White Paper. Strong opposition eventually led to the official withdrawal of the White paper in 1970 (Uribe, 2006). While Aboriginal peoples have long asserted their rights to govern themselves, the momentum for a greater Canada-wide recognition of Aboriginal self-government rights began in the 1970s (Wherrett, 1999).

In 1983, a special committee in the House of Commons produced the Report of the Special Committee on Indian Self-Government (commonly referred to as the Penner Report), which insinuated the creation of an Aboriginal third order of government. It also proposed a constitutional entrenchment of the right to self-government (Tennant et al., 1984). The Penner Report was a significant departure from then-current federal policies concerning Indian bands. And although the Committee was only focused on Indian bands, it raised the profile of Aboriginal issues in Canada and had a striking influence on the constitutional debate (Wherrett, 1999).

A few years later in 1985, partly in response to the Penner Report, the federal government released the Community-Based Self-Government policy, as an initiative to provide more band control, local government scope of power and decision-making autonomy to local Aboriginal governments than was previously possible under the *Indian Act* (Wherrett, 1999). This was achieved through self-government legislation, which delegated a range of specific jurisdictions on reserve (AANDC, 2010).

Aboriginal governments could also pursue self-governing arrangements through comprehensive land claim settlements, which the federal government has been negotiating since 1973. Comprehensive land claims are claims based upon traditional use, continuous occupancy and un-extinguished Aboriginal title. Policy on comprehensive claims negotiations has changed in the last 30 years. In 1986, a new element to the comprehensive claims policy permitted the possibility of negotiations on a broader range of self-government matters than was previously possible. However this revised policy stated explicitly that self-

government arrangements negotiated through comprehensive land claim settlement would not be constitutionally entrenched, unless there was a specific constitutional amendment to that effect (Wherrett, 1999). Through this policy, the federal government revealed its preference to negotiate self-government arrangements separately from other treaty areas to avoid entrenchment under section 35 of the *Constitution Act, 1982*, which states:

35. (1) The existing aboriginal and treaty rights of the aboriginal peoples of Canada are hereby recognized and affirmed.
- (3) For greater certainty, in subsection (1) "treaty rights" includes rights that now exist by way of land claims agreements or may be so acquired.

A groundbreaking proposition for self-government occurred in the 1992 Charlottetown Accord, which would have constitutionally entrenched existing treaty rights and the right to Aboriginal self-government, and subsequently recognized Aboriginal governments as a third order of government in the Canadian federation, constitutionally autonomous from the federal and provincial governments. There were also provisions for how Aboriginal peoples would be represented in the Canadian parliament. However, the Accord was voted down in a public referendum of the same year (McIntosh & Foot, 2014).

In 1995, in response to the evolving jurisprudence on Aboriginal self-government and growing public awareness of Aboriginal policy matters, the federal government announced the Government of Canada's Approach to Implementation of the Inherent Right and the Negotiation of Aboriginal Self-Government⁶ (known as the Inherent Right Policy). Key principles of the Inherent Right policy are:

- The recognition that the inherent right of self-government is an existing Aboriginal right under section 35 of the *Constitution Act, 1982*;
- Aboriginal self-government will be exercised within the existing Canadian constitution and operate within the Canadian federation;
- The *Canadian Charter of Rights and Freedoms* will apply to Aboriginal governments and institutions;
- Inherent right will not be implemented in a uniform manner across Canada, but instead will result from negotiations, accounting for varying geographic, socio-political, legal and economic circumstances of Aboriginal communities; and
- Rights in self-government agreements may be constitutionally protected as treaty rights under section 35 in new or existing treaties, or as part of comprehensive land claim agreements (INAC, 1995; Wherrett, 1999).

⁶ Rustand (2010) and Gibson (2009) stipulate that the Inherent Right Policy is unnecessary and unconstitutional, and that it erroneously treats Aboriginal claims for self-government as a rights claim, rather than a claim for governmental power.

In 1996, the Royal Commission on Aboriginal Peoples (RCAP) issued a five-volume, 4,000-page, 440-recommendation report urging significant changes to the relationship between Aboriginal peoples and the Government of Canada. Included in the report were numerous recommendations for revisiting the models and financing of Aboriginal self-government (RCAP, 1996). The federal government responded to the RCAP report in 1998 by releasing, *Gathering Strength: Canada's Aboriginal Action Plan*, which articulated a policy framework that included strengthening Aboriginal governance and developing a new fiscal relationship with Aboriginal communities (Hurley & Wherrett, 1999).

Current self-government arrangements are varied, recognizing the diverse historical, cultural, political and economic circumstances of each Aboriginal group. There is no single model of self-government, as negotiations are focused on accounting for the differing needs of Aboriginal communities (AANDC, 2015b), through either comprehensive self-government agreements with individual Aboriginal groups or incrementally through the transfer of authority or through developing more flexible arrangements in a particular policy or service area (e.g. education) (Wherrett, 1999).

More recently, in July of 2015, the federal government released *Canada's Fiscal Approach for Self-governing Arrangements*, (hereinafter known as the Fiscal Approach). The Fiscal Approach represents a unique shift in policy concerning fiscal arrangements that support Aboriginal self-governments, in that fiscal policy is now transparent and publically available. This differs from previous federal negotiations position where funding methodology and formal federal policy statements were a matter of secrecy as they were part of confidential negotiation mandates (AANDC, 2015c). The concluding section of this chapter examines the various elements of the new Fiscal Approach in more detail.

A few months later, Prime Minister Trudeau as part of his government's plan moved that, "[i]t is time for a renewed, *nation-to-nation relationship* with First Nations peoples, one that understands that the constitutionally guaranteed rights of First Nations in Canada are not an inconvenience but rather a sacred obligation" (Mass, 2015, para. 2, emphasis added). Alluding to the government's first budget of 2016, Trudeau also went on to state that, "[i]t's time for a *new fiscal relationship* with First Nations that [provides] communities [with] *sufficient, predictable and sustained* funding" (Mass, 2015, para. 10, emphasis added).

However, it is not entirely clear what the Trudeau government means when it proclaims a 'renewed nation-to-nation relationship' with Aboriginal peoples. Moreover, there is further ambiguity on how and what operationalizing a nation-to-nation relationship entails. At the time this research paper was produced, the federal government has yet to put forth any new policies relating to Aboriginal self-government or fiscal arrangements.

4.2 FISCAL ARRANGEMENTS CURRENTLY IN PLACE IN CANADA

Over the past three decades, as federal policy on self-government evolved so did fiscal arrangements that supported Aboriginal communities—although there was not always a direct or one-to-one relationship. Existing fiscal arrangements in place throughout Canada are varied in nature and in a way illustrate an evolution of fiscal arrangements. Notable fiscal arrangements are summarized in this section.

Under Indian band government, fiscal relations and the accompanying arrangements do not fully manifest through written agreements or legislation. Rather, the relationship between the federal government and Indian bands develops through funding arrangements. The legal framework for these arrangements is federal legislation (i.e. the *Indian Act*) and funding is provided through grants and contributions (see Appendix D for a detailed description). Although initially, when the *Indian Act* came into effect, funding was stringent, with heavy conditions and reporting requirements imposed on recipients, over the years funding arrangements evolved to give flexibility and provide certainty through alternative funding arrangements. No single model, however, exists for determining funding allocations to all bands and the funding does not have any equalization factors. Any adjustments to funding occur at the discretion of the federal government. Annually, chiefs and band council negotiate on funding and related matters. Accountability for band expenditures is to INAC⁷ (Hawkes & Maslove, 1989).

In 1978, the Kativik Regional Government was created through provincial legislation, the *Act concerning Northern Villages and the Kativik Regional Government*, in accordance with the 1978 James Bay and Northern Quebec Agreement. Self-government practiced under this arrangement is public in character with a regional scope of government and semi-autonomous governmental power. Kativik has the legal status of a municipality and is financed 50% by the Government of Québec, 25% by the Government of Canada and the remainder sourced from municipal tax revenues (Annual Report, 2014). External financing is largely conditional with funding adjustments at the discretion of the donors. Accountability is to the Province through annual audit reports. The Province also retains decision-making authority over funding proposals and negotiates annually with Kativik regarding funding (Hawkes & Maslove, 1989).

In 1984, the Cree-Naskapi transitioned from the Indian Act into self-government through the enactment of the *Cree-Naskapi (of Quebec) Act*, aligning with commitments made under section 9 of the 1978 James Bay and Northern Quebec Agreement and section 7 of the 1978 Northeastern Quebec Agreement (Hurley, 2009). Under this arrangement, the nine Cree community governments and the Cree Regional Authority have local and regional scope of

⁷ It should be noted that although the currently-used title is “Indigenous and Northern Affairs Canada (INAC)”, legally the department is still called “Department of Indian Affairs and Northern Development (DIAND).” Legal accountability is to the Minister of DIAND.

government and semi-autonomous governmental power, which includes managing a land regime, participating in an environmental and social protection regime and partnering with various entities in economic development opportunities. Legislation serves as the legal framework of the fiscal arrangement. In 2008, the Agreement Concerning a New Relationship between the Government of Canada and the Cree of Eeyou Istche was reached setting a new way forward for modernizing the Cree governance regime (AANDC, 2015b).

The Sechelt Indian band in 1986 entered into what is considered today as the first self-government agreement. The *Sechelt Indian Government Act* (federal legislation) and the *Sechelt Indian Government District Enabling Act* (provincial legislation) provide the Sechelt Indian band (consisting of 33 reserves) with a local and regional scope of government and the legal status of a municipality. The fiscal arrangements consist of funding through cash transfers, conditional grants, and revenues generated through local taxation. Funding under the existing agreement is based on a formula that adjusts annually for population and cost increases⁸ and has a term of 5 years. It is unclear if the existing formula takes into consideration equalization. Accountability for expenditures is still to INAC in the form of audited consolidated financial statements.

Commencing with the signing of the Umbrella Final Agreement in 1993, eleven Yukon First Nations entered into self-government throughout the 1990s and early 2000s. The Yukon governance landscape is complex and is comprised of: an Umbrella Final Agreement; 11 final agreements; a Devolution Transfer Agreement; 11 Self-Government Agreements; Self-government Implementation Plans; Programs and Services Transfer Agreements; Self-Government Financial Transfer Agreements; Taxation Agreements; and Administration of Justice Agreements. Under this complex arrangement, the 11 self-governing Yukon First Nations (SGYFNs) exercise autonomous governance over their citizens and have authorities and responsibilities akin to territorial and municipal levels of governments. Taxation powers are shared with the SGYFNs in some areas with the federal government and territory, but can only be exercised directly within settlement land. Tax sharing in some instances is practiced between the SGYFNs for example, where a SGYFN assumes complete responsibility for the delivery of local government programs or services, the territorial government will share a portion of property taxes. Fiscal transfers are in the form of conditional block funding for governance and programs and services. Transfers are based on the principles of equalization, fiscal responsibility and cost sharing; they have mechanisms that adjust for population and align with inflation-type indices. Typically, the term length for transfers is 5 to 9 years. Accountability is met through maintaining accounts in accordance to Generally Accepted Accounting Principles (GAAP) (INAC, 2008).

⁸ Since the release of the Fiscal Approach, the terms expressed in the new policy including a revised governance formula are available for Sechelt if it chooses to renegotiate and adopt the new terms or wait till renewal.

In British Columbia, modern treaty First Nations (Nisga'a, Tsawwassen, Maa-nulth and more recently Tla'amin) entered into self-government in 2000, 2009, 2011 and 2016 respectively. Each Aboriginal government generally shares, at least conceptually, similar models of self-government and system of fiscal arrangements with the exception of Nisga'a Nation. Fiscal arrangements for the Nisga'a Nation consist of 5-year term block funding for health, education, social and local services⁹. Base level funding provided is adjusted to reflect the effects of population growth and inflation. Shared responsibility in financing Nisga'a Nation manifests through Nisga'a citizens paying applicable taxes to the federal, provincial and Nisga'a governments; and through OSR contributions.

Taxation powers are unique in the case of the Nisga'a treaty. While Nisga'a has the power to directly tax its citizens within its lands, so do Canada and BC, whose power to tax residents on Nisga'a lands are not relinquished. Thus, as of 2012, any taxes levied by Nisga'a Nation will be in addition to the existing taxes in place by Canada and BC, unless otherwise negotiated under a tax coordination agreement. Consequently, in 2014, Nisga'a and BC signed the Nisga'a Real Property Tax Coordination Agreement, which resulted in Nisga'a occupying the tax room previously occupied by BC. For the Nisga'a OSR considerations are a surrogate for tax, aligning with the Nisga'a Nation's philosophy of contributing to Canada on an equal footing as all other Canadians (Falconer, 2000).

The fiscal arrangements for Tsawwassen, Maa-nulth and Tla'amin First Nations are similar in construct. Fiscal relations between the Aboriginal governments, BC and Canada¹⁰¹¹² characteristically include: a series of one-time capital transfer funds that usually deal with land valuation, economic development, forest resources, fishery and wildlife, and resource revenue sharing¹³; a fiscal side agreement negotiated every 5 to 8 years for the provision of agreed upon programs and services, a negotiation loan repayment plan, taxation powers or tax coordination agreements, and an own source revenue agreement that specifies how the Aboriginal government takes into consideration the shared cost and responsibility of providing programs and services to its citizens¹⁴. Fiscal transfers are provided as conditional block funding with fixed adjusters of around 3% to account for projected inflation and population growth. Accountability is to the citizenship and membership of the Aboriginal government and is carried out through publically accessible audited consolidated financial statements (for a detailed breakdown and analysis see Table 2).

⁹ As per the 2000 Nisga'a Nation Fiscal Financing Agreement.

¹⁰ As per the 2010 Tsawwassen First Nation Fiscal Financing Agreement

¹¹ One Final Agreement was signed with all five Maa-nulth First Nations. Fiscal Financing Agreements were signed with individual groups: Huu-ay-aht First Nations; Ka:'yu:k't'h'/Che:k'tles7et'h', Toquaht First Nation, Uchucklesaht Tribe, Ucluelet First Nation.

¹² As per the 2016 Tla'amin Fiscal Financing Agreement.

¹³ Only the Maa-nulth First Nations and Tla'amin are provided transfers explicitly for resource revenues sharing.

¹⁴ These components may also be found in other agreements with Aboriginal groups elsewhere in Canada.

As this section has illustrated, fiscal arrangements with self-governing groups have evolved tremendously over the past 35 years. A pattern has emerged with how fiscal arrangements are negotiated; early agreements tended to be shrouded behind convoluted legalese and negotiation confidentiality, resulting in unnecessarily complex systems, as is evident in the Yukon. Over time, however, especially in BC fiscal arrangements with First Nations have fewer complexities yet are still able to retain that unique aspect of Crown-Aboriginal relations. As anticipated, the release of the Fiscal Approach will bring a harmonized approach and increased transparency to future fiscal arrangements. Fiscal autonomy has also progressively increased over time and accountability has rightfully shifted from the Minister of DIAND to the Aboriginal groups' own citizens and community members it serves.

TABLE 2: PROVISIONS IN FISCAL FINANCING/TRANSFER AGREEMENTS

	Sechelt	Yukon (11)	Nisga'a	Tlicho	Nunatsiavut	Westbank*	Tsawwassen	Maa-nulth (5)	Tla'amin
Treaty/SGA Effective Date	1986	1995 [†]	2000	2005	2005	2005	2009	2011	2016
Parties	Canada-Sechelt	Canada-Yukon FN	Canada-Nisga'a-BC	Canada-Tlicho	Canada-Nunatsiavut-Newfoundland	Canada-Westbank	Canada-Tsawwassen-BC	Canada-Maa-nulth-BC	Canada-Tla'amin-BC
Length of Term (Years)	8	5-9 ^{††}	5	7	5	5	6	8	5
Most Recent FTA Effective Date	2012	2010/2011	2009	2005	2012	Ongoing	2009	2011	2016
Current FFA/FTA Expiry Date	2019	2015/2020	2015	2013	2017	2010	2015	2019	2021
Accountability Provisions & Transparency	Audited financial statements	Accounts in accordance with GAAP	Audited financial statements; annual estimates; periodic evaluation	Audited financial statements	Audited financial statements; annual estimates; periodic evaluation	Audited financial statements	Audited financial statements	Audited financial statements	Audited financial statements
Programs Reporting Requirements	None	On programs, by request	On programs set out in schedule	None	On programs, by request	On programs, by request	On programs, by request	On programs, by request	On programs, by request
Annual Funding Adjusters ^{†††}	Actual price (FDDIPI) & actual population	Actual price (averages FDDIPI) and fixed pop. adjustor (2.2%)	Actual price (FDDIPI) & actual population	Actual price (FDDIPI)	Actual price (FDDIPI) & actual population	Fixed: 3.00%	Fixed: 3.43%	Fixed: 3.32%	Fixed: 3.16%
Detail of Funding Breakdown in FFA/FTA	By program	Block, with general breakdown (governance, programs, implementation)	Grouped by program category	Block (no breakdown)	Block, by source (AANDC, DFO, Health Canada)	Grouped by program category	Grouped by program category	Grouped by program category	Grouped by program category
Default Provisions	No provisions for alternate program delivery; no dispute resolution trigger	No provisions for alternate program delivery; includes dispute resolution trigger; "hold-back" provision	Provisions for alternate program delivery; includes dispute resolution trigger	Provisions for alternate program delivery; no dispute resolution trigger ^{†††} ; "hold-back" provision	Provisions for alternate program delivery; no dispute resolution trigger; "hold-back" provision	None ^{**}	No provisions for alternate program delivery; no dispute resolution trigger	No provisions for alternate program delivery; no dispute resolution trigger	No provisions for alternate program delivery; no dispute resolution trigger

(Source: modified from by author from AANDC, 2014. Data available from publically available documents)

* Westbank FTA is currently subject to renewal negotiations

** Although Mi'kmaq and Westbank FFAs have no explicit default provisions, a default situation may be addressed through the dispute resolution clause in the SGA.

*** In addition, disputes over FFA negotiation cannot be referred to the dispute resolution process

[†]First 7^{††} Yukon First Nation FTAs had Effective Dates in 1995. Four other YFNs signed SGAs/FTAs subsequently. Current FTAs have Effective Dates of 2010 (7 YFNs) and 2011 (3 YFNs). One YFN did not renew its FTA.

^{††}Seven YFNs have FTA terms of 5 years (expiring 2015). Three YFNs have FTAs of nine years (expiring 2020).

^{†††} An agreement may have population adjustors but not all funding areas may be subjected to the population adjustors

4.3 INTERGOVERNMENTAL FISCAL RELATIONS IN CANADA

A dichotomy predominantly exists in Canada's current fiscal system: federal-provincial and provincial-municipal relations (Bird & Chen, 1998). Non-existent in the fiscal system is Canada-Aboriginal intergovernmental fiscal relations; Prince and Abele (2003) purport that this third realm of fiscal federalism is fundamental to the realization of successful Aboriginal self-government.

The characteristics of Canada-Aboriginal intergovernmental fiscal relations are most akin to that of federal-provincial/territorial relations, as Aboriginal governments through self-governing agreements are formally recognized as an order of government. Provincial-local/municipal fiscal relations are not appropriate comparators to federal-Aboriginal fiscal relations because municipalities are constitutionally ascribed as creatures of provinces¹⁵, which is not the case of the relationship between the federal government and self-governing Aboriginal groups. Local governments and municipalities also have substantial own-source revenue, with provincial transfers comprising a small proportion of overall revenues (INAC, 2008). This contrasts with many Aboriginal governments that rely primarily on federal transfers as a source of revenue.

FEDERAL-PROVINCIAL FISCAL ARRANGEMENTS

Federal-provincial/territorial fiscal arrangements consist of four major transfer programs: Equalization; Canada Health transfer (CHT); Canada Social Transfer (CST); and the Territorial Formula Financing (TFF). The CHT and CST—often paired together and referred to as the Canada Health and Social transfer (CHST)—are semi-conditional transfers to the provinces to support areas such as: healthcare; education (post-secondary and early childhood); social services (e.g. child care) and social assistance. The Equalization and TFF both provide unconditional transfers to the provinces and territories respectively. The TFF enables territorial governments to provide public services, while also recognizing the higher cost of program and service delivery north of the 60th parallel (Department of Finance, 2015). Consult Appendix E, F and G of this paper for a detailed description of the CHST, Equalization and the TFF, respectively.

The intention of the Equalization program is not to equalize provincial revenues, but rather to achieve the goal of *reasonable comparability* (Hjartarson, Pearce & Mendelsohn, 2010), which is a founding principle of federal-provincial fiscal relations constitutionally enshrined within subsection 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

¹⁵ As per Section 92(8) of the *Constitution Act, 1867*

levels of taxation.”

The federal-provincial/territorial transfer system is enabled by the *Federal-Provincial Fiscal Arrangements Act* (the Act), which sets out the various tax-collection agreements, formulas for the unconditional equalization payments, and conditional block grants under the CHST. Part 1.1 of the Act also defines the formula for the annual TFF transfer for each of the territories. The renewal cycle for equalization, CHST and TFF is usually every 5 years. However, the tax-collection agreements have been indefinitely extended since 1977 (Dobell, 2013).

Adopting a macro perspective, Prince and Abele (2003 p. 247) consider current federal-provincial relations to include the following elements:

1. The constitutional division and allocation of legislative powers and roles and responsibilities between the orders of government;
2. The division of taxation and borrowing powers (i.e. revenue raising powers);
3. Agreements for the collection and disbursement of revenues, and the harmonization of income and sales tax systems between governments;
4. The transfer of tax points from the federal government to the provinces;
5. Equalization transfers (only if a provincial government’s fiscal capacity is below the national average);
6. Intergovernmental transfer payments (i.e. conditional specific-purpose grants, semi-conditional general-purpose grants, or unconditional block grants); and
7. Political and administrative processes for consultation, bargaining, planning, and bi-lateral decision-making about intergovernmental fiscal arrangements.

FEDERAL-ABORIGINAL FISCAL ARRANGEMENTS

The foundation of the fiscal relationship between an Aboriginal government and the Government of Canada¹⁶ is found in the Fiscal Chapter of the Final Agreement. Some of the fiscal chapters are constitutionally protected, if they are part of a modern treaty, but those that are agreement-based or legislative are not, as in the case of Sechelt, Westbank and the Yukon First Nations. The Fiscal Chapter provides a strategic, principled basis for negotiating the Fiscal Financing/Transfer Agreement (FFTA) and Own Source Revenue Agreement (OSRA), often referred to as the fiscal side agreements. The FFTA and OSRA (Figure 3) are not considered part of the modern treaty or self-government agreement as they are intended to be updated from time to time to account for the changing economic circumstances of the Aboriginal government.

While the taxation chapter within a treaty (and corresponding tax arrangements) is theoretically considered part of the fiscal arrangements (Figure 3), operationally it is distinct

¹⁶ Often considered the parties to fiscal arrangements—but some cases also involve the respective province and territory.

as tax policy is under the purview of the Department of Finance, and therefore, the negotiation of its provisions and associated tax side agreements is with the Department of Finance and not INAC.

Typically, the fiscal chapter includes language that commits the parties to periodically negotiate fiscal arrangements. Under this commitment, the parties are obliged to negotiate and attempt to reach agreement on funding arrangements. The terms expressed in the fiscal chapter are the most long-term and permanent elements of the fiscal arrangements (AANDC, 2014).

An analysis of fiscal chapters shows discernable variation of terms expressed (Table 3 below). Different treaty provisions and historically varying funding patterns ascribed in agreements have propagated dramatic divergences in funding levels between Aboriginal governments. Some of these differences in funding can be attributed to geographic, economies-of-scale and socio-economic variation that result in different expenditure needs. However, prior to the Fiscal Approach there have never been any systematic attempts by AANDC or the TAG sector to benchmark service or harmonize funding levels or expenditure need methodology among Aboriginal governments to those in neighboring and comparable non-Aboriginal communities (AANDC, 2014). Furthermore, it is ambiguous to what extent existing funding arrangements meet that standard or instead translate into unequal treatment of Aboriginal governments relative to either each other or comparable non-Aboriginal communities; and this still remains the case despite the release of a harmonized Fiscal Approach.

Negotiated FFTAs contain transfer amounts that support program and service delivery and governance operations of an Aboriginal government; these agreements typically last 5-8 years after which they must be renewed through re-negotiations. Gross funding amounts associated with the agreed-upon program and service responsibilities are explicitly stated in the fiscal side agreements, including taking into consideration the fiscal capacity of the Aboriginal government's through offsetting own source revenues against gross funding (AANDC, 2014).

The resulting transfer amounts and their associated adjusters contained in FFTAs are often the subject of detailed negotiations between INAC and the Aboriginal group. INAC's negotiation position is based on instructions set out in mandates. Barnsley (2005, p. 8) maintains that in fiscal year 2006-07, INAC mandates unfairly restricted the growth of governance funding to support self-government. Barnsley's claims, however, are unsubstantiated, as federal negotiation mandates are protected under Cabinet confidentiality.

Ultimately, in instances where different negotiated outcomes result in large funding discrepancies, Canada could be exposed to allegations of inequitable funding allocations. A recent example of inequitable federal funding can be found in the Canadian Human Rights

Tribunal’s decision [2016 CHRT 2], where funding for on-reserve child welfare and family services provided by AANDC was found to be insufficient and unresponsive to changing program needs and workloads. This case stems from the 2008 Auditor General of Canada’s Report, which audited the First Nations Child and Family Services Program created by INAC. The Auditor General found the funding formula employed by INAC to be “inequitable”, “outdated”, “not adapted to small agencies” and “not properly coordinated” (para. 4.48 to 4.58). Although this specific case concerns program funding for Indian Bands under the *Indian Act*, it nonetheless, has implications for funding provided to self-governing Aboriginal groups.

TABLE 3: PROVISIONS IN FISCAL CHAPTERS

	Core Governance	Land Claims Implementation	Education	Social Development	Public Works	Economic Development	Health	Land Management
Sechelt	●		○	●	●	●	○	●
Yukon (11)	●	●	○	●	●	●	○	●
Mi'kmaq			●					
Nisga'a	●	●	●	●	●	●	○	●
Tlicho	●	●				●		
Nunatsiavut	●	*	●		●	●	○	
Westbank	●		○		●	●		
Tsawwassen	●	*	○	●	●	●	○	●
Maa-nulth (5)	●	*	○	●	●	●	○	●
Tla'amin	●	*	○	●	●	●	○	●
Sioux Valley	●							
Deline	●					●		

KEY

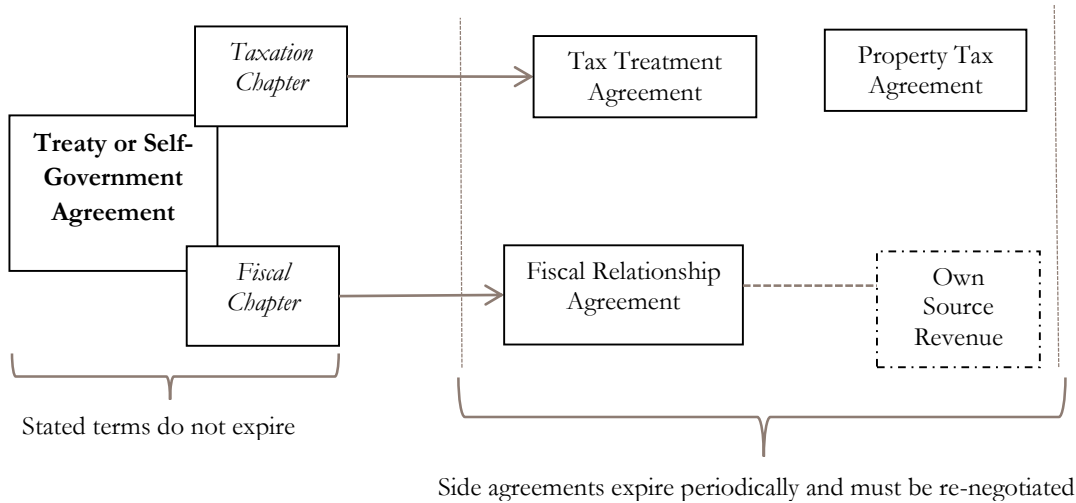
- High-level provision
- Low-level provision
- Mid-level provision
- No provision
- * All or part of implementation funding for ongoing activities provided as a one-time upfront payment

(Source: modified by author from AANDC, 2014)

In addition to fiscal transfer arrangements, most self-governing Aboriginal groups across Canada also have tax arrangements or the ability to enter one. Taxation is exercised concurrently along with the federal and provincial tax power, unless otherwise specified in a treaty or side agreement.

Together the fiscal chapter, tax chapter, FFTA, OSRA, and tax side agreements (where applicable) form the fiscal arrangements framework, with the side agreements providing a means to operationalize the fiscal arrangements. Under the new Fiscal Approach, the majority of the fiscal relations framework remains intact with the exception that the FFTA and OSRA have been combined into a new side agreement (Fiscal Relationship Agreement) along with a few other nuances (Figure 3 below).

FIGURE 3: FISCAL ARRANGEMENTS FRAMEWORK



(Modified and adapted from AANDC, 2014 by author)

Apart from the fiscal chapter and associated side agreements, an Aboriginal government is also able to enter into joint funding agreements with non-governmental organizations or other governments to enhance existing or establish new programs and services within the Aboriginal government’s purview. Citizens of the Aboriginal government will continue to be eligible for federal and provincial programs available for Aboriginal people, provided that the respective Aboriginal government has not assumed responsibility for those programs and services (AANDC, 2014).

Prince and Abele (2003, p. 248) provide a summary regarding the inclusion of the following elements in Canada-Aboriginal fiscal relations (under modern treaties):

1. Explicit statement and identification of those legislative powers to be held exclusively by the Aboriginal government; or shared with a non-Aboriginal party; and those which will remain in the federal or provincial domain;
2. Revenue raising powers devolved to the Aboriginal government;
3. Agreements about the harmonization of local taxes between Aboriginal governments and local municipalities in areas where the Aboriginal groups have been deemed to have legal jurisdiction;
4. Federal contributions (negotiation support funding) for the Aboriginal groups’ participation in treaty negotiations;
5. Federal-provincial cost-sharing agreements regarding the provision of programs and services to Aboriginal groups;
6. Funding commitments ensure levels of service provision comparable to prevailing levels in the region; and
7. Financial transfer arrangements with Aboriginal groups or regional Aboriginal organizations within or outside treaties.

These seven elements encompass the fiscal arrangements currently in effect in for Canada-Aboriginal fiscal relations.

SIMILARITIES BETWEEN ABORIGINAL & PROVINCIAL/TERRITORIAL FISCAL RELATIONS

Both systems inherently consist of technical complexity and asymmetry in the sheer number and variations of funding metrics and financing formulas, program and service considerations, revenues and processes. The variation and differences between the systems is rooted in the histories, and the fundamental constitutional relationships the federal government has had with Aboriginal groups (Prince & Abele, 2003).

Both systems have been often criticized for the lack of transparency, accountability, and mutual mistrust, and both systems are susceptible to political controversy (Hjartarson, Pearce & Mendelsohn, 2010; Stasyszyn, 2012). Fiscal arrangements crucially affect revenues and budgets, social policy, and constitutional law. Fiscal transfers embody a monetary form, yet are value-based expressions of efficiency, equity, evaluation, autonomy and accountability (Prince & Abele, 2003). Inherent to fiscal arrangements are the tradeoffs of efficiency and equity—which should be a policy decision and not necessarily a technical matter. Hjartarson, Pearce & Mendelsohn (2010) measured the performance of the federal-provincial fiscal arrangements and found that equity has been weighted more heavily than efficiency. Predictably, within Canada-Aboriginal fiscal relations the focus is on equity rather than overall efficiency for the transfer system—albeit the performance in any capacity has yet to be measured formally. In both fiscal systems the spending power of the federal government has significant influence over the finances of the provincial, territorial, and Aboriginal governments.

DIFFERENCES BETWEEN ABORIGINAL & PROVINCIAL/TERRITORIAL FISCAL RELATIONS

There are also numerous differences between Canada's fiscal relationship with Aboriginal governments compared to the provinces and territories. Table 4 is adapted from Prince and Abele (2003, p. 249) and summarizes the key differences. For the purposes of this paper, the Government of Nunavut¹⁷ is categorized as a territory and not an Aboriginal government. Although aspirations for self-government by the Inuit are expressed in a form of public government, it functions in Canada's federal system as a territory. In this sense, the Government of Nunavut represents all the people residing in the territory, both Inuit and non-Inuit. This form of self-government is unique in Canada (AANDC, 2015b).

Proportionately, there is a vast difference in the total transfer amounts involved between Canada-Aboriginal governments and federal-provincial/territorial. In 2012-13, the federal government provided a little over \$60 billion in major transfers (equalization, CHST and

¹⁷ Resulted from the 1993 Nunavut Land Claims Agreement

TFP) to the provinces and territories¹⁸. In contrast, a mere \$260 million (estimated) in 2012-13 was transferred in support of all 23 Aboriginal governments¹⁹ (AANDC, 2014), which roughly approximates to \$15,000 per Aboriginal person residing on Aboriginal government lands. Canada-Aboriginal transfers are expected to grow over time with an increasing number of Aboriginal groups entering into self-government or modern treaties.

An important principle of federalism is the division of roles and responsibilities between orders of government in a particular state, with each order having jurisdiction, a degree of autonomy and decision-making authority over defined activities. Aboriginal governments that have a modern treaty derive their legal authority from the *Constitution Act, 1982* and from their respective comprehensive land claims, or self-government agreements and specific claim settlements with the federal governments (Prince and Abele, 2003).

TABLE 4: SUMMARY OF KEY DIFFERENCES BETWEEN THE TWO FEDERAL FISCAL SYSTEMS

	Federal-Aboriginal	Federal-Provincial/Territorial
<i>Gross Transfer Amount</i>	In 2012-13, an estimated \$260 million in support of all 23 Aboriginal governments.	In 2012-13, approximately \$60 billion for Equalization, CHST and TFP.
<i>Jurisdiction</i>	Only as stated and defined in modern treaties and/or self-governing agreements. Aboriginal governments generally have autonomy limited to the few areas of exclusive jurisdiction.	Split between the two orders of government. Each order has specific roles and responsibilities with each order relatively autonomous.
<i>Program Responsibilities</i>	Aboriginal governments have accepted (and are able to accept) different sets of program and expenditure responsibilities, so funding arrangements differ from one Aboriginal government.	Provinces and territories take on very similar program and expenditure responsibilities.
<i>Revenue-raising Powers</i>	Some Aboriginal governments have taxation power as specified in a treaty; however, they may choose not to exercise it. This is likely to improve in the future as more Aboriginal governments take up taxation.	Areas of taxation are constitutionally enshrined and both orders have significant borrowing power.

¹⁸ For 2016-17 total transfers have risen to \$71 billion.

¹⁹ 2016-17 data for Federal-Aboriginal transfers unavailable. And as of 2016, there are 26 self-governing groups in Canada

<i>Horizontal Equity</i>	<p>Historically, Aboriginal governments do not benefit from the same stability, predictability or income equalization, as the provinces and territories.</p> <p>This is likely to improve with the implementation of the Fiscal Approach, as the policy states an equalization type of principle in the financing of self-government.</p>	<p>The principle of equalization results in large transfers of capital and in improved fiscal stability for poorer provinces.</p> <p>Territorial governments are part of the TFF, which ensures that the principle of equalization (that the provinces are under) is applied North of 60°.</p>
<i>Conditionality & Term of Transfers</i>	<p>Some conditions are placed on the block funding transfers. Terms are usually 5-8 years in length.</p>	<p>Most federal transfers to provinces and territories are unconditional and multi-year.</p>
<i>Nature of Negotiations</i>	<p>Separate, bilateral negotiations occurred under different political and policy climates. Key features of the separately negotiated fiscal chapter and fiscal funding agreements with individual Aboriginal governments currently differ significantly from one agreement to another (see Table 2 and 3).</p>	<p>Negotiations renewed every 5 years-primarily underlying adjustors. Context of negotiations has remained relatively stable over time.</p>
<i>Executive Federalism (or similar system)</i>	<p>Currently there is no direct comparator to executive federalism. A number of ad hoc committees and working groups have been formed to meet the need for discussion and negotiation.</p> <p>This could change in the future with the advent of the new Fiscal Approach Policy, which calls for the establishment of a fiscal advisory forum. In its fully matured form the advisory forum could be a form of executive federalism.</p>	<p>Executive federalism provides a forum for information sharing and decision-making.</p>

(Source: adapted from Prince & Abele, 2003 by author)

However, in practice most Aboriginal communities have constrained autonomy and few areas of exclusive jurisdiction. For example, if an Aboriginal government sought to assume responsibility for a social program (that is under provincial jurisdiction) they face two issues. The first being an obvious one: since the social program is under provincial jurisdiction, the Aboriginal government is understood to have only those responsibilities that are delegated by the respective province. Although there are multiple methods employed to work around this constraint, the core framework for all Aboriginal governments is the same. The second issue is limited funding capacity. A major revenue source for governments is taxation. As it stands today, the federal and provincial governments together occupy most areas of taxation, which limits the Aboriginal capacity to obtain funding. Historically, in most cases an Aboriginal government's ability to borrow funds has also been limited and as a result, their revenue-raising capacity is diminished (Prince & Abele, 2003).

The varying aspirations of self-governing Aboriginal communities have resulted in a differing

set of program responsibilities assumed by the Aboriginal government. Consequently, funding arrangements expressed through fiscal financing/transfer agreements differ from one Aboriginal government to another because each government may have accepted (and are able to accept) different sets of program and expenditure responsibilities. In contrast, the provinces and (to a lesser extent) territories tend to exercise very similar sets of powers and take on very similar program and expenditure responsibilities (AANDC, 2014). Table 5 summaries program responsibilities drawn by each Aboriginal government.

TABLE 5: FUNDING ELEMENTS BY ABORIGINAL GOVERNMENT

	Sechelt	Yukon (11)	Mi'kmaq	Nisga'a	Tlicho	Nunatsiavut	Westbank	Tsawwassen	Maa-nulth (5)
Education	○	○	●	●		●	○	○	○
Social Dev.	●	●		●				●	●
Public Works	●	●		●		●	●	●	●
Econ. Dev.	●	●		●	●	●	●	●	●
Health	○	○		○		○		○	○
Land Mgmt.	●	●		●				●	●
Land Claims Implementation		●		●	●	*		*	*

KEY

- High-level provision
- Low-level provision
- Mid-level provision
- No provision
- * All or part of implementation funding for ongoing activities provided as upfront payment

(Source: AANDC, 2014)

Fiscal, funding and own-source revenue arrangements with Aboriginal governments are negotiated and renewed on a separate, bilateral (or trilateral) basis resulting in substantial and in some cases significant differences between agreements (see Table 2 and 6 for a detailed breakdown on the varying provisions). Conversely in the federal-provincial/territorial context, negotiations proceed through a common legislative framework for addressing fiscal arrangements.

Until relatively recently, treaties—especially historic treaties—did not refer to any areas of taxation (Bartlett, 1992; Prince & Abele, 2003). Comprehensive land claims (modern treaties) and agreements negotiated in BC and in the North are now delving into areas of tax policy—specifically redressing section 87 of the *Indian Act* and phasing out tax exemptions for status Indians and incorporating revenue-sharing provisions and new treatment of own-source revenues. An example is the *Nisga'a Final Agreement* in which tax provisions attempt to include a greater sense of aboriginal interests in tax policy (Borrows & Rotman, 1998, p. 809; Graben, 2007). As Aboriginal governments try to capture a larger portion of revenues that is generated by their communities, conflicts will undoubtedly increase. In this regard, Canada-Aboriginal fiscal politics will more closely align with conventional Canadian fiscal federalism (Prince & Abele, 2003).

The applicability of transferring tax room from the federal or provincial purview to Aboriginal governments and other forms of revenue sharing will be an important feature in

the continued evolution of Canada-Aboriginal fiscal relations (Prince & Abele, 2003). The transfer of tax room in this case reduces the portion of the federal and/or provincial government's respective share. This creates room for the Aboriginal government to collect the corresponding portion, thus increasing their share of tax revenues. Among most modern treaty groups, the Aboriginal government has the ability to levy direct taxes on its members within treaty settlement lands. The federal government and the province are willing to negotiate possible taxes exercised by the Aboriginal government that apply to non-Aboriginal members that reside within treaty settlement lands. In either case, the Aboriginal government does not have and cannot exercise exclusive taxation powers, but rather must operate concurrently with the federal government and province's taxation authority. Tax coordination agreements coordinate the taxes that the Aboriginal government and the federal government levy, ensuring that the tax burden for taxpayers is relatively the same whether or not they reside on or off treaty settlement lands. Tax collection and administration in most cases is provided by the Canada Revenue Agency.

In situations, however, where an Aboriginal government's lands border or overlap into local municipalities, the policy regarding the sharing of municipal tax revenue has yet to be formulated (Mountjoy, 1999, p. 325 as cited in Prince & Abele, 2003). Nonetheless, in the past number of decades, comprehensive land claim agreements, self-government agreements and other non-treaty agreements have been progressively moving tax base sharing and clear delineation of OSR—this is especially evident within modern treaties (Nisga'a, Tsawwassen, Maa-nulth). Questions on whether the Aboriginal government should spend these revenues on the provision of social programs and services in their communities, rather than still relying on federal government funding, remain unresolved (Finlayson, 2002; Prince & Abele, 2003).

A key difference in Canada-Aboriginal fiscal relations is the absence of an equalization-type of program or formula as is present in federal-provincial fiscal arrangements. Equalization aids in achieving horizontal balance in a fiscal systems. In the provincial context, the “have not” provinces receive equalization transfers from the federal government, while the “have” provinces (currently Alberta and BC) do not (Prince & Abele, 2003). There is a variant of the equalization principle that underscores the fiscal arrangements of the *Nisga'a Final Agreement* (NFA), specifically, “to enable the provision of agreed-upon public services and programs to Nisga'a citizens and, where applicable, non-Nisga'a occupants of Nisga'a Lands, at levels reasonably comparable to those prevailing in Northwest BC” (NFA, 2000, p. 1841; Graben, 2007, p. 84; Prince & Abele, 2000, p. 385). In the *NFA*, however, there is no mention of the other half on the equalization concept, namely the reference to reasonably comparable levels of taxation (Graben, 2007).

Aboriginal governments, like most provinces, territories and other subnational governments, often have a fiscal gap, which is the difference between expenditure requirements (fiscal need) and the available revenues to finance them (fiscal capacity). Intergovernmental

transfers bridge this fiscal gap. Aboriginal governments also have limited capacity to generate revenue. The cost of delivering programs and services is also typically greater due to diseconomies of scale and geographic remoteness. As a result, Aboriginal governments are heavily dependent on federal transfers. Although historically, most federal transfers to Aboriginal governments have been parsimonious and restrictive, recent federal policy has moved to flexible block funding with 5-year terms. This aligns with the multiyear transfer payments to provinces and territories. Transfers to Aboriginal governments remain mostly conditional, while transfers to provinces and territories have fewer conditions. The current fiscal arrangements between Canada and Aboriginal governments have been described as being restrictive, not promoting autonomy or local accountability, and inducing continued dependency on the federal government for funding support (Brunet-Jailly, 2008; Sniderman & Ferbey, 2012).

In the past decade, the design of Aboriginal fiscal arrangements have been slowly approximating that of the federal-provincial, except for the lack of a system of executive federalism, which is a hallmark of the provincial fiscal relations. A key feature of executive federalism is the aspect of joint decision-making about intergovernmental fiscal arrangements, procedural relationship, and economic policy. Thus far there have been a number of national and regional intergovernmental committees; a federal caucus and federal steering committee that provides direction to federal departments on modern treaty implementation; and federal senior oversight and technical working groups and isolated bilateral negotiations that help further the discussion on policy related issues (Prince & Abele, 2003; AANDC, 2011a).

As evident from the preceding section, the average Aboriginal person living in Canada is involved with two very distinct fiscal systems: one being the federal-provincial/territorial and the other the federal-Aboriginal. Both these systems form the overarching architecture of how the funding of programs and services that Aboriginal Canadians receive operate—whether or not they are on or off Aboriginal Government lands. The two systems share some basic features, but differ substantially on a fundamental, structural level.

TABLE 6: VARYING PROVISIONS IN OWN-SOURCE REVENUE AGREEMENTS

	Sechelt	Yukon (11)	Mi'kmaq*	Nisga'a	Tlicho	Nunatsiavut	Westbank*	Tsawwassen	Maa-nulth (5)
Most Recent OSRA Effective Date	2012	2010/11	None*	2000	2005	2005	None*	2009	2011
Inclusion Rate	50%	50%	-	Taxes – 100% Settlement Trusts – 18.6% General – 46%	50%	50%	-	50%	50%
OSR Phase in Period	15	20	-	12	20	20 (Federal) 13 (Provincial)	13	20	20
Current Inclusion Rate	3.8%	50% [†]	0%	15.8% (S.T.) 39% (Gen)	10%	7.5%	0%	0%	0%
Transfer Floor	\$1,142 per capita (\$2009)	None	-	None	\$350 per capita	\$1,142 per capita (\$2009)	-	\$1472.22 per capita (\$2002)	\$8491.94 - \$2732.57 per capita ‡
Basic Exemption	\$114,200			None				\$1,370,000 from year 1-9, \$139,125 price adjustment year 10-20.	Starts at \$181,038 - \$302,396
Included Revenues									
Income Derived from Capital Transfer	N/A	×	-	✓	✓	✓	N/A	✓	✓
Investment Income	✓	✓	-	✓	✓	✓	✓	✓	✓
Income & Sales Tax	N/A	✓	-	✓	✓	✓	N/A	✓	✓
Corporate Income	Remittance model	Remittance model	-	Tax proxy model	Remittance model	Remittance model	-	Remittance model	Remittance model
Property Tax	N/A	N/A	-	✓	✓	✓	✓	✓	✓
Business Income	Remittance model		-	Tax proxy model	Remittance model	Remittance model	-	Remittance model	Remittance model
Property Income	Remittance model		-	Tax proxy model	Remittance model	Remittance model	-	Remittance model	Remittance model
Impact Benefit Agreement payments	N/A	N/A	-	N/A	N/A	×	N/A	N/A	N/A
Transfer of Revenue Source from Provinces/Territories			-			×	N/A	×	×
Fees or Charges	✓	✓	-	✓	✓	✓	✓	✓	✓
Resource Revenue Payments	N/A	✓	-	×	×	×	×	✓	×
Sale of Capital Assets	✓	✓**	-	✓**	✓**	✓**	✓	✓**	✓**

(Source: modified by author from AANDC 2014. Data source from publically available documents)

* Mi'kmaq and Westbank OSRAs are currently being negotiated

** Sales of treaty lands do not count under "sales of capital assets" and are not included in OSR capacity

†7 out of 11 Yukon First Nations already have fully phased-in OSR rates for Resource Royalties, Income Tax (PIT) and Sales Tax (GST); all Yukon First Nations except Carcross/Tagish will have these three elements fully phased-in by 2015. However, OSR phase-in for all other sources of income will not be complete until 2024 (for the First 7) or 2025 (Kluane, Ta'an Kwach'an, and Kwanlin Dun)

‡ All expressed in \$2004: Toquaht (\$152,855); Uchucklesaht (\$213,894); Huu-ay-aht (\$451,585); Ucluelet (\$598,435); Ka:'yu:'k't'h'/Che:k'tles7et'h' (\$598,435)

RECENT DEVELOPMENTS IN CANADA-ABORIGINAL FISCAL ARRANGEMENTS

In July of 2015, the federal government released the Fiscal Approach, shifting Aboriginal fiscal relations towards a national framework and making a considerable effort to ensure greater transparency and equity when determining transfers to Aboriginal governments. The Fiscal Approach is distinct because it marks the first time that funding methodologies have been transparent and publically available, instead of being treated as confidential negotiating mandates (AANDC, 2015c).

The Fiscal Approach is applicable to Aboriginal groups who have an existing self-government agreement or modern treaty, or those currently involved in self-government or comprehensive land claim negotiations. The federal government intends to honor all commitments made in existing agreements. The terms stated in the Fiscal Approach only take effect once negotiated and set out in final agreements between the parties. The Fiscal Approach, in essence, is the federal policy that helps guide federal negotiators in self-government negotiations or renewals.

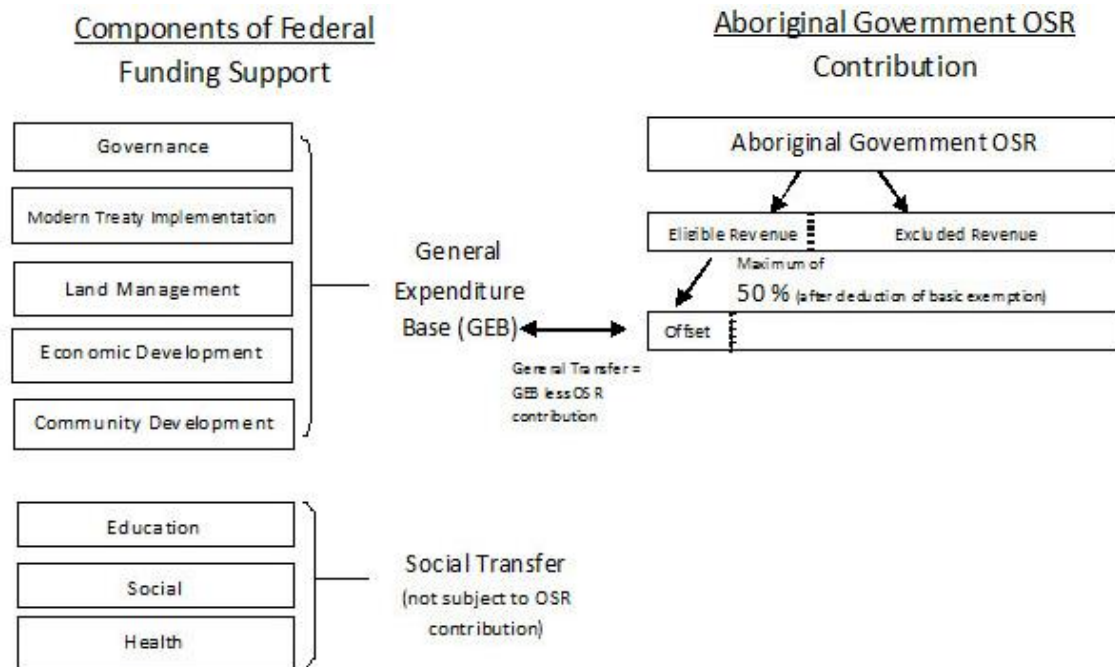
There are five elements of the new Fiscal Approach, which include:

- A policy statement that publically articulates the underlying rationale of the determination of fiscal transfers to Aboriginal governments;
- Funding methodologies that are used to determine funding amounts;
- A revised own source revenue (OSR) policy that ensures self-governing Aboriginal groups continue to share fiscal responsibility while protecting federal funding for education, health, and social development;
- Accountability provisions; and
- An advisory forum at which representatives from Aboriginal governments, provinces, territories and Canada can openly discuss and review fiscal policy matters (AANDC, 2015c, p. 4).

Fiscal Transfer Model

Figure 4 below illustrates the current model used to provide fiscal transfers to self-governing Aboriginal groups. The fiscal transfer model comprises components of federal funding support and an Aboriginal government's OSR contribution. Federal funding support has two main components: the General Expenditure Base (GEB), which includes governance, implementation, land management, social and economic development funding; and the Social transfer, which includes education, social and health funding. The Social transfer is not subject to OSR inclusion; thus it does not reduce federal funding for education, social or health program and services (AANDC, 2015c).

FIGURE 4: THE FISCAL TRANSFER MODEL



(Source: AANDC, 2015c, p.6)

OSR contribution is first determined by separating eligible revenues from excluded revenues. Of the eligible revenues, a maximum of 50% is included. This amount is considered as the Aboriginal government OSR contribution amount; the OSR offset cannot be a negative value. Thus, the general transfer is equal to the GEB minus the OSR contribution and will not be less than the transfer floor. Mathematically the OSR contribution and the transfer model is computed as:

EQUATION 1: GENERAL TRANSFER FORMULA

$$GenTr = [(Gov + MTI + LM + EcDev + CoDev) - (< 0.5(EliRev))] + (SocT)$$

- GenTr* = General Transfer
- Gov* = Governance funding
- MTI* = Modern Treaty Implementation funding
- LM* = Land Management funding
- EcDev* = Economic Development funding
- CoDev* = Community Development funding
- EliRev* = Eligible Revenues
- SocT* = Social Transfer

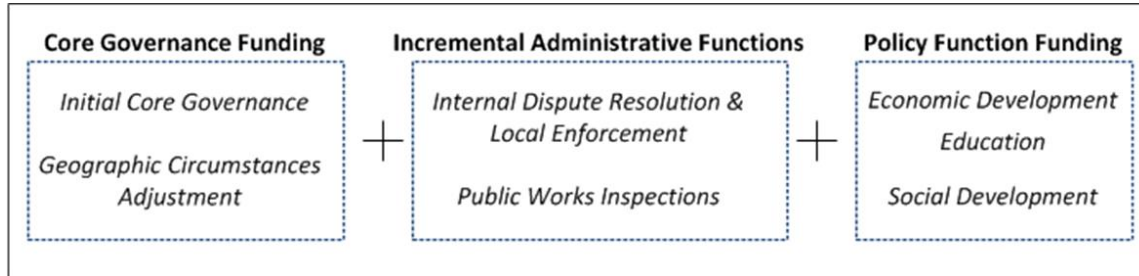
(Source: Adapted from AANDC, 2015c)

Funding Methodologies

The various components of the general transfer are calculated using different methodologies. The total governance funding is the sum of core governance plus funding for administrative and policy

functions (see Figure 5 and Equation 2). Core governance funding consists of initial funding that is adjusted by geographic and environmental circumstances. It is the only component of governance funding that is formula based; the other two (Incremental Administrative Functions and Policy Function Funding) are based on underlying program authorities or existing funding levels. Equation 3 states the core governance funding formula.

FIGURE 5: GOVERNANCE FUNDING UNDER THE FISCAL APPROACH



(Source: Created by author from AANDC, 2015c)

EQUATION 2: TOTAL GOVERNANCE FUNDING FORMULA

$$\begin{aligned}
 \textit{Total Governance} &= \textit{Core Governance} + \textit{Incremental Administrative Functions} \\
 &+ \textit{Policy Function Funding}
 \end{aligned}$$

(Source: Adapted by author from AANDC, 2015c)

EQUATION 3: CORE GOVERNANCE FORMULA

$$\begin{aligned}
 \textit{CoreGov} &= \{f + [(v_1 \times \textit{Pop}_1) + (v_2 \times \textit{Pop}_2) + (v_3 \times \textit{Pop}_3)]\} \\
 &\times [1 + (0.2 \times R_i) + (0.1 \times E_i)]
 \end{aligned}$$

- $f = \$220,000$ Fixed amount
- $v_1 = \$1,300$ for \textit{Pop}_1 where, <400 people
- $v_2 = \$400$ for \textit{Pop}_2 where, $400 \leq 5000$ people
- $v_3 = \$220$ for \textit{Pop}_3 where, >5000
- R_i = Remoteness Index for respective community
- E_i = Environmental Index for respective community

(Source: Adapted by author from AANDC, 2015c, p. 13-14)

Funding for Incremental Administrative Functions consists of a base amount of \$44,000 plus a per capita amount (\$450 per person to a maximum of \$220,000) and is in addition to 2% percentage of total eligible program funding (AANDC, 2015c, p. 14). Policy Function Funding is based on a base amount of \$55,000 plus a per capita amount (\$275 per person to a maximum of \$165,000) and is in addition to 2% percentage of total eligible program funding (AANDC, 2015c, p. 16). Both the Policy and Incremental Administrative Functions funding is designed to provide greater support to

Aboriginal governments in recognition of the diseconomies of scale governments with smaller populations face.

In Table 7, a description of funding methodologies is provided, and as the table illustrates the majority of funding is based on current funding authorities or existing funding levels provided under an expiring fiscal agreement.

TABLE 7: FUNDING METHODOLOGIES FOR COMPONENTS OF FEDERAL SUPPORT

Components	Funding Methodologies
Governance	Formula based; transparent.
Modern Treaty Implementation	Assessment of the specific activities associated with a modern treaty. Includes the possibility of formula based methods in the future
Land Management	Funding equal to amount provided under First Nations Land Management regime
Economic Development	Program funding authorities or existing levels and additional policy function funding.
Community Development	Program funding authorities or existing levels. No additional policy functions funding.
Education	Federal K-12 Program funding authorities or existing levels and additional policy function funding
Health	Program funding authorities or existing levels. No additional policy functions funding.
Social Development	Program funding authorities or existing levels and additional policy function funding

(Source: author)

OWN-SOURCE REVENUE POLICY

The Fiscal Approach also makes key revisions to the OSR policy that enables Aboriginal governments to retain more of the revenues raised, while not contributing to the decrease in federal transfers (AANDC, 2015a). Key features of the revised OSR policy include:

- OSR offsets will not be applied to federal transfers for social, education and health programming;
- Income from portfolio investments income will not be included as eligible revenues;
- Profits of tax-exempt business entities controlled by Aboriginal governments will be included at the corporate income tax rate for small businesses;
- Income arising from impact benefit agreement payments relating to projects off the Aboriginal government land-base will not be included; and
- In most cases, revenues arising from transfers or revenue sharing provided directly by provinces or territories will be excluded from federal OSR calculations (AANDC, 2015a, para. 2).

These OSR policies take into account the capacity of Aboriginal governments to contribute to the costs of administrating and operating their own government during the determination of fiscal transfers. Subsequently, it is assumed that over time as capacity increases, reliance on fiscal transfers would decrease, as Aboriginal governments will be expected to contribute more funding towards the provision of programs and services to its citizens. Fiscal transfers to territorial governments, who also are heavily dependent on federal transfers, operate in a similar fashion (AANDC, 2015a).

Given the Fiscal Approach was just recently made available, there are no final agreements that have the Fiscal Approach terms that have concluded, and thus, analysis on the policy is nonexistent. The Fiscal Approach, however, does make noticeable improvements from the shortcomings identified in previous fiscal policies and is a significant departure from previous policy discourse. The new fiscal policy will be the subject of discussion and analysis in Chapter 5 of this paper.

5.0 LITERATURE REVIEW: INTERNATIONAL FISCAL ARRANGEMENTS

Applying lessons learned in intergovernmental finance from international practices to the Aboriginal fiscal relations context is relevant because the relationship self-governing Aboriginal groups have with the federal government can be akin to the federal-provincial relations, as Canadian fiscal federalism can be said to contain an Aboriginal order of government²⁰. Additionally, Aboriginal governments often have regional economies and resource-based industries and have difficulties in gaining access to revenue sources and maintaining accountability. In this respect, they are comparable to developing and transitional economies. Anwar Shah, Robin Boadway, Michael Smart and Richard M. Bird are substantial contributors to this field and their findings will be summarized in this section.

The first part of this section will survey potential funding mechanisms, fiscal arrangements and promising practices in intergovernmental fiscal transfers from the international context using a framework of six objectives that national fiscal transfers should pursue. Subsection two will identify values and principles of sound fiscal transfer arrangements that will be used to inform the policy recommendations in Section 8.

Federal fiscal transfers to self-governing Aboriginal groups help finance a significant portion of expenditures by Aboriginal governments. Similarly, for developing and transitional in the international context, intergovernmental fiscal transfers finance about 60% of sub-national expenditures (Shah, 2003). In both contexts, these intergovernmental transfers have important implications for efficiency, equity and accountability in the provision of programs and services to communities by the recipient government.

DESIGNING FISCAL TRANSFERS

In most developing and transitional economies, intergovernmental transfers are a significant proportion of revenues for sub-national governments. These transfer systems generally have four objectives to achieve: allocative efficiency, distributional equity, macroeconomic stability, and to correct for inter-jurisdictional benefit spillovers (Bahl, 2000; Bird, 2000; Schroeder & Smoke, 2003). To ensure recipient governments are able to provide direct services efficiently, clear mandates, adequate resources, sufficient autonomy in decision-making and appropriate accountability is needed (Bird & Smart, 2002). In order to satisfy these conditions, transfers must be designed properly.

The main mechanisms for intergovernmental transfers are grants and revenue sharing. Although in practice fiscal transfers vary in terms of the conditions imposed on the transfer, in general there are two types of grants: unconditional and conditional. Unconditional grants do not specify the type expenditures that can be financed; they are simply just budget support. Conversely, unconditional transfers state what expenditures can be financed using the transfers. They may also require the recipients to adhere to matching requirements, which is the contribution of a specified amount of

²⁰ Often the subject of debate, but for the intent and purposes of this paper, Aboriginal governments in practice can be seen as a third order of government that has both provincial and local government type of direct service provision.

their own resources to finance a pre-stated percentage of expenditures. Under matching requirements the grantor can either match recipient funds without any limit (open-ended), or only matches the recipient's contributions up to a pre-determined limit (close-ended). Matching requirements encourage greater accountability and local ownership of grant financed expenditures and close-ended matching requirements help in ensuring the grantor is able to have control over the costs of the transfer program (Bird, 2000; Schroeder & Smoke, 2003). Recipients with a deficient fiscal capacity, however, might face greater burdens with conditional transfers that have matching requirements. In light of this, grantors can take into consideration the recipient's fiscal capacity and vary matching rates inversely with the recipient's per capita fiscal capacity in an effort to create more equitable conditions for poorer jurisdictions to participate in grant financed programs (Shah, 2003).

How fiscal transfers are designed is crucial for safeguarding the efficiency and equity of programs and service provision, and the fiscal sustainability of sub-national governments. Linking revenue-raising capacity closely as possible to expenditure needs enhances accountability. In general, federal and national governments have access to a revenue base that is needed to satisfy their own direct service responsibilities compared to lower levels of governments. This enables national governments to use spending power through fiscal transfers to influence the state's allocation of funding to achieve national efficiency and equity objectives (Shah, 2003). Boadway and Shah (2007), along with Bird and Smart (2002) identified broad objectives that the design of fiscal transfers to account for: vertical imbalance; horizontal imbalance; benefit spillovers; nationwide equity objectives; local priorities in areas of high national but low local priority; and macroeconomic stability in depressed regions.

I. ADDRESSING VERTICAL FISCAL IMBALANCE

A fiscal gap is considered as the difference between a government's revenue-raising ability and expenditure needs. Vertical fiscal imbalances are attributed to: unsuitable assignment of responsibilities; centralization of taxation powers; inefficient tax competition by state governments; and a shortage of tax room at the state level due to tax burdens imposed by the national government (Shah, 2007). It should be addressed through the reassignment of responsibilities, tax decentralization or tax abatement by the center and the sharing of the tax base by permitting subnational governments to levy taxes at the national level. Unconditional transfers, revenue sharing or derivational (point of collection) principle based tax sharing scheme should only be employed as a last resort (Shah, 2003, 2007). This is because these types of transfers weaken local accountability to citizens and taxpayers. Taxation by tax sharing is not an adequate mechanism to address a fiscal gap, because it creates disincentives the donor from expending effort to collect those taxes that are shared compared to taxes that are fully retained (Shah, 2003).

Vertical fiscal imbalance is resolved when total expenditures and the sum of revenues from all sources are balanced for the most prosperous recipient government, measured by its fiscal capacity. Fiscal gaps will remain for all other less prosperous recipient governments; however, those gaps are considered as issues to be addressed by horizontal fiscal equity (the subject of the next objective) as it stems from fiscal inequity between recipients rather vertical than inequity between the grantor and recipient (Bird & Smart, 2002).

A well-designed system of intergovernmental transfers offers stability and flexibility for recipients. There are three methods to determine the distributable pool (i.e. the total transfer amount to be distributed): through a fixed proportion of all revenues collected by the central government; using a formulaic approach, such as a percentage of specific recipient expenditures; or on an ad-hoc basis as is done with other budgetary spending. Bird and Smart (2002) suggest that the first method offers recipients both a degree of stability and flexibility, but caution against narrowing the distributable pool to specific revenues as this biases tax policy. Instead establishing a proportion of all national taxes should be practiced as is done to an extent in Columbia and Argentina.

The central government in the Philippines provides transfers to local governments based on a predetermined share of specific taxes at the national level. Funds are allocated according to inputs and weights are applied: population (70%), area (20%) and equal share (10%). No conditions are placed upon these transfers except that 20% of the funds transferred should be spent for local development based on local priorities (Bird & Rodriguez, 1999).

Developed countries such as Austria and Japan employ similar systems. Local governments in Austria receive 12% of income and value added taxes. In Japan, 32% of income and alcohol taxes collected at the national level are allocated to local governments. In both countries the transfer's mechanisms are formula-based, taking into account multiple factors including population and service area size (Bird & Smart, 2002).

Some industrial countries (Canada, Denmark, Finland, Norway and Sweden) have tax sharing systems in place—that is, personal and corporate income taxes are harmonized by permitting the national government to provide tax abatement in conjunction with the subnational government applying parallel tax rates at the national level (Shah, 2003, 2007). In developing and transitional economies, tax sharing and general revenue sharing are typically used to tackle the fiscal gap. Deficit grants have been utilized in the past by a number of countries (namely China, India, Malaysia, Pakistan, and South Africa) to fill fiscal gaps, however, it resulted in the ballooning of sub-national deficits. Deficit type grants are still in effect in China, Hungary and South Africa (Shah, 2003).

II. ADDRESSING HORIZONTAL FISCAL IMBALANCE

Decentralizing taxing authority and decision-making concerning public expenditures produces differential net fiscal benefits (imputed benefits from public spending minus tax burden) that impacts citizens differently depending on the fiscal capacities of the government who has jurisdiction over their place of residence (Boadway, 2007). This results in both fiscal inequity and fiscal inefficiency in resource allocation. Fiscal inequity occurs when citizens with identical incomes are treated differently depending only on their residence's geographic location. Fiscal inefficiency in resource allocation occurs when citizens make relocation decisions and comparing gross income (private income plus net public sector benefits minus relocation costs) at new locations—whereas economic efficiency warrants a consideration of private income minus relocation costs (Shah, 2007; Dafflon, 2007). Therefore, a country that values horizontal equity and fiscal efficiency will need to address the fiscal inequity and fiscal inefficiency, which naturally arises in a decentralized government. Differences in net fiscal benefits can be eliminated by using central-state fiscal transfers

that consider the tax capacity of each region relative to the other recipient regions, and upon the relative need for and cost of the provisions of public services at the regional level. The need for equalization-type transfer increases depending on how decentralized the tax system is (Shah, 2003, 2007).

Putting equalization into practice requires the fiscal transfer system to consider three essential ingredients: needs, capacity and effort. The transfer system should be comprehensive enough to provide sufficient funds for differential expenditure needs due to inherent cost disabilities rather than those that arise primarily from variation in policies (Shah, 2003), while taking into account fiscal effort exerted. Total funds comprise own source revenues plus the transfer amount (Bird & Smart, 2002).

Fiscal capacity equalization is mathematically straightforward once a policy decision is made on the national standard level of services. Commonly used measures are: state gross domestic product; state factor income, which includes all capital and labor income within the state; state factor income accruing to residents only; state personal income; and personal disposable income (Shah, 2007, p. 22). These macro measures, however, are inappropriate in reflecting a state government's fiscal capacity. Boadway (2002a) advises against integrating macro indicators into equalization formulas on the basis that fiscal inefficiency and inequity are resultant of a conflicting mix of taxes levied by state governments. Using the representative tax system approach is another method to measure fiscal capacity and is a good approach for state governments that have taxation powers and exercise the responsibility (Boadway & Shah, 2007).

Fiscal need equalization, on the other hand, is complex and often controversial. This is due to fiscal need being intrinsically subjective in nature and the use of analytical methods to capture "need" results in poor precision. Moreover, differences in demographics, service areas, populations, local community needs, state policies and behavior influences of recipient governments add to the complexity. Despite these difficulties, Boadway and Shah (2007, p. 29) note that there are a number of approaches to measuring expenditure needs:

- Ad-hoc determination of expenditure needs, which includes arbitrarily determined factors (such as population size, density and growth, road length, geographic and remoteness location) and relative weights. Currently in place in Germany, Canada, China, India and South Africa.
- Representative expenditure system with direct imputation methods, which is parallel to the representative tax system approach. Subnational expenditures are divided and stratified by their various functions (direct programs and services). Then, the total expenditures by each jurisdiction are determined for each of the functions. Cost factors are identified and weights assigned using direct imputation methods. Total expenditures for the respective jurisdictions are calculated based on relative need/cost of each of the functions. This approach is used in Australia.
- Theory-based representative expenditure system, which employs a conceptually defined fiscal need and specified expenditure functions with relative weights assigned to various need factors and the use of econometric analysis to determine their impact on grant fund allocations.

In Australia, the Commonwealth Grants Commission is an example of both fiscal capacity and fiscal need equalization. The formulas employ regression analysis and use a subjective sample of various programs and services. The data used in the regression analysis is historical, which is inappropriate when underlying structures are subject to change due to technology and other dynamic considerations. For the programs and services category, tedious work is needed to specify the determinants of each of the various programs and services. Thus, very few countries employ a comprehensive approach to fiscal equalization. Instead countries such as Canada and Switzerland, Sweden and Denmark opt for fiscal capacity equalization approaches either at the federal-state or state-local levels (Gusen, 2012; Shah, 2003).

Measures of fiscal effort indicate the relative extent to which the revenue-collection powers of a level of government are fully utilized. It is intended to represent actual revenue collected as a percentage of potential taxes (Chervin, 2007). A number of developing and transitional economies attempt to incorporate explicit measures of fiscal effort or tax effort into distributive grant formulas. Brazil uses per capita income levels among the different states and allocates grants accordingly, while in Nigeria and Columbia rudimentary measures of tax efforts are included in their distributional formulas. As evident from a number of countries, explicitly integrating fiscal effort into grant formulas is met with difficulty for a number of reasons (Smart, 2007). Firstly, as with fiscal need, fiscal effort is not easy to compute. Secondly, even if fiscal effort is computed (e.g. as a ratio of actual taxes collected to the potential taxes based on estimated fiscal capacity), it does not by itself convey any meaningful information (Chervin, 2007). Thirdly, there is an absence of reliable empirical estimates regarding fiscal capacity that renders the concept impractical (Bird & Smart, 2002; Smart, 2007).

Whether the federal or state government finances and administers an equalization program is either determined by constitution (e.g. Canada) or by legislation at the national or provincial level (e.g. Australia and Germany). Paternal type program in which higher-order governments finance and administers equalization at lower levels is the norm (e.g. Canada, Australia), while fraternal type programs where governments at the sub-national level establish a 'common funding pool' and wealthier governments contribute to the pool and poorer governments are recipients of the pooled funds, are rarely practiced (except for Germany and Ghana at state level, and Denmark at the municipal level) (Shah, 2003; Fjeldstad, 2001).

Although fraternal-type programs are rarely practiced—as disincentives are created when municipalities have control or influence over the tax rate levied on shared bases (Baretti, Huber & Lichtblau, 2000)—they seem to be preferred as they balance the interests of the collective and the contributing governments. It also helps foster unity, as recipients are clearly able to see the results of the funding contributions from other governments. Conversely, federal politics and budgetary policies largely guide paternal programs (unless stated in a constitution e.g. Canada) and consequently lack the discipline that is inherently present within fraternal programs. Countries such as Germany and Denmark combine both paternal and fraternal mechanisms in their grant programs. In the Germany, the federal government solely finances a small supplementary component of the

equalization program while in Denmark at the local level the fraternal approach is used for both fiscal capacity and fiscal need equalization (Bird & Smart, 2002; Shah 2003).

The determination of the total resource pool differs between each equalization program. Under the Canadian program, both the total pool available and how the transfers to the provinces is allocated is driven by formulas and enshrined by legislation. In the Australian context, legislation determines the total pool, which is the total revenue of the General Sales Tax (Schroeder & Smoke, 2003).

Most transitional economies utilize equalization mechanisms in their grant programs. Countries such as Romania, Ukraine, Latvia and Lithuania employ transfer formulae that incorporate fiscal capacity and/or expenditure need concerns. Developing countries implicitly attempt equalization objectives in their general revenue sharing mechanisms, rather than explicitly having an equalization standard (e.g. Argentina, Brazil, Columbia, India, Nigeria, Mexico, Pakistan and South Africa). These mechanisms are burdened by varying and conflicting objectives built into the same formula and as a result do not achieve individual objectives. And because these mechanisms lack any apparent equalization standards, they fail to address regional equity objectives adequately (Shah, 2003).

III. ACCOUNTING FOR BENEFIT SPILLOVERS

In some instances, regional governments do not have incentives to provide suitable levels of services that would yield spillover benefits and positive externalities to residents in neighboring jurisdictions. Thus, a system of open-ended matching conditional grants based on expenditures that take into consideration the extent of spillover, will provide proper incentives for the regional government (Shah, 2003). Theoretically, to induce the right amount of benefit spillover from public services the matching grant has to provide a unit subsidy approximately equal to the marginal value of the spillover benefit (Bird & Smart, 2002). This effectively reduces the relative price of each of the particular services in the locality (Petchey & MacDonald, 2007). The matching rate of the grant may decline as spending grows if the positive externalities subsidize; it can also vary across regions and if there are expected to be greater benefit spillovers in some jurisdictions or a higher local price elasticity of demand for the public service.

Bird and Smart (2002) stipulate that unless matching grants are paired with a transfer that equalizes fiscal capacities (horizontal equity), poorer governments are discriminated against. To avoid such situations, matching rates are set inversely to the recipient's revenue capacity or income level of jurisdictions. Pragmatically, however, the extent of the spillover is hard to measure precisely, so the precise matching rate will be rather arbitrary (Shah, 2003). But nonetheless, inclusion of a matching rate in a grant even if arbitrary does encourage an optimal level of service provision by the recipient government (Petchey & MacDonald, 2007).

Accounting for benefit spillovers in fiscal transfers have only been explicitly applied in a few developing countries, namely Zambia, South Africa and South Korea (Bird & Smart, 2002; Shah, 2003). Reasons may in part be due to interregional benefit spillovers may occur at the sub margins instead of at the margins, which theoretically the matching rate should be set at. Other reasons are likely because transitional and developing countries are more concerned with equity considerations

rather than efficiency. Thus, transfers in these jurisdictions tend to be redistributive. Correctly designing a matching grant formula is information intensive. Data is needed on specifications of levels of services to be provided and the associated costs; the data needs to also be accurate, precise and updated to align with actualities (Bird & Smart, 2002). A good example of a matching grant program is in South Africa, where close-ended matching transfers are delivered to teaching hospitals based upon an estimated benefit spillover value derived from the correlation of enrollment of non-local students and the use of hospital facilities by non-residents (Shah, 2003). Zambia and South Korea employ similar systems of matching grants, where each recipient state receives a transfer that results from subtracting the cost estimates of providing a specified service from the estimated revenues to be generated locally as per local taxation rates (Bird & Smart, 2002).

IV. PRESERVING THE INTERNAL COMMON MARKET AND TO ATTAIN NATIONWIDE EQUITY OBJECTIVES BY IMPLEMENTING NATIONWIDE MINIMUM STANDARDS.

There are two critical reasons for implementing nationwide standards for regional services. Firstly, minimum standards benefit the country as a whole as they contribute to the free flow of goods, labor, services and capital, and also reduce inefficient inter-regional expenditure competition. This will subsequently improve trade benefits from the internal common market. Secondly, implementing minimum standards will serve the country's equity objectives. Public services provided at the sub-national level such as health, education and social development are intended to be redistributive, that is, they provide in-kind transfers to residents in communities regardless of region (Shah, 2003, 2007).

The Canada Health and Social Transfers (CHST) program is an example of a simple but effective design of a grant system. Under this program, for the health portion the federal government transfers per capita based funding to the provinces with the growth rate linked to the growth rate of GDP. There are no conditions placed on the provinces for expenditures as long as the five overarching conditions regarding access to healthcare are satisfied. If conditions are not satisfied penalties are imposed (see Appendix E for more information). The CHST has enabled each of the provinces in Canada to ensure that all citizens have universal access to health care regardless of personal income or residence (Department of Finance, 2012a).

In a federal system, while the provision of programs and services occurs at the state or local level—desired for efficiency, flexibility and accountability—it ultimately makes it difficult to achieve federal equity objectives. Tax competition and factor mobility do not incentivize sub-national governments to provide adequate access to health education and/or social programs and services for marginalized populations (e.g. low-income, elderly). Restricted access to such services is justified by greater susceptibility to ill health faced by marginalized individuals, and consequently greater risks for cost curtailment. To alleviate such perverse incentives, conditional non-matching grants where the conditions imposed by the grantor reflect federal efficiency and equity concerns can be employed (Shah, 2003, 2007).

Additionally, there is a financial penalty if the recipient does not comply with any of the conditions. This shifts the focus on the grant from one that is based on use of funds to one that is based on achieving standards in quality, access and level of services. These types of conditional non-matching

grants do not de-incentivize sub-national governments from attaining cost efficiency but rather foster compliance with standards for access and level of services specified by the federal government. Conditional non-matching transfers can also create incentives for creative and competitive approaches for service delivery (Shah, 2007). The design for these transfers is discussed in the sub-section below.

Performance-Oriented Transfers

Results-based (often used interchangeably with output-based or performance-oriented) grants have long been touted for creating a competitive service environment and lowering transaction costs for citizens in obtaining public services. Performance-based transfers link financing to actual service delivery performance by placing conditions on the outputs while maintaining flexibility in the design and approach of programs and services. Table 8 below illustrates a results-based output chain that helps grant recipients to focus on the outcomes of service delivery congruent to just service provision. Funding that is linked to performance helps achieve efficiency and value for money (Shah, 2007, p. 9).

TABLE 8: APPLICATION OF A PERFORMANCE-ORIENTED CHAIN TO K-12 EDUCATION

Program Objectives	Improve quantity, quality, and access to education services
↓	
Inputs	Educational spending by age, gender, urban/rural; spending by grade level, and number of teachers, staff, equipment, operations and maintenance
↓	
Immediate Inputs	Enrollment, teacher per student ratio, class size
↓	
Outputs	Provincial exam scores, graduation rates, drop-out rates
↓	
Outcomes	Literacy rates, supply of skilled professionals
↓	
Impact	Informed citizenry, civic engagement, enhanced international competitiveness

Source: Modified by author from Shah (2007, p. 11)

In the results-based chain the program activities and inputs, outputs, outcomes, impact and benefits all need to be monitored. In performance-oriented grant design, reporting either internal or external shifts from the traditional focus on inputs, to attention on outputs (especially outputs that produce results) and benefits. Conditionality placed on this system should occur on the outputs rather than the outcomes. This is because outcomes are often out of the control of the recipient. Performance-oriented transfers provide positive incentives that encourage alternate service delivery practices, accentuating output-based accountability (Shah, 2007).

Table 9 below compares features of a traditional conditional grant to that of a performance-oriented transfer. In general, evidence from the international context suggests performance-oriented transfers encourage cost-efficiency; preserve local autonomy; encourage competition and innovation; and incentivize transparency and accountability.

TABLE 9: TRADITIONAL CONDITIONAL VS. PERFORMANCE-ORIENTED TRANSFERS

Features	Traditional	Performance-oriented
Grant objectives	Spending levels	Quality and access to public services
Grant design and administration	Complex	Simple and transparent
Eligibility	Recipient government departments/agencies	Recipient government provides funds to all government and non-government providers
Conditions	Expenditures on authorized functions and objects	Output-service delivery results
Allocation criteria	Program or project proposal approvals	Demographic data on potential clients
Compliance verification	Higher level inspections and audits	Client feedback and redress, comparison of baseline and post-grant data on quality and access
Penalties	Audit observations on financial compliance	Public censure, competitive pressures, voice and exit options for clients
Managerial flexibility	Little or none. No tolerance for risk and no accountability for failure	Absolute. Rewards for risks but penalties for persistent failure
Local autonomy & budgetary flexibility	Little	Absolute
Transparency	Little	Absolute
Focus	Internal	External, competition innovation and benchmarking
Accountability	Hierarchical to higher-level government, controls on inputs and process with little or no concern for results	Results based, bottom-up client driven

Source: Shah (2007, p. 14)

V. INFLUENCING LOCAL PRIORITIES IN AREAS OF HIGH NATIONAL BUT LOW LOCAL PRIORITY

Conflict over the priorities of the other orders of government inevitably arises in a federal system. The federal government uses their spending powers by employing matching transfers to induce state governments to follow priorities established by federal government. Closed-ended matching transfers with matching rate of percentage of expenditures financed from own source revenues, to link inversely with fiscal capacity would be suitable (Shah, 2003, 2007). Using ad hoc grants or open-ended matching transfers for local tax effort is not recommended. The open-ended nature of the latter may create budgetary problems for the grantor, and the former is doubtful to trigger behavioral responses consistent with the grantor's objectives (Bahl, 2000). Developing countries such as India, Malaysia and Pakistan have close-ended conditional matching programs. In the late 1990s, Pakistan's open-ended matching transfers for state tax effort went awry and the central government ceased the transfer program, as it could not meet its program obligations (Shah, 2003).

VI. CREATING MACROECONOMIC STABILITY IN DEPRESSED REGIONS

Central governments often use capital grants as a tool to improve the economic productivity in depressed regions. Capital grants provided the subnational government without provision for future upkeep of facilities have been shown to be ineffective (Bird, 1994; Shah 2003, 2007). This is because grants such as these often stimulate infrastructure to be built that is later not maintained by the grant recipient (commonly the sub-national government), as the benefits of the infrastructure is not yet realized or due to the lack of means to perform regular maintenance (Shah, 2003; Schroeder & Smoke, 2003).

There are a number of ways to improve the effectiveness of capital grants. Firstly, there should be a systematic process for selecting recipients for such transfers. The systematic process should be free from political influence and bias, and include criteria that awards grants based on needs and capacity and economic evaluation of the proposed capital project. Secondly, the recipient should be required to prepare an investment and maintenance plan prior to receipt of funds. Thirdly, adequate technical resources and assistance should be made to the recipient for planning, financing, implementing, and maintaining the project. This is particularly important especially if the recipient has inadequate capacity. Fourthly, recipients should be required to report periodically on progress and grant funded projects should be monitored and evaluated (Bird & Smart, 2002). Finally, since capital projects are often resource intensive projects, the local community should be involved citizen engagement and stakeholder participation. These are typically overlooked and as a result these projects fail, in part because proposer local ownership, community interest and oversight are nonexistent (Shah, 2003; Boadway & Shah, 2007).

Shah (2003) suggests that the use of capital grants should be limited and required to be paired with matching funds from recipients. The matching rate should be determined as discussed under objective three. Additionally, the private sector could also be encouraged to participate in infrastructure building by providing political and risk mitigation from investment.

Issues in Subnational/Local Transfers

As local governments and municipalities vary in population, geographic size, service area and the types of programs and services offered, general-purpose transfers to the local government level should reflect these distinctions. A promising method is to group and classify local governments by population size, municipality type, service area, urban/rural distinction and fiscal capacity, and then employ a separate formula for each of the classes (Boadway, 2004). Funding through grants should vary directly with service area and inversely with fiscal capacity.

INSTITUTIONAL ARRANGEMENTS FOR FISCAL RELATIONS

There are multiple options for which order of government should design the architecture of intergovernmental fiscal relations. According to Shah (2007b), a natural option is for the federal government to be exclusively responsible as they are accountable for the national objectives that are to be conveyed. In many developing and transitional economies this is the case. However, problems can arise on the grounds that the federal government can become overly involved with subnational decision-making, subsequently hindering the full benefits of decentralization from occurring. This can be inhibited to some degree by imposing constitutional restrictions on the ability of the federal government to countermand the decisions of the subnational government. Conversely, agreements could state that the subnational government could have a veto in decision-making.

Another option is to have a separate body design the arrangement of fiscal relations and also be involved with the enforcement and ongoing reform. This body could be completely impartial, operate arm's length from both the federal or state government, or be a collaborative bilateral body with representatives from both orders of governments. It could also be a decision making body or be purely advisory in nature. Ultimately though, it needs the ability to coordinate decision-making at both orders of government to be effective (Shah, 2007b).

There are four commonly deployed models for determining the system of transfers. The first solely relies upon the central government to deciding the transfer system. This model is dis-advantageous as it biases the transfer system towards a centralized decision-making, rather than a decentralized outcome, which is the purpose of the transfer system. In India, the federal government is responsible for delivering the Planning Commission transfers and federally sponsored schemes to the states. Input by the federal government is significant and these transfers have numerous conditions placed on them, which undermines state autonomy. In Brazil, the formulas for the transfers are encapsulated into the 1988 constitution, safeguarding state interests against federal intrusion. These safeguards, however, have an obvious disadvantage in that they prevent the fiscal arrangements from being flexible and responsive to changing economic climate (Shah, 2007b).

The second model is to set up a quasi-independent body (such as a grants commission) that is mandated to lead the design and monitor performance of the transfer system. Commissions can be permanently embedded in the intergovernmental fiscal arrangements (e.g. Australia, South Africa), or ad-hoc or periodic in nature, such as in India, where a commission makes recommendations

every 5 years. Ad-hoc or periodic commissions in some countries (South Africa) are largely ineffective because many of the recommendations are overlooked and disregarded by the government. Some commissions (e.g. in India) have had most of their recommendations implemented but still have been ineffective because of the numerous constraints they have placed upon themselves. Permanent commissions (e.g. Australian Commonwealth Grants Commission) also have been somewhat ineffective, as they have become overly academic in their approach and contributed to complex fiscal arrangements (Shah, 2003, 2007a).

The third model is utilizing executive federalism to negotiate and develop the terms of the fiscal transfer system. In Canada, the presence of federal-provincial committees enables political input from each of the provinces involved into the decision-making process and attempts for the parties to reach a consensus (Shah, 2007b).

The fourth model is a variation on executive federalism and relies on an intergovernmental-legislative-civil society committee to negotiate and develop reform (if needed) in the existing fiscal arrangements. This model is chaired by the federal government but provides for equal representation of all constituents in the privy jurisdictions. An example of this is the Finance Commission in Pakistan. Approaches such as these are advantageous as they encompass representation of all stakeholders in the process—the donor (central government), recipients (state governments), civil society and experts. This helps keep the entire system simple and transparent. However, a distinct disadvantage is that stalemate concerning decisions might occur as this model relies on unanimity and consensus building—as recently evident in Pakistan (Shah, 2007b).

PROMISING PRACTICES FROM THE INTERNATIONAL CONTEXT

The preceding section identified a number of lessons that have been learned from the practice of intergovernmental fiscal transfers. The following summarizes these lessons identified by Shah (2003; 2007a; 2007b), Bird and Smart (2000; 2002), and Schroeder and Smoke (2003) and serve as a precursor for section 5 of this report where these findings will be discussed and analyzed in the aboriginal self-government context.

Practices to Avoid:

1. General revenue sharing programs with multiple factors – These undermine accountability, and fiscal efficiency and fiscal equity objectives. An alternative is tax decentralization or tax base sharing as they offer increased accountability while preserving the recipient autonomy.
2. Grants that finance state deficits – These incentivize recipient's debt to accumulate.
3. Fiscal effort provisions in unconditional grant programs – improving service delivery performance while increasing cost efficiency should be a public sector objective.
4. Process based or ad hoc conditional grant programs – These administered through central governments undermine local accountability, flexibility, and fiscal efficiency and equity.
5. Capital grants without long-term funding stability – These have the potential to create infrastructure that is later abandoned due to lack of funding for upkeep and maintenance.
6. Discretionary transfers – In a federal system, these create disunity and dissention as they invite favoritism and competition between recipients.

Practices to consider:

1. Simplicity in the design of fiscal transfers – simple and transparent systems will have a wider acceptability amongst stakeholders.
2. Single objectives per transfer program – this is consistent with a simple design. Multiple objectives will only complicate the grant program and will result in the risk of not achieving any one objective. Multiple objectives in a grant program also run the risk of having objectives conflict with each other.
3. Insert sunset clauses in the transfer program – periodic review at the end of the term (approx. 5 years) will help ensure that the program is responsive to the needs of the recipient while being affordable to the grantor. Having a fixed term also ensures funding stability and budgetary predictability for the participating governments.
4. Use a grant program that equalizes per capita fiscal capacity to a fixed standard – this best helps achieve fiscal equalization. Fiscal capacity equalization formulae that use a representative tax system is less data-intensive and arduous than computing expenditure need equalization, which requires comparatively complex analysis (inviting controversy and debate).
5. Require a performance-orientated (output-based) approach for specific purpose grant programs – examples can be standards of service quality and accessibility. Conditions imposed on outputs allow for the grantor’s goals (such as national objectives) to be realized without impeding local decision making on program and service delivery.
6. No one model of institutional arrangements for fiscal relations is considered the best – but stakeholder participation in decision-making is crucial. The inclusion of an objective criterion that is mutually beneficial to the interests’ of both parties (or stakeholders) should be sought after. A consensus for equalization is also important for the success and sustainability of the fiscal arrangement.

5.1 PRINCIPLES OF INTERGOVERNMENTAL FISCAL ARRANGEMENTS

Fiscal arrangements both in the Canadian and international context are often guided by principles that are critical to ensuring the efficiency and equity in the provision of programs and services and the fiscal sustainability of national governments. Boadway and Shah (2007) have identified several guiding principles that should be considered when designing successful fiscal transfers:

1. *Clarity in objectives* – clearly and precisely specified objectives should guide the development of the transfer design
2. *Autonomy* – including complete independence and flexibility in priority setting should be granted to subnational governments. Constraint around the categorical structure of programs should also be alleviated. Regarding tax base sharing, state governments should be permitted to implement their own tax rates on central bases, revenue sharing or block grants.
3. *Revenue adequacy* – Subnational governments should have adequate revenues to perform designated responsibilities. That is, the costs of performing responsibilities (e.g. program delivery) should not exceed the growth of grant payments.

4. *Responsiveness* – The transfer program should be flexible in accommodating extenuating or unpredictable circumstances of subnational governments.
5. *Equity* – Transfers should correlate directly with fiscal need while varying inversely with tax capacity of subnational governments.
6. *Predictability* – Fiscal transfer mechanisms should be predictable and ensure that subnational governments have at minimum five years to plan ahead. The formula of a fiscal mechanism (often a grant) should explicitly state funding limits for annual fluctuations. Any changes in the formula that potentially reduce funding should be mitigated by incorporating grandfathering provisions
7. *Transparency* – The allocation methodology of transfers should be widely disseminated to stakeholders in order to receive support on the inputs, objectives and the operation of the transfer program
8. *Efficiency* – The design of transfers should be neutral in influencing subnational governments' choices of allocating resources
9. *Simplicity* – Transfer allocation should be based on objectives variables and easy to use and understand.
10. *Right Incentives* – The transfer design should correctly incentivize sound fiscal management and discourage inefficient practices.
11. *Scope* – There will be some recipients who benefit at the expense of others from the fiscal arrangements, therefore, it would be prudent to identify the beneficiaries and ways to mitigate potential adverse effects the transfer program might unintentionally create.
12. *Protecting the grantor's objectives* – result based or performance orientated transfers ensure that the grantor's objectives are protected, while maintaining flexibility for the recipient in use of funds
13. *Affordability* – As the grantor's budgets are finite and constrained, the transfer program must recognize this. If matching grants are utilized they should be close-ended.
14. *Singular in focus* – Each transfer program should focus on one specific object and avoid multiple objectives that could unintentionally conflict with each other.
15. *Accountability* – The transfer system must have accountability mechanisms built into the design. The grantor should be accountable for the design and operation of the program, while the recipient should be accountable to the grantor and the public for financial prudence and service delivery performance.

It ought to be noted that some of the preceding principles might in practice conflict with others; therefore, both donors and recipients have to prioritize principles when designing fiscal transfer systems (Shah 1994b; Canada 2006).

Recent developments in federal fiscal policy with respect to self-governing Aboriginal groups have been pioneering in terms of transparency and openness. The Fiscal Approach states that self-governing fiscal relations will be guided by the principles of:

- *Shared responsibility* – federal, provincial and Aboriginal governments all have a part in and share responsibility for financing self-government

- *Reasonably comparable* access to programs and services that is available to other Canadians living in comparable communities
- *Consistent* and *equitable* funding support under *stable, predictable* and *flexible* fiscal arrangements
- *Transparency* and *openness* regarding fiscal matters
- *Accountability*, clear roles and responsibilities and sound public administration
- Encouraging *efficiency* and *cost-effectiveness* – in addition take into account different circumstances endured by communities
- *Affordability* – for the federal government’s fiscal finances (AANDC, 2015c, p. 3).

Simply adhering to economic principles and transplanting promising practices within the field of intergovernmental fiscal transfers into the Aboriginal policy context will not produce a well-functioning system of self-governing fiscal arrangements due to two key limitations. Firstly, there are conflicting objectives inherent within intergovernmental fiscal transfer systems. Decentralization versus centralization; the former contributes to efficiency in the transfer system and the latter conversely contributes to equity. Thus, value judgements will have to be made on the trade-offs between efficiency and equity. There is an emphasis in the public finance literature that there is no ‘gold-standard’ system of fiscal arrangements that should be adopted by every country. For any given country the type of fiscal arrangement most suitable is dependent on economic circumstances, redistributive objectives and national solidarity. Nonetheless, there are some common principles that are shared among most intergovernmental fiscal arrangements.

Secondly, there are varying models of self-government currently in effect, ranging from legislative to sectoral to modern treaty, which having differing degrees in autonomy. Some models of self-government are incomparable to sovereign nations for the purposes of drawing best practices in intergovernmental fiscal transfers from the international context. The best comparator would be Modern Treaty groups as they are often considered to a third order of government in Canada’s federal system²¹.

²¹ This view is perpetually contested (see Rustand (2010) and Gibson (2009)), however, for comparative purposes this assumption is made in this paper.

6.0 FINDINGS FROM INTERVIEWS

This chapter will present findings from the interviews with subject area experts from the federal government, academics, and current or former representatives of Aboriginal governments. Thematic analysis was used to sort and analyze the interview data; it produced multiple themes that can be organized to form a narrative. Interviewees' comments and responses are organized under the identified themes. In instances where interviewees' comments or inferences were better supported by other sources, supplementary sources have been incorporated and referenced accordingly. Adopting this approach, allows for a more vivid yet concise expression of responses to be articulated than otherwise possible.

OVERVIEW OF THEMES

- **Problems that manifest within self-government fiscal arrangements stem from issues inherent within the *Indian Act*.**

Interviewees suggested that the establishment of the *Indian Act*, resulting in a small patchwork of reserves often situated in areas of low economic potential and nonexistent health and social programming, has not only contributed to broader socio-economic issues plaguing Aboriginal communities across Canada, but also to the issues that arise within self-government—in particular, the stagnant economic development opportunities and the lack of Indian band governance and financial management capacity building^{22,23}. The reserve system also created a concept of land management vastly different from the conventional approach. The *Indian Act* defines reserve land as, “a tract of land, the legal title to which is vested in Her Majesty that has been set apart by Her Majesty for the use and benefit of a band”. Reserve land differs from the common notion of private land because: a) the legal title to reserve lands is held by the Crown rather than by the Aboriginal groups or community; b) the land cannot be legally seized or mortgaged by non-Aboriginals. Individuals residing in reserves have no vested interest in personally investing in preventative maintenance and upkeep of reserve assets (AANDC, 2013, para. 6).

In addition, under Sec. 87 of the *Indian Act*, property and income taxation do not apply to Aboriginal community members. Although some may see this as a benefit, one interviewee noted that the concept of tax as a means for a government to finance expenditures for public services is lost by some community members and perpetuates as a community transitions to self-government²⁴. This ingrained notion of “refusal to pay taxes to any government including the local Aboriginal government”²⁵ (as described by one federal official) complicates efforts to incentivize self-reliance of the self-governing group. Academics and one local government finance expert agree that private fee

²² Federal Official A, interview by author, March 7, 2016

²³ Aboriginal Group Representative A, interview by author, March 23 2016

²⁴ Federal Official A, interview by author, March 7, 2016

²⁵ Federal Official A, interview by author, March 7, 2016

simple ownership of reserve land and exercising property tax are promising ways to spur economic development and self-reliance^{26,27,28}.

- **Fiscal arrangements should encourage Aboriginal groups to aggregate²⁹ into larger conglomerates either for treaty or self-government negotiations or for service provision.**

Current federal policy adopts a stance of “policy neutrality” regarding incentivizing aggregation within treaty and self-government negotiations³⁰. That is, the policies do not incentivize or disincentivize aggregation³¹. This longstanding position is evident in BC where the majority of the 65 groups currently negotiating treaties have population of less than a 1000 people—7 groups have populations of less than 300 and one has just 66 people. However, while firm estimates remain the subject of debate³², some minimum population is needed for efficient governance and service delivery; fiscal arrangements should encourage very small groups to aggregate³³. Caution will be needed; one interviewee pointed out that BC tried incentivizing aggregation in their resource revenue sharing policy but was met with criticisms by First Nations³⁴. Other interviewees suggested that aggregation for service provision (e.g. health, education), or service delivery arrangements with neighboring municipalities^{35,36}, might be less controversial than merging treaty negotiations or fiscal arrangements.

- **Fiscal arrangements should not solely be about funding but should also improve governance and financial management capacity within the community.**

The root of governance issues perhaps traces back to early colonist practices and early Indian policies of imposing Euro-Canadian town council models onto local First Nations communities, ignoring traditional forms of governance³⁷. As Indian bands transition to self-governments, the corresponding fiscal arrangements should enable good governance and financial management practices^{38,39}. Multiple interviewees (federal, academic and Aboriginal group representatives) all

²⁶ Aboriginal Group Representative A, interview by author, March 23 2016

²⁷ Aboriginal Group Representative B, interview by author, April 15, 2016

²⁸ Academic Informant B, interview by author, April 14, 2016

²⁹ Aggregation, in this context, refers to different Aboriginal groups combining for the purposes of treaty or self-government negotiations or for service provision; such collaboration need not imply full political amalgamation.

³⁰ Federal Official B, interview by author, March 16, 2016

³¹ Federal Official B, interview by author, March 16, 2016

³² Federal Official B, interview by author, March 16, 2016

³³ Academic Informant B, interview by author, April 14, 2016

³⁴ Federal Official B, interview by author, March 16, 2016

³⁵ Academic Informant A, interview by author, March 15, 2016

³⁶ Federal Official A, interview by author, March 7, 2016

³⁷ Federal Official B, interview by author, March 16, 2016

³⁸ Federal Official B, interview by author, March 16, 2016

³⁹ Federal Official A, interview by author, March 7, 2016

indicated that some Aboriginal groups lack “in-house” governance and financial management resources and often have to contract outside experts to fulfill the need⁴⁰⁴¹⁴²⁴³. Continued dependence on extra-community resources undermines the self-reliance Aboriginal governments strive for. A consultant for numerous BC First Nations referred to the sentiment enunciated by the following excerpt from National Post article⁴⁴:

“Some bands have the capacity to make the transition to self-governing status, but it is obvious *many others do not*. The Walkerton E. coli tragedy remains a vivid reminder of what can happen when incompetent, unqualified people are charged with a vital public service. *Governance is bad enough in remote reserves* like Pikangikum in northern Ontario, where nine people died in a house fire this month, the consequence of massive overcrowding compounded by the absence of a fire-fighting service, building or fire codes and piped water. *No self-government treaty is going to change that.*” (Iverson, 2015, para. 14, emphasis added).

The evolution of funding arrangements with Aboriginal groups has resulted in increased autonomy, flexibility and responsiveness⁴⁵. This is evident in contribution agreements and the self-government funding model, where funding is typically transferred through multi-year block-funding grants with formulaic adjusters, with recipients having the ability to reallocate funding within the block⁴⁶. The approach coupled with the lack of governance capacity building, however, has been described as the “fund and abandon approach”⁴⁷ further increasing the potential risk of ineffective fiscal arrangements.

- **Fiscal arrangements should be constructed on a multilateral policy framework built on shared principles, priorities, and methodologies for determining and allocating fiscal transfers.**

This notion takes the current Fiscal Approach a step further and transforms a merely federal policy and position to a multilateral policy framework that is supported by Aboriginal groups and provinces/territories⁴⁸. Principles and priorities stated in the multilateral framework would be those that are shared between the parties⁴⁹. Like the Fiscal Approach the framework should be Canada-

⁴⁰ Federal Official A, interview by author, March 7, 2016

⁴¹ Federal Official B, interview by author, March 16, 2016

⁴² Academic Informant A, interview by author, March 15, 2016

⁴³ Aboriginal Group Representative A, interview by author, March 23

⁴⁴ Aboriginal Group Representative A, interview by author, March 23

⁴⁵ Federal Official A, interview by author, March 7, 2016

⁴⁶ Federal Official A, interview by author, March 7, 2016

⁴⁷ Federal Official A, interview by author, March 7, 2016

⁴⁸ Academic Informant A, interview by author, March 15, 2016

⁴⁹ Academic Informant A, interview by author, March 15, 2016

wide and apply to all Aboriginal governments⁵⁰. Adopting this approach would lead to collaborative development of funding methodologies and a shared understanding of outstanding issues such as *reasonably comparable*⁵¹. For example, an academic informant proposed the use of the concept of assumed average need where additional costs for a vulnerable population is assumed, could be used to address the issues outstanding regarding reasonably comparable⁵². Assumed average need is frequently used in pension planning and in disability metrics and social policy issues. Funding under this framework would be based on generosity, mutual trust and a citizen-plus model⁵³. All parties should adhere to transparency and evidence-based strategies. The framework could also include a section on how provinces/territories could contribute to successful fiscal relations with Aboriginal governments⁵⁴.

- **There is an imminent need for institution-building within the current system of fiscal arrangements.**

Until the recent release of the Fiscal Approach, a national forum for formal policy review has not been a part of Canada-Aboriginal fiscal relations. Policy development has occurred on an ad-hoc basis in consultations and engagement of various Aboriginal communities^{55,56}. This breakthrough of policy inertia occurs in the Fiscal Approach where the establishment of a collaborative review and advisory process (an Advisory Forum) to serve as avenue for facilitating regular review and revision of fiscal policy is explicitly stated. However, almost a year since the policy was released the Advisory Forum has yet to be initiated. The instatement of such Forum provides a channel to operationalize a nation-to-nation relationship⁵⁷ with Aboriginal governments that Prime Minister Justin Trudeau seeks (Mass, 2015).

Along with the Advisory Forum, there is a need for accurate, reliable and up-to-date data and statistics on Aboriginal communities and the services they receive⁵⁸. To date, there is no such system to collect comprehensive data⁵⁹. Available data sources for inputting into funding formulas are census and various statistics collected by the provinces and territories⁶⁰. With the number of self-governing groups increasing, there will be a growing need for reliable and ongoing data collection.

⁵⁰ Academic Informant A, interview by author, March 15, 2016

⁵¹ Academic Informant A, interview by author, March 15, 2016

⁵² Academic Informant A, interview by author, March 15, 2016

⁵³ Academic Informant A, interview by author, March 15, 2016

⁵⁴ Academic Informant B, interview by author, April 14, 2016

⁵⁵ Federal Official A, interview by author, March 7, 2016

⁵⁶ Federal Official B, interview by author, March 16, 2016

⁵⁷ Academic Informant A, interview by author, March 15, 2016

⁵⁸ Academic Informant A, interview by author, March 15, 2016

⁵⁹ Academic Informant A, interview by author, March 15, 2016

⁶⁰ Federal Official A, interview by author, March 7, 2016

- **Aboriginal-Canada fiscal arrangements should be based on transparent terms that reflect coordinated federal approaches that help achieve the guiding principles.**

Over time the fiscal transfer systems has become unmanageable, dysfunctional, and most importantly inequitable for Aboriginal groups⁶¹. Federal officials commented that under the old fiscal policy (i.e. prior to the release of the Fiscal Approach) some Aboriginal groups have gotten, “better deals, and more favorable terms than others”⁶². And that this was due in particular to isolated bilateral negotiations⁶³. Within the federal bureaucracy, the internal “mandating process also needs to be streamlined and coordinated,”⁶⁴ to ensure equitable outcomes for negotiating Aboriginal groups⁶⁵.

It is also unclear of whether “any of the funding methodologies stated in the Fiscal Approach in fact help achieve the principle of equalization,”⁶⁶ that is alluded to within 10.2 of the principles of the policy. Furthermore, it is not explicit if the funding methodologies or fiscal arrangements do encourage principle 10.6 of efficiency and cost-effectiveness⁶⁷, as there are no aspects of performance measurement in place in any existing agreements or federal policy.

Future federal policy concerning fiscal arrangements could be linked with socioeconomic outcomes of Aboriginal communities⁶⁸. Under this approach funding would be tied to a community’s health, education, and social development outcomes in an attempt to address the socioeconomic gap and inequity between Aboriginal and non-Aboriginal communities⁶⁹. This, however, would be “a non-trivial exercise in costing out precisely how much funding is need to fill in the socioeconomic gap,”⁷⁰ especially given that reliable economic costing data does not exist.

- **Fiscal transfers should provide incentives both at the individual level and at the community’s governance level.**

Program funding provided by AANDC to some First Nation communities has been stalled at the band governance level and not filtered down to community members. Education, for example has been a problematic program to fund. In some cases, education funding transferred to a First Nations

⁶¹ Federal Official A, interview by author, March 7, 2016

⁶² Federal Official B, interview by author, March 16, 2016

⁶³ Federal Official A, interview by author, March 7, 2016

⁶⁴ Federal Official B, interview by author, March 16, 2016

⁶⁵ Federal Official A, interview by author, March 7, 2016

⁶⁶ Aboriginal Group Representative A, interview by author, March 23, 2016

⁶⁷ Federal Official B, interview by author, March 16, 2016

⁶⁸ Federal Official A, interview by author, March 7, 2016

⁶⁹ Federal Official A, interview by author, March 7, 2016

⁷⁰ Federal Official B, interview by author, March 16, 2016

has not been spent accordingly. Now there could be a number of plausible reasons for this, but some consultants⁷¹ and federal officials^{72,73} have noted a number of cases such as these in not only education but other program areas as well. Therefore, some interviewees suggest that federal funding provided to a particular sector, for example education, should be designed as financial support for the individual^{74,75}. In the case of education, an interviewee proposed that funding could be allocated to the Aboriginal government for construction (if needed), policy development and operation and maintenance, and also should disseminate down to students in the form of financial support for school achievement, improvement of grades, etc⁷⁶. Performance-oriented transfers could create such incentives; however, some interviewees conceded that implementing this approach in an Aboriginal self-government context would not gain support, as self-governing communities argue that performance-oriented transfers limit perceived autonomy and by nature contravene the nature of self-government⁷⁷.

⁷¹ Aboriginal Group Representative A, interview by author, March 23, 2016

⁷² Aboriginal Group Representative A, interview by author, March 23, 2016

⁷³ Federal Official B, interview by author, March 16, 2016

⁷⁴ Federal Official A, interview by author, March 7, 2016

⁷⁵ Federal Official B, interview by author, March 16, 2016

⁷⁶ Federal Official A, interview by author, March 7, 2016

⁷⁷ Federal Official B, interview by author, March 16, 2016

7.0 DISCUSSION AND ANALYSIS

Previous sections have summarized available literature, provided an overview of the current state of Aboriginal fiscal arrangements and compared it to that of federal-provincial fiscal relations; outlined potential funding mechanisms, fiscal arrangements and promising practices from the international context; and described themes that emerged from the interviews. This research recognizes that due to the unique history, legal, and sociopolitical circumstances Aboriginal fiscal arrangements embodies, findings from other contexts cannot simply be transplanted to the Aboriginal self-government context and be expected to be compatible. Rather, an analytical policy framework needs to be constructed to help guide the discussion and analysis, and contour applicable lessons learned from the field of intergovernmental fiscal transfers into Aboriginal self-government fiscal arrangements. And if relevant, components or mechanisms will be identified that can be adopted into the new Fiscal Approach. These objectives are the focus of this section.

7.1 POLICY FRAMEWORK

The following analytical policy framework was developed from the review of literature pertaining to Aboriginal self-government policy and Canada-Aboriginal fiscal arrangements. It has been modified and adapted from Hawkes and Maslove (1989 p. 103) and is based on the premise that models of Aboriginal self-government are pragmatically linked to the types of fiscal arrangements. It is also grounded in the proposition that a) there are degrees of local autonomy in the Aboriginal self-government model; b) the fiscal arrangements are supportive and are consistent with the model of Aboriginal self-government; and c) there are differing levels of socio-political and economic characteristics and administrative capacity between Aboriginal governments into which fiscal arrangements are being introduced. While there are various forms of self-government, for the purposes of this paper, the only model of Aboriginal self-government that is considered is that where a self-government component is part of a comprehensive land claim agreement, which includes constitutionally protected treaty rights under section 35 of the *Constitution Act, 1982*. And thus, the Aboriginal group under self-government has a direct fiscal relationship with the Government of Canada⁷⁸.

SELF-GOVERNMENT

Hawkes and Maslove (1989) state that the three dimensions of governmental autonomy, fiscal autonomy and socio-political, economic and administrative capacity should all be positively correlated. As Aboriginal governments become more self-governing—for example, by assuming more responsibilities for providing more programs and services—the fiscal arrangements should become less conditional. Similarly, self-government and the accompanying fiscal arrangements should take into account the variation in socio-political and economic characteristics and the

⁷⁸ By entering into a Fiscal Transfer/Financing Agreement or an equivalent, which is a type of side agreement to a comprehensive land claim (modern treaty).

administrative capacity of different aboriginal governments; and should work to improve and encourage greater self-sufficiency.

For the purposes of this paper, the model of Aboriginal self-government to be considered is one that includes: 1) a land base over which the government can exercise jurisdiction; 2) an ethnic government comprising membership determined by ethnic criteria; 3) both a regional and local scope of government; and 4) constitutionally (as opposed to federal legislation) derived source of power and ability to exercise legislative and adjudicative power within the Aboriginal government's field of jurisdiction as defined in the respective treaty.

SOCIO-POLITICAL AND ECONOMIC CHARACTERISTICS

Fiscal arrangements must account for the various political, social, economic and geographic circumstances of Aboriginal communities. Small populations, remote locations, unstable political leadership, lack of community support, limited economic development potential and poor social and health outcomes hinder successful fiscal arrangements. Fiscal arrangements should also consider the different administrative capacities of Aboriginal governments. Regarding the political characteristics of Aboriginal communities, the existence of accountability mechanisms between the Aboriginal government and its citizens should be clear and unambiguous. In particular, what is the budgetary process through which funds will be allocated to programs and services, and how is the allocation responsive to changing demand and/or community priorities. Strengthening and enhancing the administrative capacity for financial management, planning, and budgeting are another critical factors for successful fiscal arrangements. These factors help Aboriginal governments use funds efficiently and effectively in performing governance functions including program and service delivery (Hawkes & Maslove, 1989).

FISCAL ARRANGEMENTS

Since the model of self-government this paper focuses on is self-government as part of a comprehensive land claim, only the fiscal arrangements that are compatible with that model will be discussed and analyzed. Although there are a number of existing fiscal arrangements that could serve as models for future systems and a recently released new federal policy (the Fiscal Approach), the focus of this paper is not to solely critique existing arrangements or the new fiscal policy. But rather, the intent is to provide an over-arching policy framework regarding self-government and fiscal arrangements, and provide options and recommendations that will build upon the new fiscal policy on self-government fiscal arrangements.

PARAMETERS

The following presents two sets of parameters that are adapted from Hawkes and Maslove (1989, p. 107). The first set poses basic issues fiscal arrangements need to address:

- *Legal framework of the arrangement* – It may be Constitutional, as equalization payments to the provinces are; contractual or an agreement between the Aboriginal and federal government; or legislative, passed by the federal government. Moving from constitutional to contractual to legislative increases the dependency of the Aboriginal government. Currently, although modern

treaties are constitutionally protected, self-government fiscal arrangements per se are mostly contractual⁷⁹.

- *Source of funds* – It may either be a cash transfer from the general revenues of the federal government, or the Aboriginal government might have direct access to a specific tax base, or a hybrid of both. In the case of taxation, the Aboriginal government might be granted a certain percentage of revenues collected from a specified tax base(s) but the federal government would still be acting as the collection agency.
- *Basis for receipt of funding* – That is, funding could be granted as a matter of entitlement (e.g. specific claim or land settlement), through an unconditional grant program (e.g. equalization), or through a conditional grant program (e.g. the Canada Health and Social Transfer). Grants based on entitlement gives Aboriginal governments a high level of autonomy, while conditional grant programs may imply that Aboriginal governments are strictly administrative or program delivery entities.
- *Basis of renewals* – Under the current system of fiscal arrangements, side agreements expire every 5-8 years and need to be renegotiated. Often these renewal negotiations are long and protracted potentially impacting the responsiveness of funding to account for the possible changing circumstances of the recipient. In light of this, alternatively, fiscal side agreements could be ‘evergreen’ and incorporate live funding adjustors that automatically update annually or bi-annually to account for changing program volume, workload or circumstance.

Overall, fiscal transfers should reflect the notion that as an Aboriginal government’s overall autonomy increases, so should the type of funding. To date, transfers are based primarily on an unconditional settlement as part of a comprehensive land claim, and semi-conditional funding for programs and services.

The second set of parameters is more technical in nature and relate to the aspect of program design. Although only five parameters are outlined below, in practice there could be many more. The five below have been identified as being essential components of self-government fiscal arrangements (adapted from Hawkes & Maslove, 1989, p. 109)

- *Determinacy* – Is the transfer to the Aboriginal government determined solely by the use of the fiscal formula, or does the formula merely determine a portion for an individual Aboriginal government of a global sum that is allocated for all self-governing groups. The former should be applied to Aboriginal governments are these types of governments are viewed to be autonomous in their respective jurisdictions. This is how most transfers to provinces and territories are determined. The latter is used primarily for specific program or service delivery agencies.
- *Redistributive* – Does the fiscal arrangement contain explicit equalization factors. Most intergovernmental fiscal arrangements both within Canada (i.e. the provinces and territories) and in the international context rely on equalization type arrangements to ensure horizontal fiscal

⁷⁹ With the exception of Sechelt which is legislative.

equity among recipient governments. There are two methods to achieve equalization. The first relies on fiscal capacity or another relative measure to determine eligibility for participating in the program, and the level of support required. The federal equalization program utilizes this approach. The second method is specifying an absolute standard to bring recipients up to such as funding standard to provide public services that have been objectively defined.

- *Responsiveness* – how does the funding adjust or adapt to economic conditions over time. In the context of Aboriginal intergovernmental fiscal arrangements, funding is usually linked with an index such the Final Domestic Demand Implicit Price Index (FIDDIPI) and adjusted by population, to take into account inflation and cost of living. In addition, funding increases might be legislated or negotiated in an agreement.
- *Accountability* – How does the recipient held accountable for the funding spent and to whom? Aboriginal governments are delegated a certain level of autonomy over funding decisions and thus, accountability in this sense is to their citizens and membership. Achieving this fundamental level of accountability typically involves publishing and annual report of spending and making publically available consolidated financial statements.
- *Transparency* – Would the transfer and funding methodologies and arrangements be transparent to other Aboriginal governments but also to Aboriginal communities and the general public. Transparent methodologies helps garner support for the objectives of the transfer program and foster sound governance.
- *Term* – The length of the funding agreement, whether it is fixed years or indefinite. A longer length of term enables greater planning, predictability and autonomy.

The values that these parameters assume can be of varied combinations. However, to fulfill the purposes of this paper's objectives, the parameter's values have been applied to the model of self-government in which an Aboriginal group has a settled comprehensive land claim along with a self-government agreement.

Using this policy framework we can now integrate the findings learned from both the Canadian and international context (discussed in Section 4 and 5, respectively) and the analysis of interviews (Section 6) to produce objectives of Canada-Aboriginal fiscal transfer arrangements. These findings will certainly need to be analyzed and tailored in order to be applicable to the Aboriginal self-government context. Where applicable, the Fiscal Approach will be discussed in relation to the findings obtained. This will be the focus of the following subsection.

7.2 APPLICATION OF THE POLICY FRAMEWORK

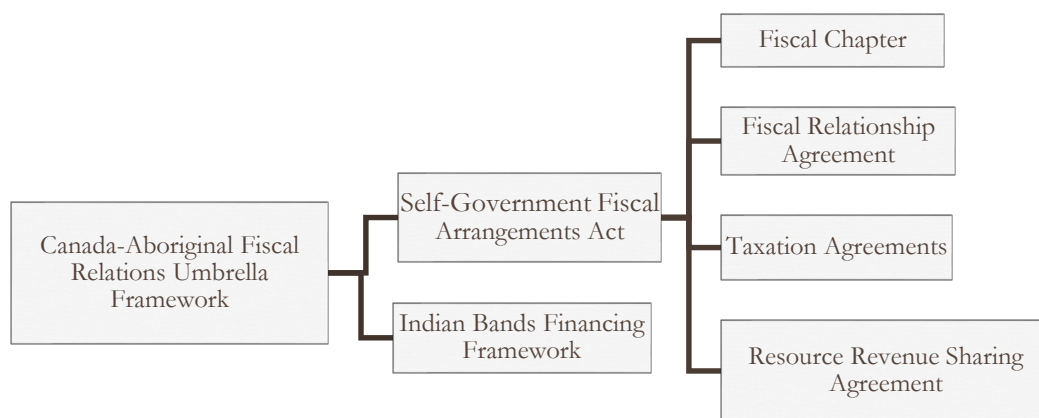
The interrelationships between the three dimensions of governmental autonomy, fiscal autonomy and economic and community characteristics produces six key objectives (adapted from Hawkes & Maslove, 1989, p. 110; Boadway & Shah, 2007, p. 11) that are fundamental in the design of fiscal arrangements in support of Aboriginal self-government. Table 9 towards the end of this section provides a summary of the various components of the policy framework and the strategic objectives fiscal arrangements should pursue.

Objective 1: Fiscal arrangements should reside in a common Canada-wide framework

Designing financial arrangements to support a particular government rarely results in a single grand system constructed at a particular moment in time. Fiscal arrangements are also very rarely static, but instead are fluid to respond and adapt to changing economic circumstances and citizen needs. It is pragmatically impossible to design a fixed and stable system of fiscal arrangements that accounts the uncertainty of future fiscal need over time. Usually, fiscal and funding arrangements are the products of intensive and ongoing negotiations between the parties to determine feasible arrangements that equip and enable the recipient government to carry out its responsibilities. This objective revises and reforms suggestions based on Volume 2 of the 1996 Royal Commission Report (p. 292).

Fiscal arrangements in support of Aboriginal self-government should have a shared nationwide framework that guides fiscal policy and negotiations with individual Aboriginal groups. Under this objective there ought to be two levels of good faith negotiations. At the national level, the negotiating process entails developing and establishing a nationwide umbrella framework that sets broadly the relationships between all Aboriginal governments, the provinces/territories and the federal government. This umbrella framework would include both Aboriginal communities still operating under the *Indian Act*, and Aboriginal groups under self-government⁸⁰ (see Figure 6). Under this concept, the nationwide umbrella framework envisioned is policy-based. The aim of the umbrella framework is to present a cohesive, reconciliatory approach to fiscal and funding arrangements with Aboriginal groups. Principles that guide fiscal relations and strategic objectives of the fiscal arrangements could reside within the umbrella framework.

FIGURE 6: PROPOSED CANADA-WIDE ABORIGINAL FISCAL RELATIONS SYSTEM



(Source: author)

Building upon the nationwide umbrella framework, under the Self-Government Fiscal Arrangements Act (SGFAA) bilateral or trilateral (if involving a province) negotiations should

⁸⁰ A detailed description is not provided as it is outside the scope of this paper

proceed with the respective Aboriginal groups in accordance to the type of self-government model they currently are under. The SGFAA is expected to be legislative as in the case of the *Federal-Provincial Fiscal Arrangements Act*, which the Canada-Aboriginal Fiscal arrangements could be mechanized after⁸¹. By legislating the SGFAA, Canada formally recognizes the fiscal relationship that Aboriginal governments have with the Crown (and to an ancillary extent with provinces and territories). At this level, fiscal side agreements could be possible instruments to employ in operationalizing the SGFAA, and facilitates the harmonization and coordination of ancillary fiscal arrangements through various side agreements or other mechanisms. Unlike current federal policy on fiscal arrangements, resource revenue sharing would be explicitly included within the SGFAA, to ensure natural resource revenues are shared and allocated equitably with all Aboriginal communities as part of recognizing broader Aboriginal title⁸². Harmonizing at a strategic level is advantageous because, for example, the negotiation of tax-sharing agreements that harmonize taxation of the Aboriginal, provincial and federal governments in instances where a common tax base is shared to allow for the collection of specific Aboriginal government taxes by existing systems often results in greater efficiencies through economies of scale.

Strategically, legislating the SGFAA allows the certainty and assurance of funding that negotiating groups seek to be transferred over into legislation. Instead the fiscal chapter can focus on recognizing a constitutionally protected fiscal relationship and a few principles that are intrinsic to that relationship. Principles that can be inserted into the chapter are: shared responsibility for providing citizens with essential public services, and concept of vertical and horizontal equity. The remainder of the principles can reside in the SGFAA. A proposed fiscal chapter is provided in Appendix H.

Legislating the SGFAA also enables the Fiscal Relationship Agreement (FRA) to solely focus on aspects that operationalize the fiscal relationship that is articulated by the SGFAA and fiscal chapter. This model of the FRA is envisioned to be primarily a mechanical piece that by nature will have to be negotiated periodically. The negotiations, however, is not expected to be particularly onerous or time-consuming as is presently the case. This is because the seemingly contentious clauses that are the subject of protracted negotiations in the current FRA model will be subsumed into the SGFAA, resulting in a more streamlined, objective agreement. Negotiations in part will hone down on decisions regarding inputs of values and metrics. Modeling the FRA in this manner, shifts negotiations from centering unequivocally on federal monies to be transferred (which is often influenced by political pressure), to a quantitative process of methodology building, data verification and formula inputting. Understandably, this approach can result in more productivity and increases the potential of an ongoing development of funding mechanisms that are more equitable, responsive and sensitive to the needs of Aboriginal governments and communities.

⁸¹ There are number of issues that have been raised regarding federal-provincial fiscal arrangements (see Guerin, 2012), but the intent of this comparison was to provide an example.

⁸² Suggestion by Academic Informant B, interview with author, March 2016

Canada-Aboriginal fiscal relations should be operationalized through a national advisory body that provides a channel for policy review, revision and co-development of future federal policies. An element of the Fiscal Approach includes the establishment of an advisory forum that addresses into fiscal matters; however, this concept should be expanded to address fiscal issues with Indian bands too. This modified version of the advisory forum would have a statutory mandate to ensure continuity by future federal governments and prevent the unilateral dismantlement of the body by Canada. The structure of the advisory body would consist of multi-level committees and sub-committees, each focusing around a particular policy area or issue. Participants in general would include Aboriginal governments, Indian bands, provinces and territories and federal departments (such as INAC, and central agencies); specific participation at various committees or sub-committees would depend on topic area. The advisory body would operate at an arms length from INAC, and any decisions reached by the advisory body would be non-binding to all of the parties involved.

Annually, or as needed, the advisory body would produce reports that could be tabled in the federal parliament of Canada and respective legislatures of Aboriginal governments. Although, there would be no commitments or obligations required of the parties regarding the implementation of recommendations or conclusions, the Minister of INAC and the political leadership of Aboriginal governments could respond to the report's findings. Accountability, under the advisory body, would be that of *reciprocal transparency*⁸³, meaning that transparency practiced by one party ought to be reciprocated at the same level by the others.

The Fiscal Approach provides a good starting point for the development of a SGFAA, as provides a common national framework for fiscal arrangements that support Aboriginal self-government. It also embodies transparency in regards to the funding methodologies. It should however be a companion piece to a broader, more strategic umbrella policy framework that explicitly articulates how Canada intends on addressing fiscal relationships with self-governing and non-self-governing Aboriginal groups. The complete package would consist of: 1) a nationwide umbrella framework (policy-based); 2) the respective self-government fiscal relations legislative framework (and a sister policy-based framework relating to non-self-government Aboriginal groups); 3) fiscal relations chapter to be embedded in a modern treaty; 4) a fiscal side agreement that is re-negotiated periodically; and 5) a national advisory body that provides a channel for periodic policy review and revision.

Objective 2: Fiscal arrangements should appropriately support the respective self-government model

The primary concern here is the degree of autonomy in the self-government model and the basis for the receipt of funding. Autonomy, in this instance refers to the discretionary decision-making powers of the Aboriginal government. Increased political autonomy such as power to design and

⁸³ Term coined during interview by Academic Informant A, interview by author, March 15, 2016.

deliver programs within the jurisdictional areas and taxation power must in practice be linked to unconditional funding.

By drawing attention to the polar extremes, the relationship between the form of self-government and the accompanying fiscal arrangement becomes clearer. If, for example, the fiscal arrangement composed only of conditional grants, the Aboriginal government would have no meaningful autonomy in determining program-funding policy. In this situation, the federal government (as the donor) sets the eligibility requirements and the rate at which the transfer matches program spending in a specified reference year. In this case, the Aboriginal government is essentially a funding administrator—although it does have some influence in negotiating the fiscal arrangement.

Conversely, at the opposite extreme is a scenario where the Aboriginal government receives entirely unconditional transfers. Under this scenario, the access to a revenue source that does not place conditions on what or where the resources are allocated, results in uninhibited autonomy in program funding decisions⁸⁴.

Between the two polar extremes lies a spectrum of possible combinations between the model of self-government and fiscal arrangement. It is important to ensure that within the fiscal arrangement itself there is a sufficient degree of non-conditionality present to reflect the autonomy as stipulated in the corresponding self-government agreement. The mechanisms within the fiscal arrangement should not hinder the efficacy of the self-government agreement. This does not mean that all funding transfers to an Aboriginal government need to have the same conditionality placed upon them. But it does imply the use of a broad range on transfer mechanisms. For example, local and regional Aboriginal communities adhering to national or provincial standards (such as housing codes, public health, and education) should be a requirement of financial transfer agreements. Accordingly, a carefully defined set of conditions could be built into a grant, while another grant could have no conditions placed upon it, thus providing flexibility to the Aboriginal government and preserving autonomy over decision-making (Hawkes & Maslove, 1989).

Ensuring that recipients of grants adhere to nationwide minimum standards is a similar practice that occurs in the international context in order to preserve the internal common market and to attain nationwide equity objectives (see section). Conditional non-matching grants are utilized in which conditions imposed by the grantor reflect federal efficiency and equity concerns can be employed. Conditional non-matching transfers have also been shown to incentivize creative and competitive approaches for program and service delivery at both the local government and the sub-national level (Adams & Maslove, 2009; Shah, 2007).

Specifying the exact proportion of unconditional grants in an Aboriginal government's total funding is challenging. There is no recommended threshold proportion (Hawkes & Maslove, 1989). But in

⁸⁴ In practice, this would only be for the short-term as future adjustments in funding may occur depending upon the economic circumstances or community outcomes of the Aboriginal group.

the provincial context, there seems to be a clear inverse relationship between the proportion of conditional grants to revenues and budgetary discretion (Cutt, 1989).

In addition, accountability could be a central factor in the relationship between the fiscal arrangement and the self-government model. In this situation reporting and auditing requirements of the Aboriginal government could be reflected as a varying level of conditionality in the grant. The purpose of the accountability mechanisms is to enable the federal government to ensure that the recipient was meeting all the conditions placed on the transfer. Less constrained funding would have lower levels of reporting attached and be longer in term, while more constrained funding would have higher levels of accountability and be of shorter terms. Longer-term durations provides the Aboriginal government with funding stability and assurance, enabling long term planning, ultimately enhancing the operationalization of the self-government arrangement. Conversely, offering short (~1 year) to medium term (1-5 years) contracts could be another method the federal government could impose conditions on the Aboriginal government who are discordant with the level of autonomy insinuated within the self-government arrangement.

In Canada today, there are various forms of self-government in effect: legislative as in the case of Sechelt Indian Band; stand-alone self-government such as Westbank First Nation; and sectoral agreements such as Mi'kmaq education in Nova Scotia. Current federal policy on fiscal arrangements (i.e. the Fiscal Approach) includes these types of self-government arrangements⁸⁵ (AANDC, 2015). The fiscal arrangements do give recipients some autonomy over decision-making—although funding involved is conditional for programs and services the Aboriginal government is relegated the autonomy to spend monies within the program area according to their fiscal discretion. The Fiscal Approach does not, however, explicitly articulate that different models of self-government will need different types of fiscal arrangement to accompany them, and that both the self-government arrangement and the fiscal arrangement should be compatible with each other. This should be one of the fundamental tenets of the Fiscal Approach, and should be reflected in future revisions.

Objective 3: Fiscal arrangements should be attuned to the sociopolitical and economic circumstances of the Aboriginal community

Aboriginal communities have long been documented as having generally lower level of economic development compared to non-Aboriginal communities (Anderson, 1999; Wien, 1997). As a result, Aboriginal governments face limitations in the amount of own source revenues they can generate. Raising corporate taxes is an option—albeit a poor option—because even if taxes are raised, low levels of economic activity will not produce a significant increase in revenues and it could be at the detriment of spurring economic growth (Macek, 2015; Wasylenko, 1999). Furthermore, many Aboriginal residents are often low income compared to non-Aboriginal (Wilson & Macdonald, 2010), and many do not earn more than the basic exemption, so any increases in the income,

⁸⁵ With the exception of the James Bay and Northern Quebec Agreement, Northeastern Quebec Agreement, Inuvialuit Final Agreement, Gwich'in Comprehensive Land Claim Agreement, Nunavut Land Claims Agreement, Sahtu Dene & Metis Comprehensive Land Claim Agreement, and Nunavik Inuit Land Claims Agreement.

consumer, or point of sale taxes could be at the expense of marginalizing a vulnerable population. With a low capacity to generate revenues through taxation, Aboriginal governments will depend more on transfers relative to expenditures from the federal government. This raises questions of the autonomy and legitimacy of self-government itself, especially the level of effective autonomy (Hawkes & Maslove, 1989). If for example, a sub-national government were to be heavily reliant on the national government for funding of the recipient's governmental operations, it can be argued that the sub-national government is not autonomous at all and perhaps not a legitimate form of government⁸⁶. This suggests that the fiscal capacity and economic circumstances and prospects of the Aboriginal government cannot be unaccounted for when designing fiscal transfers and fiscal arrangements.

Accountability to citizens becomes an important consideration when a recipient government has a high dependence on a grantor for funding. This especially is highlighted under Aboriginal self-governments, where Aboriginal governments are primarily responsible to their citizens and membership. If a significant percentage of revenues consist of federal transfers, can the Aboriginal government's accountability to its citizens be as strong and effective as it would be if the revenues were sourced from the local community itself? The connection between effectiveness of local government control and the localized contribution to public finances is a crucial issue in Aboriginal governance and is also one that is echoed in the international context as well (Shah, 2007). Significant financing at the local or regional level is a prerequisite for effective government accountability to its citizens. Additionally, it inhibits the grantor from exerting unilateral control in the decision-making over funding allocations; this should occur at the local or regional level.

Given the recent public release of the Fiscal Approach, it is unclear of whether the current policy is entirely reflective and attune to the differing economic and community circumstances of Aboriginal governments. It does, however, take into consideration the varying geographic and environmental situations of Aboriginal communities that ultimately factor in economic development. It also offers additional funding for community, social and economic development.

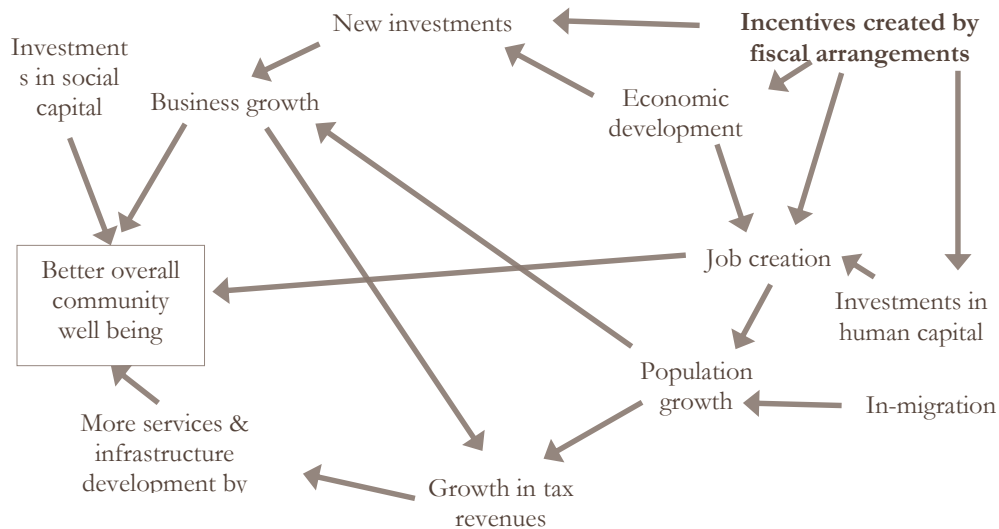
Fiscal arrangements should incentivize revenue generation, especially in major economic sectors occupied by Aboriginal governments. Through an assessment of First Nations communities by Sixdion (1997) identifies the following as major source of revenue generation: natural resources; information technology; international/inter-tribal trade; eco-tourism; offshore investment and capital sources; and community economic development. Research conducted by Bains and Ishkanian (2016) shows the significance impact OSR (especially natural resource revenues). In 2014, First Nations brought in an estimated \$3.3 billion in own-source revenues, the majority of which exceeded their individual federal transfers.

However, fiscal arrangements should not be solely focused on revenue generation but also incorporate mechanisms for improving and enhancing an Aboriginal community's governance,

⁸⁶ Federal Official A, interview by author, March 7, 2016

financial management and administration and self-reliance capacity. In doing so, incentives must be create to develop and retain in particular, human capital and aboriginal leadership. Figure 7 below illustrates the cyclical features and inter-connectedness between the determinants of economic development. The quicker the movement between determinants, the faster the growth of businesses and job creation, which results in increased tax revenues enabling Aboriginal governments to provide more programs and services and contributing to overall community well-being.

FIGURE 7: CYCLICAL RELATIONSHIP OF ECONOMIC DEVELOPMENT



(Source: modified and expanded by the author from Huang (2012))

To incite economic growth in economically depressed regions, findings from the international context suggest using capital grants paired with a matching portion that the recipient provides. In the Aboriginal self-government context, requiring the Aboriginal government to match a portion of the capital grant (given the scarcity of available funds) would be impractical. Instead, both the Aboriginal government and the federal government could work together in engaging the local private sector in providing the matching portion of the grant and participating in infrastructure building. Including the private sector (especially if its from the local community) and also undertaking community and stakeholder engagement would be beneficial as enables local ownership, community interest and oversight.

Other strategies to stimulate revenue generation by Aboriginal governments would be to create incentives for businesses to locate and situate themselves within Aboriginal government lands (with the support of the Aboriginal government). One way to achieve this would be to create the appropriate tax incentive at the federal level. Table 10 displays the 2016 federal corporate income tax rates for different types of businesses. A revision to apply the small business tax rate of 10.5% for businesses of all sizes on Aboriginal government lands could be a plausible strategy; this would probably need to be a temporary provision (lasting five to ten years) in order to avoid creating

permanent differences between tax rates on Aboriginal versus non-Aboriginal lands. Under this strategy, revenues generated from businesses (depending on size and type) that pay the corporate tax rate would be transferred to the Aboriginal government. Companies that not only operate on Aboriginal government lands, but also provide jobs and employment (e.g. agricultural and resource-based companies) to Aboriginal community member could be entitled to corresponding federal (and provincial) tax credits to encourage economic development and job creation.

TABLE 10: FEDERAL CORPORATE TAX RATES (2016)

Type	Tax Rate (%)
General Manufacturing & Processing, Investment	15.0
Small Business	10.5
Canadian controlled private corporation	38.7

(Source: Canada Revenue Agency, 2016)

In employing this strategy, revisions should be made to A41 (p. 19) that pertains to business entity profits of the Fiscal Approach to transfer a portion of tax revenues accrued to the Aboriginal government instead of wholly accrued by the federal government. In this way the Aboriginal government not only contributes profits arising from government business enterprises to the federal government for broader national public services provided (such as national defense, financial services etc.) but also enables the Aboriginal government to retain revenues for reinvestment into local community needs.

Natural resource revenues could be another source of significant source of own source revenues for all Aboriginal governments located in a particular province (not just those who have the geographic predisposition having natural resources located with their lands. Under this approach, all Aboriginal communities would be entitled to a proportion of natural resource revenues generated by the province. This proportion could equate to the percentage of Aboriginal population per community residing in the respective province. As suggested under objective 1, this would be part of a provincial natural resource revenue sharing agreement.

Objective 4: Fiscal arrangements should enable Aboriginal governments to increase self-reliance on OSR generation

To date, Aboriginal governments are largely dependent on fiscal transfers from the federal government as a major source of revenue in funding programs and services—although there are a number of First Nations governments that do have significant own-source revenues (Bains & Ishkanian, 2016). Aboriginal communities should be enabled and incentivized to pursue economic development opportunities, including promotion of traditional activities. With increased economic activity, local employment opportunities would increase resulting in higher incomes of residents creating a larger tax base and improving the fiscal capacity of the Aboriginal government to fund a larger proportion of public services within the community.

Hawkes and Maslove (1989, p. 114) characterize this incentive factor as a Transfer Reduction Rate (TRR). The TRR is a subtractive concept, namely it is the amount the transfer is reduced by. Fiscal capacity would be defined as the revenue that the local tax base would produce at national average tax rates. The local tax base would include all revenue sources where the Aboriginal government has been given the jurisdiction to exercise levies and tax (e.g. user fees, property and sales tax). This would ultimately include revoking the tax exemption under section 87 of the *Indian Act*, and requiring the Aboriginal government to exercise taxation powers within their jurisdiction⁸⁷. National average tax rates and fiscal capacity benchmarks could be determined by taking the average of a sample of Aboriginal and non-Aboriginal governments that are comparable to each other in areas of jurisdiction and economic circumstance (Hawkes & Maslove, 1989).

Conceptually, the TRR would produce values that represent a spectrum of incentive structures. For example, a $TRR \geq 1.00$ implies that the Aboriginal government's fiscal capacity grew on a ratio of 1:1 or more. This outcome is a negative extreme because it suggests that as the Aboriginal government succeeded at developing its economy, it will have to increase taxes within its jurisdiction at the national average tax rate in order to maintain its aggregate revenues at the original level. Thus, despite the presumed net benefits the Aboriginal community would receive from greater economic activity, the disincentive to pursue economic development is theoretically very strong. Conversely, a $TRR < 0$ implies the Aboriginal government's fiscal transfer increases twofold as its economic development grows. The intersection of $TRR = 0$ is a point where the transfer is unaffected by economic growth. While mathematically neutral, economically speaking a value of zero still represents a positive incentive (Hawkes & Maslove, 1989).

According to Hawkes and Maslove (1989, p. 114), the territorial agreements involve a TRR that approximately equals 1. Furthermore, they suggest that a fiscal arrangement where, $0 < TRR \leq 0.5$ would incentivize the Aboriginal government to pursue economic development. In practice, however, it is difficult for the concept of OSR to receive support. Firstly, OSR as a federal policy does not apply to Aboriginal groups under the *Indian Act*; it only comes into effect after a group signs into a self-government agreement. Secondly, experience from table negotiations and dialogue about Aboriginal perspectives is that it is difficult to seek agreement in a financial transfer agreement (or equivalent) if there is a remote possibility of reduced funding even if it results from increased community or economic success—even if the offset is not one-to-one⁸⁸. Thirdly, making an OSR contribution is a difficult case advocate for especially if indirect economic benefits received by the community are unable to be fully quantified. Lastly, compared to the \$265 million AANDC transferred to all Aboriginal governments, the gross amount of OSR offset of all self-governing groups is only estimated to be \$4 million in 2013, which is about 1.5% of total federal transfers⁸⁹

⁸⁷ Though modern treaty groups have concurrent powers of taxation with the province and federal government, they do not always exercise them.

⁸⁸ Federal Official A, interview by author on March 7, 2016

⁸⁹ Total OSR offset will increase after all groups reach their full phase in period.

(AANDC, 2015). With such a small proportion, one might wonder if there is any real effect of this policy other than for the presence of the *shared responsibility* principle.

Modifying the proposed TRR to include a long phase-in period could receive support could receive support. An incremental phase-in period over 20 years in which an offset grows at a low exponential rate could smooth the transition of TRR. The current OSR policy within the Fiscal Approach includes a phase-in factor (along with a maximum inclusion rate and sectoral factor), which is described below. It should be a point of emphasis that even though the phase-in factor reaches a value of 100%, the inclusion factor restricts the rate of all eligible revenues to 50%.

EQUATION 3: PHASE-IN FACTOR

Phase-in Period = 20 yrs.	Phase-in factor:
	1-5 yrs. = 0%
	6 yr. = 6.6%
	6-19 yrs. = + ~6.23%/yr.
	20 yr. = 100%
	(Source: AANDC, 2015)

Another option to incentivize self-reliance would provide more sources of revenue generation for self-governing groups. As discussed under objective 3 of this section, augmenting the federal corporate tax bracket to offer businesses lower taxes for businesses occurring on Aboriginal government lands, with revenues transferred to the Aboriginal group could not only spur economic development but also generate more own source revenues for the Aboriginal group. Subsequently, OSR policy would need to be amended to include to such taxation revenues as eligible revenues. This might seem counterintuitive, but because the relationship between fiscal transfers and the OSR offset is not 1:1, the Aboriginal government would in general tend to gain from this strategy.

Ultimately, as noted there is a substantial difficulty with even considering own-source revenue within metrics that incentivizes self-reliance for self-governing groups, because under the *Indian Act*, there is no such offset applied. Presumably, this can create sufficient financial disincentives for some Aboriginal groups of entering into self-government, rather than remaining under the *Indian Act*. This is an issue that must be addressed in future policy analysis than concerns Indian bands. The modified TRR models described here might not fully work in these current forms, but they do provide a starting point for discussion.

Objective 5: Fiscal arrangements should include vertical and horizontal equity mechanisms

Ensuring fiscal arrangements integrate both vertical and horizontal equity properties within its mechanisms are vital in contributing to the viability of Aboriginal communities. Hawkes and Maslove (1989) propose two methods with which vertical and horizontal equity can be met: the adequacy variant (AV) and the relative standard variant (RSV). The AV centers on the actual costs of delivering each of the programs and services a particular Aboriginal government is responsible for providing. By providing Aboriginal governments each with the fiscal resources needed in the

provision of specified programs and services, the AV helps achieve horizontal equity among the various Aboriginal governments and communities. This does not infer that each program or service has to be funded individually and conditionally. But it does require the total transfer amount to be sufficient enough to support the Aboriginal government in providing the specified programs and services. The actual allocation of funds, however, depends on the conditionality of transfer components and the priorities of the Aboriginal government.

The RSV focuses on the fiscal capacity of the particular Aboriginal government rather than on the actual costs of programs and services provision and delivery. This approach is similar to the one taken in the federal-provincial Equalization program. For federal-Aboriginal fiscal arrangements, a national standard based on a comprehensive set of relevant revenue sources from a wide sample of Aboriginal communities could be adopted. Subsequently, the total transfers to Aboriginal governments would then be calibrated so that each government was brought up to the national standard, which could be based on an average of communities included in the sample. In short, a transfer that equalizes per capita fiscal capacity to a fix national standard (suitable to Aboriginal communities) would be a mechanism to strive towards⁹⁰. Undertaking this approach would require comprehensive data collection and maintenance on relevant Aboriginal government revenue sources, such as property values, volumes of activities subject to user fees, sales of services). Strength of the RSV is that it requires a less amount of data to be compiled than the AV approach, which requires substantial costing analysis of program and services delivery. This is because the RSV is based on fiscal capacity rather than actual costs. The TFF is a sophisticated version of the RSV model. Each individual grant is based on the difference between the gross expenditure need (GEB) and the capacity for revenue generation (eligible revenues). In this way the TFF fills the gap between expenditure need and fiscal capacity. The GEB for each of the territories is adjusted annually to ensure that expenditures align with relative growth in population and provincial and municipal growth escalator (Department of Finance, 2012b). Appendix F provides an overview of the TFF transfer components.

The RSV method falls short in adequately measuring expenditure need of Aboriginal governments, which is vital given the litany of challenges faced by Aboriginal communities, including higher fiscal need, low fiscal capacity and poor socio-economic outcomes. Solely focusing on fiscal capacity, does not account for what differences between the spending needs of Aboriginal governments. Governments responsible for providing public services in the far north have arguably higher expenditure needs than governments in close to urban centers. Thus, the RSV method, albeit a good start, needs to be modified to account for expenditure needs.

Adopting and integrating a number of features based on the representative expenditure system, as practiced in the international context would help bolster the RSV as it stands. Firstly, expenditure need should be measured across broad categories such as: health, education; social services; and social assistance. Secondly, measuring needs should account for three key aspects: workload, which

⁹⁰ This aligns with practices from the international context

is the difference in service volume between Aboriginal governments; service cost, differences in costs of service provision occur between regions; and the differing geographic and environmental circumstances between Aboriginal governments. The metrics used should be empirically derived and free from the influence of with the federal government or Aboriginal governments. Finally, indices and parameters currently already in place regarding the Equalization program and which are less contentious among Aboriginal governments could be ported over to the expenditure need system. Examples are, (but not limited to): different weights to budgetary allocation, 3-year weighted moving averages, caps on annual growth of Aboriginal fiscal equalization transfers (adapted from Guerin, 2012; Boadway & Shah, 2007).

Adapting to this modified RSV model would require the development of a new expenditure escalator to reflect the narrower range of public services Aboriginal governments typically provide. And given the diverse locations and unique circumstances that face Aboriginal governments, a single escalator might not be adequate. Instead, multiple escalators will be needed (Hawkes & Maslove, 1989; Guerin, 2012). Additionally, the modified RSV will require a common method in accounting for population. Fiscal transfer calculations currently either use number of status Indians on Aboriginal government lands or regional population figures, but this is a flawed and inaccurate method (as discussed in Section 2). Instead, true service population or a citizen-based approach⁹¹ should be pursued in accounting for population. If a broader population count is employed, the federal government will have to either subsume the additional funding costs, or financially reconcile (either in whole or partially) the additional costs borne by provinces and territories for providing public services to Aboriginal citizens residing off-Aboriginal government lands. This could transpire as an additional funding component provided through existing fiscal transfer programs such as Equalization, TFF; or through the construction of a separate fiscal mechanism.

In addressing horizontal and vertical equity, the modified RSV method produce administrative implications for fiscal arrangements that support Aboriginal governments. Relevant and accurate data and statistics on Aboriginal communities will have to be obtained. Databases will also have to be constructed and maintained. This may require capacity building to ensure that Aboriginal governments have the tools, expertise, human capital, leadership and means to build and maintain successful Aboriginal governments.

Objective 6: The design of fiscal transfer components should encourage benefit spillovers and positive externalities

The level of conditionality attached to various governance components and programs and services should specifically relate to the characteristics of the corresponding service areas. In cases where public services have a positive externality well beyond the service area, the federal government may want to ensure that the responsibilities for the public services are met in specific methods and maintained at in specific ways and at precise levels. Public health is an example of a service that has

⁹¹ See Cousins (2013, p. 66) for a detailed description of moving towards a citizen based funding approach.

positive impacts well beyond the local community; it is also it is an example where the financier of the service does not have an incentive to provide a level of service that would yield spillover benefits to the neighboring regions. Essentially, this is a case where there is a strong national interest in a particular program or service area and where the federal government should act in ensuring that such programs and services account for benefit spillover.

In the international context research suggest utilizing a system of open-ended matching conditional grants based on expenditures that take into consideration the extent of spillover. In practice, however, this is difficult to achieve because the extent of the spillover is hard to measure precisely, so the correct matching rate will be rather arbitrary.

In cases where there is a national interest in the general design and outcome of programs but not a strong national interest in the administration or design features conditional grants would be suitable. An often-used model for these types of transfer programs is the CHST program. Transfers to Aboriginal governments would have conditions placed upon them, such as the program yielding outcomes on par with a national average or the program embodying certain characteristics, but they would not be tied actual expenditures by the Aboriginal government. Therefore, the Aboriginal government could spend less on the program—granted they would have to meet transfer conditions—and allocate monies to other priority programs. This could provide a sufficient incentive to pursue increased program delivery efficiencies.

In areas where the jurisdictions of two or more Aboriginal governments border each other, significant redundancy and inefficiency could occur if multiple Aboriginal governments provide the same or similar public services. To avoid this, Aboriginal governments usually contract with an existing service delivery agent to provide public services to the entire region.

Alternatively, Aboriginal governments could enter into a regional shared services system similar to the regional district system BC municipalities have, where Bish and Filipowicz (2016) have shown that service delivery efficiencies are realized when all of the services are either contracted out or provided by one of the larger municipalities to the entire region or sub-region. Transferring governance of shared services provision to a regional body produces efficiencies because:

- a) economies of scale of a single large agent can produce a service for the entire region, or where a specialized service is produced towards which all member governments contribute financing;
- b) benefit spillovers of public services induce joint governance of the respective service; and
- c) voluntary agreements are sought from other member governments that can provide public services (e.g. policing) to another (Bish & Filipowicz, 2016).

Similarly, Aboriginal governments with small populations and those residing within the same region could benefit from shared service arrangements. Adopting a regional shared services approach will ultimately help produce higher quality public services for members and residents of Aboriginal communities.

Conditional grants are also appropriate for one-time or specific-purpose funding programs within Aboriginal communities, for example, job creation initiatives or capital projects. Specific-purpose

grant programs could require a performance or results-orientated approach. This would allow national objectives to be realized without impeding local decision-making on program and service delivery.

Spending that transpires at the local level such as road maintenance should be supported by unconditional matching transfers linked inversely to fiscal capacity. Using ad hoc grants or discretionary transfers is not recommended. Federal oversight or direction is not warranted, as decision-making should occur at the local level based on community needs and priorities. This objective relates to the previous one regarding incentives in that, if the Aboriginal community's economy expanded and its federal transfers were to be reduced, the reduction should occur in unconditional funding, because spending in conditional programs is determined by external considerations.

As noted in the preceding section concerning fiscal autonomy, conditionality should reflect the autonomy of the Aboriginal group as per the nature of the self-government agreement. In this manner, fiscal autonomy and political autonomy correlate. Similarly, financial accountability is also linked. With more political and fiscal autonomy, the Aboriginal government should be accountable to its citizens in terms of spending on public programs and services. A method of ensuring this is to specify in a fiscal side agreement the public availability of audited consolidated financial statements and ancillary reports.

TABLE 11: APPLICATION OF THE ANALYTICAL POLICY FRAMEWORK

<p>Tenet: Self-government model and fiscal arrangements are strongly linked</p> <p><u>Self-government</u></p> <p>Dimensions:</p> <ul style="list-style-type: none"> ● Governmental autonomy ● Fiscal autonomy ● Socio-political, economic and administrative capacity building <p>Parameters:</p> <ul style="list-style-type: none"> ● Land base ● Ethic government ● Regional and local scope of government power ● Constitutionally derived source of power and ability to exercise legislative and adjudicative power <p><u>Fiscal Arrangements</u></p> <p>Principles:</p> <ul style="list-style-type: none"> ● Shared responsibility; equity; cost-effectiveness; efficiency; public accountability; transparency; affordability. <p>Parameters</p> <p>General:</p> <ul style="list-style-type: none"> ● Legislative framework arrangement ● Source of funds
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- Basis for receipt of funds
 - Basis of renewals
- Technical:
- Determinacy
 - Redistributive
 - Responsiveness
 - Accountability
 - Transparency
 - Term
- Strategic Objectives:
- Fiscal arrangements should reside in a common Canada-wide framework.
 - Fiscal arrangements should appropriately support the respective self-government model.
 - Fiscal arrangements should be attune to the economic and sociopolitical circumstances of Aboriginal government and community
 - Fiscal arrangements should encourage, enable and incentivize the Aboriginal government to become more self-reliant on OSR generation.
 - Fiscal arrangements should integrate both vertical and horizontal equity into transfer mechanisms.
 - The design of fiscal transfer components should encourage benefit spillovers.

(Source: author)

TRADE-OFFS BETWEEN OBJECTIVES

These six primary objectives are not mutually exclusive of each other but rather build upon each other. Decisions to employ one objective will have cascading implications on another, and where objectives seem to conflict with one other, a trade-off will have to be made. There are potentially numerous conflicts that could arise, stipulating that trade-offs will have made (Hawkes & Maslove, 1989).

Ostensibly, the most apparent conflict lies in creating incentives for self-reliance through increasing own source revenues and achieving horizontal equity through federal transfers. As Aboriginal governments' generate increased own source revenues, over time it is anticipated that the fiscal transfers they receive would decrease. Some self-governing groups often see this as a penalty⁹². Simply stated, it is close to impossible for a fiscal arrangement to reconcile incentivizing own source revenue generation with ensuring equitable treatment of Aboriginal groups' fiscal capacity.

Due to the history of Aboriginal fiscal relations, namely the focus on individual bilateral negotiations, many Aboriginal groups view fiscal negotiations as a type of zero-sum game, and fail to see the benefits of a broader, more strategic approach to fiscal arrangements. A very similar conflict is present in federal-provincial fiscal relations—the Equalization Program. The mechanisms of Equalization are clear and transparent. Yet, there seemly is no significant disincentive for provinces to improve their fiscal capacity despite the possibility of a reduced (or zero) federal transfer. This

⁹² Federal Official A, interview by author, March 7, 2016

conflict should not, however, be a deterrent to implementing incentive structures to increase fiscal capacity. Perhaps, over time in a fully matured system of fiscal arrangements with Aboriginal groups—through mechanisms such as the fiscal advisory forum suggested in the Fiscal Approach—the above stated sentiment will disseminate in Aboriginal-Canada fiscal relations.

Another trade-off also exists in terms of the degree of autonomy embodied in the self-government model, and the level of conditionality ascribed by the fiscal arrangements. If, for example, the self-government model had a high degree of autonomy, the fiscal arrangements theoretically would be presumed to have a similar level of autonomy over the spending of fiscal transfers. Conflict arises when conditionality inevitably is placed on fiscal transfers in areas of high national interest such as public health. In this scenario, the level of autonomy in the fiscal arrangement does not correspond to the degree of autonomy in the self-government model. Furthermore, taking into consideration the equity objective, if the total transfer were to be adjusted to account for the increased fiscal capacity of the Aboriginal government, the adjustment would occur in the unconditional portion of the transfer. This, however, also results in an inconsistency between discretion over fiscal resources available to the Aboriginal government and its level of self-government autonomy (Hawkes & Maslove, 1989).

CHALLENGES IN ACHIEVING OBJECTIVES

Unexplored in the Aboriginal policy literature are the conflicting interests that permeate bilateral fiscal negotiations between an Aboriginal group and the federal government. Under existing approaches, an individual Aboriginal government or group involved in fiscal negotiations or renewals have an understandable interest in obtaining the best possible terms in their fiscal side agreements. The federal government on the other hand is interested in not only a) accommodating the Aboriginal group's requests as best as possible while safeguarding the Crown's interests, but also b) ensuring that accommodations made, occur equitably in relation to other negotiating groups. It is difficult to obtain empirical data on this, as matters of Crown-Aboriginal negotiations are privy to confidentiality.

When viewed in isolation, both the federal and Aboriginal self-interests do not pose major conflicts. However, when the entire system of fiscal negotiations is considered, challenges to achieving the aforementioned objectives materialize. Firstly, the interest of the individual Aboriginal government to obtain the best possible fiscal terms occurs results in an unseen competition between other Aboriginal groups who are also in negotiations. This occurs despite individual negotiations being confidential in nature. There is little incentive for Aboriginal groups to adopt similar terms especially when it comes to funding levels. Federal efforts to address this issue with a harmonious approach in establishing funding methodology are often met with contention, with Aboriginal groups portraying such approaches with “cookie-cutter” or “one-size-fits-all” methods⁹³. This inevitably leads to either

⁹³ Federal Official A, interview by author, March 7, 2016

inequitable fiscal outcomes or impasse in fiscal negotiations if both sides do not alter their respective interests and positions.

Another challenge in fiscal negotiations is the myriad of positions and perspectives individual Aboriginal groups have on any particular issue. This becomes especially problematic in fiscal negotiations, as the aim of federal funding is to address the health and socioeconomic issues present in many Aboriginal communities. Aboriginal policy issues are multifaceted and thus require consensus-seeking approaches to address them. Without consensus-seeking approaches, combatting the perverse and detrimental social and health conditions results in exhaustive policy processes and ultimately, policy inertia.

It is, therefore, imperative future policy action considered the instinctual interests both parties have when negotiating fiscal matters and seek methods and approaches to address them. Consensus-seeking approaches on policy issues will also be needed if the system of fiscal arrangements that supports self-government is to be effective.

8.0 RECOMMENDATIONS

The application of the policy framework articulated in the preceding section provided a scaffold for the accompanying discussion and analysis that produced six broad objectives for self-government fiscal arrangements. Building upon those objectives generates a myriad of potential improvements to the current system of fiscal arrangements. This section, however, focuses on key technical and design improvements and makes recommendations in order to progress and advance the current state of fiscal arrangements in support of Aboriginal self-government and the success of Aboriginal communities across Canada.

The latter half of this section presents a novel approach forward for future Canada-Aboriginal fiscal relations. It proposes a fundamental shift away from the current basis of arrangements fiscal relations to one that is more cognizant of the multifaceted roles, responsibilities and relationships Aboriginal governments have with not only other orders of government, but also with each other. The elements described under this approach are not intended to diminish or detract from the proposed recommendations, but are packaged together to improve the expression of ideas and concepts and overall readability.

The nine recommendations outlined below are categorized into the institutional and technical aspects of fiscal arrangements and stem from the discussion and analysis conducted in Section 7. They are not mutually exclusive of each other; rather they complement each other with the ultimate goal of spurring meaningful change in the fiscal relations between Aboriginal governments and the federal government. Neither are the recommendations ranked in any particular order but rather are organized by the different aspects of fiscal arrangements. As expected, implementing some of the recommendations might be a more contentious endeavor for INAC, due to the particular issues Aboriginal groups might raise. Tradeoffs will arise in the application and implementation of the policy options and recommendations—but it is imperative that efforts are made to balance federal, provincial and Aboriginal interests.

INSTITUTIONAL

Recommendations under this aspect of fiscal arrangements stem from Objective 1 of the analytical policy framework, discussed in Chapter 6: Fiscal arrangements should reside in a common Canada-wide framework.

Recommendation 1

It is recommended that the federal government along with the provinces, territories and Aboriginal governments develop and establish through negotiations a shared Canada-wide fiscal relations umbrella framework that sets the strategic and principled foundation for fiscal arrangements with all Aboriginal communities, including:

- Indian bands currently operating under the *Indian Act* (or replacement legislation⁹⁴);
- Aboriginal governments that are party to modern treaties, comprehensive land claims with a self-government component, or stand-alone self-government agreements.

Recommendation 2

It is recommended that the AANDC prioritizes institution-building in support of Aboriginal self-government and along with the provinces, territories and Aboriginal governments fully establishes an advisory body with a statutory mandate that includes:

- Commitment by the parties to include the involvement of senior management and decision makers;
- Commitment by the parties to review fiscal matters in a good faith manner that respects the positions of each of the parties;
- Operation in a manner that is transparent and open and is in concert to sound public administration practices;
- Commitment by the parties to practice reciprocal transparency in fiscal matters; and
- Recognition by the parties that the advisory body is not a decision making body and its recommendations are non-binding.

Recommendation 3

It is recommended that the AANDC prioritizes institution building and works with Statistics Canada to:

- Institute resources mandated to provide statistical information and analysis specifically about Aboriginal peoples and communities to inform, develop and evaluate funding mechanisms and arrangements that provide fiscal support for Aboriginal governments and communities; and
- Improves on the efficiency of data collection and statistical methods.

The goal of these recommendations is to achieve a uniform, objective, consistent, principled, transparent and collaborative approach to implementing fiscal arrangements. As discussed in previous chapters, existing fiscal arrangements and those envisioned under the Fiscal Approach are fragmented and disconnected to the point where their effectiveness is in question.

TECHNICAL

Recommendations under this aspect of fiscal arrangements stem from Objectives 3 to 6 of the analytical policy framework, as discussed in Chapter 6. Fiscal arrangements should be reflective of and attuned to the economic and community circumstances of Aboriginal government and community; encourage, enable and incentivize the Aboriginal government to move towards a greater

⁹⁴ Jody Wilson-Raybould, Attorney General of Canada has recently expressed abandoning the *Indian Act*, in favor of a reconciliation framework (Gilmore, 2016).

reliance on the own-source revenue it generates; incorporate both vertical and horizontal equity properties; and reflect the characteristics of the relevant public services.

Recommendation 4

INAC should move away from the “status Indian” criteria generally used in measuring an Aboriginal government’s population and either adopt a:

- True service population that explicitly ensures individuals are not being funded by INAC for any services provided by another level of government; or a
- Broader citizen-based approach including the consideration of financially reconciling, in whole or partially, the additional costs of public service provision borne by provinces and territories to citizens residing off-Aboriginal government lands.

Recommendation 5

It is recommended that TAG revise the Fiscal Approach to foster efficiency in governance and service provision by encouraging Aboriginal groups to aggregate either prior to the treaty or self-government negotiation process or in the delivery of programs and services.

Recommendation 6

It is recommended that Canada, the provinces/territories and Aboriginal governments share responsibility for the financing of Aboriginal self-government. This represents a major shift from the *Indian Act*, which makes the federal government solely responsible, and would require agreement from provinces/territories and Aboriginal governments.

Recommendation 7

It is recommended that TAG work with the Department of Finance to:

- Amend the federal corporate income tax to apply the small business tax rate to all businesses operating on Aboriginal government lands for some transitional period (such as five to ten years), including creating federal tax credits for those eligible businesses that provide employment for community members;
- Revise the current Fiscal Approach that pertains to the treatment of business entity profits to transfer a portion of tax revenues to the Aboriginal government instead of (as at present) crediting them entirely to the federal government.

Recommendation 8

It is recommended that INAC work on a province-by-province basis to develop a natural resource revenue sharing strategy to provide Aboriginal communities with a portion of government revenues that arise from natural resources. This portion could equate to the percentage of Aboriginal population within the province.

Recommendation 9

TAG, when designing fiscal transfers to Aboriginal governments should:

- Take into account not only the fiscal capacity of the Aboriginal government but also explicitly account for the differential expenditure needs and the fiscal effort⁹⁵ of the Aboriginal governments;
- Fully incorporate mechanisms that are formula-based, responsive and redistributive; and
- Ensure that fiscal transfer arrangements are based on transparency and encourage public accountability.

⁹⁵ The amount of total revenue that is generated by the Aboriginal government—often represented as a proportion of fiscal capacity.

A NOVEL APPROACH FORWARD

The preceding recommendations were based on the premise that Canada-Aboriginal fiscal relations were predominantly a bilateral or tripartite relationship that occurs between the federal government, province or territory and the respective Aboriginal government. However, if the concept of “fiscal relationship” is expanded to include other Aboriginal groups and governments, the concept evolves to become “fiscal relationships.” This could be a novel approach forward for Canada-Aboriginal fiscal relations. Fiscal relationships, is not a far-fetched or counterproductive approach. There are approximately 600 different Aboriginal groups across Canada. Many of them, historically or currently, have formed inter-community relationships, service delivery agreements or participate as a collective in national processes. Fiscal relationships, in this sense, go one a step further. It formally recognizes that there are fiscal relationships between Canada and multiple Aboriginal governments and the province or territory.

Fiscal arrangements under this approach would involve the Aboriginal governments within a region, Canada and the respective province. Using BC as an example, a fiscal relationships accord would be negotiated between all self-governing BC groups, the Government of BC and Canada. Indian bands as an extension of the federal government would also be involved—although they would not necessarily need to be signatories. Funding under this approach would be a significant departure from existing practices. Instead of fiscal transfers flowing from the federal government to the respective Aboriginal government, this approach would establish a common pool of funding to be redistributed. The federal government would provide the majority of monies in the redistributive pool. The province, through a sharing of natural resource revenues would contribute a percentage of funds to the pool. The remaining portion of the pool would be comprised of monies from what would essentially be Aboriginal governments’ OSR contributions. Once the redistributive pool is defined a national standard that measures horizontal equity would be established. The same mechanism that is utilized in the Equalization program can be integrated into this approach: less prosperous Aboriginal governments would draw down funding, while the more prosperous Aboriginal governments would contribute to the pool. In this way, horizontal equity between Aboriginal groups would be addressed.

Accountability in a redistributive common pool is strengthened because it shifts accountability to all the pool’s contributors. Under the existing approach, an Aboriginal government’s accountability is to its citizens and the federal government. But here, a recipient Aboriginal government would also be accountable to other Aboriginal groups who have contributed funding to the common pool.

The goal of the redistributive common pool approach is to address, in particular, the aspect of horizontal equity between Aboriginal groups across Canada. The current fiscal arrangements are not focused on attaining equitable outcomes between groups but rather filling the socioeconomic gap between Aboriginals and non-Aboriginals.

Ultimately, the success of the common pool approach will depend on seeking consensus among Aboriginal governments evolving the marred fiscal relationship they have had with the federal

government for 125 years, to one that is mutually beneficial and based on mutual trust, reciprocal transparency and good faith intentions—in fact, any future approach to addressing fiscal issues concerning Aboriginal groups will have to be advanced in such a way. In order for Aboriginal fiscal relations to succeed, it has to dramatically shift away from a relationship based on threats of legal action, confrontation, and political rhetoric.

9.0 CONCLUSION

This research paper has surveyed existing literature on fiscal arrangements that support Aboriginal self-government and provided a current state analysis of issues present within them; views and perspectives of federal officials, academics and Aboriginal group representatives were gathered; the design and arrangement of potential funding mechanisms were identified; and pragmatic recommendations, while recognizing the constraints of policy change, were provided. In doing so, this research paper noted numerous barriers and challenges that hinder the success of Aboriginal self-government fiscal arrangements. Most of the barriers and challenges are extensive and will require ongoing engagement, collaboration and consensus-seeking approaches from Aboriginal peoples and governments, and the political leadership of the provinces, territories, and Canada in order to address and overcome them.

As John Hylton has perceptively remarked, “Ignoring the problems or tinkering with solutions, approaches that have characterized Canadian Aboriginal policy for the past one hundred years, cannot possibly bring about the *wholesale changes that are needed* to recognize the legitimate aspirations of Aboriginal people to govern their own affairs” (as cited in Belanger, 2008, p. 398 emphasis added). Holistic change is needed—and one that is evidence or values based and supported jointly by Aboriginal leaders and the political leadership of the provinces, territories, and Canada.

AREAS FOR FUTURE RESEARCH

During the research and analysis for this paper a number of peripheral issues surfaced, which were beyond of the scope and objectives of this paper. However, these peripheral issues could enhance the efficacy of self-government fiscal arrangements and could benefit from further research. In particular, they include:

- Discriminatory sections present in the *Indian Act*, 1986 especially those that hinder autonomy for Indian bands.
- Uncertainty regarding the overall economic benefits of modern treaties and self-government agreements—especially given the 2014 Supreme Court decision in *Tsilhqot’in v. British Columbia*.
- Counting population for the purposes of program funding in light of the 2016 Supreme Court decision of the definition of ‘status Indian’ to include Metis and non-status.
- Funding disparities in education, health, social programs and services for Aboriginal peoples.
- Linking fiscal transfers to socioeconomic conditions of Aboriginal communities.

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APPENDIX A: COMPREHENSIVE LAND CLAIM AND SELF-GOVERNMENT AGREEMENTS

Legend/Definition

CLC – Comprehensive Land Claims

SG – Self-Government

CLC/SG – Comprehensive Land Claim with Self-Government

FN – First Nation(s)

Region	Agreement	Community	CLC	SG	CLC/SG	Ratified	Effective
Atlantic ⁹⁶	Labrador Inuit Land Claim Agreements	5 Inuit			●	2005	2005
Quebec	James Bay and Northern Quebec Agreement	9 FNs 15 Inuit	●			1977	1977
	Northeastern Quebec Agreement	1 FN	●			1978	1978
	Nunavik Inuit Land Claims Agreement	15 Inuit ⁹⁷	●			2008	2008
	Eeyou Marine Region Land Claims Agreement	9 FNs ⁹⁸	●			2011	2012
Prairies	Sioux Valley Dakota Nation Self-Government Agreement	1 FN		●		2014	2014
British Columbia	Sechelt Indian Band Self-Government	1 FN		●		1986	1986
	Nisga'a Final Agreement	4 FNs			●	2000	2000
	Westbank First Nation Self-Government Agreement	1 FN		●		2004	2005
	Tsawwassen First Nation Final Agreement	1 FN			●	2008	2009
	Maa-Nulth First Nations Final Agreement	5 FNs			●	2009	2011
	Tla'amin Final Agreement	1 FN			●	2014	2016
	Yale First Nations Final Agreement	1 FN			●	2013	TBD
Northwest Territories	Inuvialuit Final Agreement	1 Inuit	●			1984	1984
	Gwich'in Comprehensive Land Claim Agreement	1 FN	●			1992	1992
	Sahtu Dene and Metis Comprehensive Land Claim Agreement	5 FNs ⁹⁹	●			1994	1994
	Tlicho Agreement	4 FNs			●	2005	2005
	Deline Self-Government Agreement	1 FN		●		2015	2016
Nunavut	Nunavut Land Claim Agreement ¹⁰⁰	26 Inuit	●			1993	1993
Yukon	Champagne & Aishihik First Nation Final Agreements	1 FN			●	1994	1995
	First Nation of Nacho Nyak Dun Final Agreements	1 FN			●	1994	1995
	Teslin Tlingit Council Final Agreements	1 FN			●	1994	1995
	Vuntut Gwich'in First Nation Final Agreements	1 FN			●	1994	1995
	Selkirk First Nation Final Agreements	1 FN			●	1997	1997
	Little Salmon/ Carmacks First Nation Final Agreements	1 FN			●	1997	1997
	Tr'ondëk Hwëch'in Final Agreements	1 FN			●	1998	1998
	Ta'an Kwach'an First Nation Final Agreements	1 FN			●	2002	2002
	Kluane First Nation Final Agreements	1 FN			●	2004	2004
	Kwanlin Dun First Nation Final Agreement	1 FN			●	2005	2005
	Carcross/Tagish First Nation Final Agreements	1 FN			●	2005	2006

⁹⁶ The Mi'kmaq Education Partnership in Nova Scotia is counted separately and is not included in the above statistics. The Mi'kmaq Education Partnership Final Agreement came into effect in 1999.

⁹⁷ Same groups as in James Bay and Northern Quebec Agreement

⁹⁸ *ibid*

⁹⁹ Deline First Nation from the Sahtu Dene and Metis has a ratified Self-Government Agreement

¹⁰⁰ Inuit self-government aspirations are expressed through public government (which is not self-government)

APPENDIX B: INTERVIEWEES

Interviewee Code	Subject Area Expertise
Federal Official A	Aboriginal Affairs
Federal Official B	Aboriginal Affairs
Academic Informant A	Federal-provincial relations and indigenous governance
Academic Informant B	Aboriginal policy and financing self-government
Aboriginal Group Representative A	First Nations government and finance

APPENDIX C: INTERVIEW GUIDE

Note: *Questions and topics examined in this semi-structured interview are intended to be open-ended and spur discussion.*

- 1) What are the barriers and challenges to successful Aboriginal Self-Government? (How have current or existing federal policies impacted the success)
- 2) What are the issues in financing Aboriginal self-government?
- 3) How can issues that arise from inadequate fiscal arrangements be addressed? Can these challenges be overcome?
- 4) What should be the principles/values that fiscal arrangements should adhere to?
- 5) What are possible funding or transfer mechanisms that could be adopted? Provide your perspective around conditional and unconditional transfers?
- 6) What are ways to develop an Aboriginal government's own source revenue capacity?
- 7) Would Aboriginal governments support in part or in whole, the concept of rewarding performance and incentive based funding?
- 8) Going forward, what do you see in the future development of fiscal arrangements with Aboriginal Governments?

APPENDIX D: AANDC GRANT AND CONTRIBUTION FUNDING APPROACHES

Block funding approaches are primarily used for self-governing groups, while grants and set, fixed, or flex funding is used for Indian bands and Tribal councils.

Funding Authority Type					
Funding Types	Grant	Contribution			
		Set	Aboriginal Recipients		
			Fixed	Flex	Block
Description	Specific eligibility criteria; application based	Where performance conditions specified in the funding agreement are set.	Where a contribution can be based on a predetermined annual estimate of the funding required by a recipient to achieve the objectives of the transfer payment.	Where a program is expected to require a two or more year relationship with a recipient to achieve objectives can be funded under a multi-year funding agreement and the recipient has demonstrated capacity to manage transfer payments.	Where a number of programs are expected to require a five or more year relationship with the recipient to achieve objectives can be funded under a single multi-year funding agreement and the recipient has demonstrated capacity to manage transfer payments.
Reallocation of Funds	No reallocation permitted			Recipients are able to reallocate funds amongst program-specified cost categories.	Recipients are able to reallocate funds amongst the programs in the block and adjust the relative priority of programs to address changing circumstances and the recipient's priorities.
Duration	Can be multi-year			2 or more years	5 or more years
Reporting	Annual financial statements along with program operational and financial reports throughout the year.				Annual financial statements and annual program operational and financial reports.
Accountability	Primary accountability is to DIAND and to community members for delivery of programs and services in accordance with terms and conditions of the agreement.				

(Source: BC Region Program Guide, 2016)

APPENDIX E: CANADA HEALTH TRANSFER AND SOCIAL TRANSFERS

In 2004, the existing health and social transfer programs received restructuring to create two new transfers: the Canada Health Transfer (CHT) and the Canada Social Transfer (CST). The CHT is the largest major transfer the federal government makes to the provinces comprising of \$34 billion in 2013-14, \$13 billion. Both the CHT and CST programs are based in legislation and will be reviewed in 2024 (Department of Finance, 2011a).

The Canada Health Transfer

The CHT provides the provinces with long-term, predictable funding for the provision of healthcare. It supports the objective of the *Canada Health Act*, which is to “protect, promote and restore the physical and mental well-being of residents of Canada and to facilitate reasonable access to health services without financial or other barriers” (1984, c. 6, s. 3). Conditions are placed upon the transfers and provinces have to adhere to the five principles of the *Canada Health Act*, which are:

1. Public administration: The “health care insurance plan of a province must be administered and operated on a non-profit basis by a public authority” (1984, c. 6, s. 8);
2. Comprehensiveness: All insured persons should have all necessary health services provided by hospitals, medical practitioners or dentists (1984, c. 6, s. 9);
3. Universality: All insured persons are entitled to a uniform level of healthcare (1984, c. 6, s. 10);
4. Portability: All insured persons must receive coverage from their resident province if in the event that the individual moves to a different province or territory or a region outside Canada (1984, c. 6, s. 11);
5. Accessibility: All insured persons are entitled to reasonable access to healthcare (1984, c. 6, s. 12).

The CHT transfer formula is set out in section 24.2 of the *Fiscal-Provincial Fiscal Arrangements Act*, with the determination of values detailed in the accompanying regulations.¹⁰¹ As of 2013-14, the automatic escalators allow for transfers to grow by 6% annually. In 2017-18, the CHT will grow aligning with the 3-year moving average of nominal GDP (Department of Finance, 2011b).

The Canada Social Transfer

The CST includes conditional block funding for the provision of post-secondary and early childhood education, and social assistance and other social services. It is calculated on an equal per capita cash basis and as of 2009-10 will increase annually by 3% (Department of Finance, 2011c). The CST is also based on legislation: section 24.4 of the *Fiscal-Provincial Fiscal Arrangements Act* details a formula that determines the transfer amount.

¹⁰¹ Canada Health Transfer, Canada Social Transfer and Wait Times Reduction Transfer Regulations (SOR/2004-62) last amended in 2013

APPENDIX F: THE FEDERAL-PROVINCIAL EQUALIZATION PROGRAM

The Equalization program addresses fiscal disparities between the provinces, enabling less prosperous provincial governments to provide their residents with reasonable comparable levels of public services, at reasonably comparable levels of taxation to those in other provinces.

Equalization, as a principle, is constitutionally entrenched within section 36(2) of the *Constitution Act, 1982*, which states:

"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."

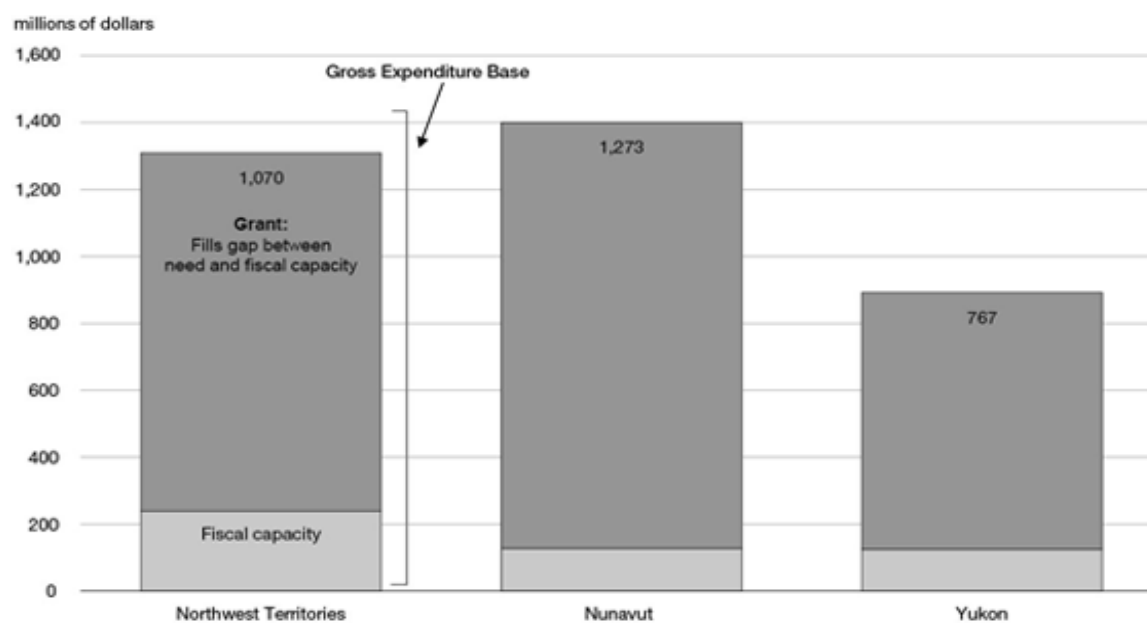
Equalization transfers are provided unconditionally and are operationalized through the *Fiscal-Provincial Fiscal Arrangements Act*. Transfers are based on fiscal capacity rather than expenditure need. Prior to any adjustments made, an equalization payment for any given provinces equals the amount by which its fiscal capacity is below the average fiscal capacity of all the provinces together. This amount is then compared to two scenarios: 1) full exclusion of natural resources revenues; 2) or 50% exclusion of natural resource revenues. The provinces receive whichever amount in the two scenarios is larger. The equalization transfer is then adjusted to ensure that provinces receive a net fiscal benefit from their natural resources equivalent to 50% of the per capita natural resource revenues of the receiving provinces (Department of Finance, 2012a).

APPENDIX G: THE TERRITORIAL TRANSFER FINANCING PROGRAM

The Territorial Formula Financing (TFF) program enables the three territorial governments (Yukon, Nunavut and the Northwest Territories) to provide their residents with reasonably comparable level of public services at comparable levels of taxation to those in the provinces. The TFF is the largest unconditional transfer received by the territories and also accounts for the high cost and challenges of providing essential public services to a large number of small isolated communities in the North (Department of Finance, 2012b).

TFF includes three individual formulas designed to recognize the unique geographic and socioeconomic circumstances each of the territories face. Each individual grant is based on the difference between the gross expenditure need (GEB) and the capacity for revenue generation (eligible revenues). In this way the TFF fills the gap between expenditure need and fiscal capacity. The GEB for each of the territories is adjusted annually to ensure that expenditures align with relative growth in population and changes with provincial-municipal spending (see Figure 8 below).

FIGURE 8: TERRITORIAL FORMULA FINANCING



(Source: Department of Finance, 2012b)

Eligible revenues include two components of OSR. The representative tax system is used to measure revenues from personal income, business income, tobacco, gasoline, diesel fuel, alcoholic beverages and payroll, while an approximated revenue block approach with a 2% annual escalator is used for revenues from capital tax, general sales taxes, commercial and non-commercial vehicle licenses, hospital and medical insurance premiums, insurance premiums, property tax, lottery and other games of chance revenues, miscellaneous revenues and preferred share dividends.

Eligible revenues do not include natural resource revenues generated by the territories; they are treated separately through individual agreements with the Yukon government and Nunavut (negotiations are ongoing with NWT) as part of the overall devolution of federal jurisdiction over onshore natural resources.

By structuring the TFF as a single estimate and payments system, allows for predictability and stability in funding for recipients of TFF. The TFF also incentivizes the investment and development of territories' OSR by excluding 30% of the territory's revenue capacity from the TFF grant calculation (Department of Finance, 2012b).

APPENDIX H: PROPOSED FISCAL CHAPTER

----- FISCAL RELATIONS -----

“Self-Government Fiscal Arrangements Act” refers to the legislative framework of fiscal arrangements in support of Aboriginal self-government in Canada that can be amended from time to time in accordance with the legislative authority of the Parliament of Canada.

“Fiscal Relationship Agreement” means the agreement contemplated in paragraph 2 of the Fiscal Relations Chapter.

“Essential Public Services” means service(s) that are run that are essential for the benefit of the general public.

GENERAL

1. Without altering the legislative authority of Parliament, of the Legislature of [PROV/TERR] or of {X Aboriginal Government}, or the rights of any of them with respect to the exercise of their legislative authority, Canada, [PROV/TERR] and {X Aboriginal Government} are committed to:
 - a. Promoting equal opportunities for the well-being of members of {X Aboriginal Group}; and
 - b. Furthering socio-economic opportunities of {X Aboriginal Group} to reduce disparity in opportunities

FISCAL ARRANGEMENTS

2. Canada, [PROV/TERR] and {X Aboriginal Group} (“the Parties”) are committed to establishing a fiscal relationship in good faith founded on mutual trust and respect, to be given effect through a Fiscal Relationship Agreement that will be guided by the *Self-Government Fiscal Arrangements Act*, and the following principles:
 - a. That each party has a role and share responsibility in ensuring that members of {X Aboriginal Group} have, at minimum, access to essential public services that are reasonably comparable to those available to other Canadian living in communities of similar size, location and circumstance at reasonably comparable levels of taxation;
 - b. Fiscal arrangements among the Parties should be reasonably stable, predictable, and flexible;
 - c. Fiscal arrangements among the Parties should encourage efficiency and cost-effectiveness, taking into account the circumstances of {X Aboriginal Group}, including its size, location, accessibility, and socio-economic conditions while

recognizing that funding can only be part of the solution to socio-economic disparities;

- d. The Parties should practice transparency and openness in fiscal matters;
 - e. {X Aboriginal Group}, within the limits of its fiscal capacity, should contribute to the cost of delivering essential public services; and
 - f. The Parties will meet together either bilaterally, multilaterally, or from time to time as part of a larger advisory body designed for the purpose, to discuss the implications of any significant changes that are proposed for federal or provincial support for {X Aboriginal Government}'s programs and services.
3. In determining its funding support for {X Aboriginal Government} pursuant to 2(c), Canada will not consider the following amounts to be part of {X Aboriginal Government}'s capacity to support itself from its own-source revenues:
- a. Capital Transfer(s);
 - b. Proceeds from the sale of {Aboriginal Group Lands}; and
 - c. Amounts received as a settlement of an aboriginal or treaty right under Section 35 of the *Constitution Act, 1982*; and
 - d. Amounts provided to {X Aboriginal Government} as compensation for, or in settlement of specific claims under Canada's Specific Claims Policy.