Costs and Coase
A Way Forward

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> The solution is essentially the transformation of the conflict from a political problem to an economic transaction. An economic transaction is a solved political problem.
>
> Abba Lerner, "The Economics and Politics of Consumer Sovereignty," *American Economic Review*, 62, May 1972, page 259.

> The delineation of rights is an essential prelude to market transactions.
>
> Ronald Coase, "The Federal Communications Commission," *Journal of Law and Economics*, 2, October 1959, pages 1-40.

> ... I believe that all of the parties have characterized the content of Aboriginal title incorrectly. The appellants argue that Aboriginal title is tantamount to an inalienable fee simple, which confers on Aboriginal people the rights to use those lands as they chose and which have been constitutionalized by s. 35(1). The respondents offer two alternative formulations ...The content of Aboriginal title, in fact, lies somewhere between these positions.
> ... its characteristics cannot be completely explained by reference either to the common law rules of real property or the rules of property found in Aboriginal legal systems.
>
> Chief Justice Antonio Lamer, *Delgamuukw v. British Columbia*, paragraphs 110-112.

Notes will be found on page 417.

Ludwig Wittgenstein, a famous philosopher from Vienna, it is reputed to have said, "If a question can be asked then it can be answered." The question raised by *Delgamuukw* is a simple one: can the question of who owns what land and why be resolved without bankrupting the country? The answer I try to provide here goes beyond the well-traversed legal and political approaches to one based on the economic insights provided by Ronald Coase, a University of Chicago economist and Nobel Laureate. The examples discussed in this paper come from British Columbia, but as others have argued, the questions raised may be valid in other provinces.

I examine the costs of doing nothing and the cost of doing something. Specifically, I examine the direct and indirect costs of negotiation and litigation. I conclude that for negotiation to cost less and to produce more economic growth than litigation, a workable set of property rights must be defined formally or informally. Coase provides considerable theoretical guidance in how to define and use property rights successfully. Ultimately, I conclude that the process of sorting out Aboriginal land claims may be better handled without the direct participation of governments. Aboriginal bands and resource users could arrive at their own agreements on the uses of, and rents paid on, Crown lands under Aboriginal title claim. It does not matter to resource users who they pay, but how much they pay. What governments would lose in resource rents, they would make back in more general taxes on economic activity which would surely rise.

What is the cost of doing nothing?

The first question decision-makers might ask themselves is, "What is the cost of doing nothing?"

The cost of doing nothing may be actually quite high. Well before *Delgamuukw,* the issue of Aboriginal title and lands claims had led to perceived higher risks for investments in B.C. Until quite recently, the B.C. forest industry enjoyed four years of strong markets and prices. During that time, capital investment remained low by historical standards. Today, profits go toward boosting internal rates of return to cover future risk or to acquisitions in other provinces and countries. Many reasons may explain why this is so, including high taxes, high labour costs and a heavy regulatory burden. Among them surely lurks the possibility of uncompensated or inadequately compensated expropriation through a possible land claims settlement.

In a recent Fraser Institute survey of mining company executives, my colleague Laura Jones reported that, "Uncertainty concerning the settlement of native land claims is identified as a deterrent to exploration investment in every province. However, it is considered the greatest

liability in British Columbia, where 92 percent of survey respondents consider land claims uncertainty a serious deterrent to exploration investment. Of that 92 percent, 34 percent indicate that they would not invest in British Columbia due to the uncertainty surrounding claims."

Let me make very clear two important points about the costs of settling or not settling Aboriginal land claims. First, it is not a zero-sum game between Aboriginal and non-Aboriginal British Columbians. Economic uncertainty among non-Aboriginal citizens does not equal economic certainty for Aboriginal people. One side's loss is not the other's gain. *Delgamuukw* will lead to either more wealth-creating economic exchanges for all of us or for none of us, Aboriginal and non-Aboriginal alike. The price will be the same.

Second, when I talk of costs, I'm not referring to the land, itself. The land of British Columbia has no intrinsic economic value. Its only economic worth lies in its use as a source from which to extract natural resources or as a site for activities such as tourism and recreation. This statement is no less true for Aboriginal people. Ownership of land, no matter how defined, is not an end in itself: Aboriginal title agreements are just words on paper unless the land can be used for whatever purposes, including doing nothing with it.

If the land has no intrinsic value, what's important then to Aboriginal and non-Aboriginal people alike is how much, and in what ways, we can make use of the resources held within Crown lands. All of us want to enjoy immediate and long-term use of the land, whatever use that may be. All of us want to ensure the land can support varied uses, whether forestry, mining, recreation or preservation. In short, the more ways to achieve exchanges between landowners and land users, the more exchanges there will be and thus the greater the potential for wealth creation.

The ability of all British Columbians, Aboriginal and non-Aboriginal, to enjoy a higher material standard of living depends on increasing the quantum of exchanges through as many kinds of land uses as profitable within the market economy and permissible within the environmental and other land use regulations set by the legislature.

What is the cost of uncertainty?

Often one hears that the cost of unresolved land claims is uncertainty. The questions that need to be asked and answered are: "Uncertainty for whom? About what? And how will this uncertainty inhibit economic growth?"

Uncertainty in the context of Aboriginal title must mean something more than just not knowing what will happen in the future. Every enterprise dependent upon some form of access to Crown land, indeed

every enterprise, faces the unknown. Is the uncertainty over the scope of Aboriginal title fundamentally different than the possibility of whopping new provincial taxes, fluctuations in the Canadian dollar, new American tariffs, slumping Asian markets, new competitors from South America, or the scientific discovery of new and cheaper substitutes for B.C.'s resource products? If a dollar off the bottom line is a dollar off the bottom line no matter what the cause, then Aboriginal title is just one more factor companies must take into account when risking their capital to produce wealth-creating exchanges.

The uncertainty that matters is how we might collectively and individually respond to such a state. The uncertainty surrounding Aboriginal title in B.C. is not whether it exists, but whether the federal government, the provincial government and the Aboriginal bands are capable of implementing it in an economically rational manner. Furthermore, are these three groups capable of understanding that the private sector, the wealth creators, will act rationally even if these groups do not. The private sector will swiftly alter its economic exchanges in response to the behavior of governments and Aboriginal bands.

The Cost of Doing Something

There are five relevant cost areas in which the behavior of governments and Aboriginal bands will be watched and judged:

(1) costs to taxpayer of treaties and compensation;

(2) treatment of existing leases and compensation for their abrogation;

(3) direct government and Aboriginal rents applied to continuing leases;

(4) transaction costs of defining the scope of Aboriginal title and negotiating its exercise; and

(5) the costs of Aboriginal self-government to the extent they result from land transfers.

Whether these costs are borne directly or indirectly through taxation, the effect is the same fewer potential exchanges.

Costs to taxpayers of treaty settlements and compensation

The Delgamuukw decision opens the possibility that the definition and application of Aboriginal title will take place through the courts rather than through the existing treaty processes such as those that exist in British Columbia.[1]

There are three main public sector costs to be incurred in settling Aboriginal land claims, whether through the courts or through negotiations:

- land transferred;
- cash paid for land claimed but not transferred; and
- cash paid to compensate Crown licence holders on land transferred to Aboriginal bands.

Delgamuukw has introduced a whole new cost—the compensation to Aboriginal bands for past usage of lands for which they can prove Aboriginal title. Lamer wrote that the price of compensation starts at market value and could include all earnings since 1846. Though Aboriginal title does not apply to private property, the Crown must still compensate Aboriginal owners. What is the cost of compensating the Musqueam, Squamish, Capilano and Tsawwassen bands for the occupation and development of Vancouver?

The question on the surface raises the fears and expectations of billions of dollars to be paid out. But these fears and expectations may melt under scrutiny. Logically, a claim for compensation cannot be based on deriving a percentage of the current and accumulated market value of the land when that land only has the bulk of its value because of more than a century of development, however improperly the land was acquired. Chief Justice Lamer has done no one a favor with his scattered musings on the economic calculation of how to determine compensation. It makes more sense to take the value of the land at the time of the abrogation of Aboriginal title and to apply interest to that value. That said, the virtue of compound interest would make that sum astronomical. One bright bulb calculated that if the Manhattan tribe had converted the $24 dollars worth of trinkets into cash and placed it in an interest-bearing account, the sum today would nearly equal the value of New York City.

At some point the compensation figure, even if calculated on value at the time of alienation, becomes so large that the injury to the economy of creating that much more public debt hurts everyone including Aboriginal people, whether or not they pay taxes. After all, the compensation paid out will be in Canadian dollars, a currency whose value has steadily eroded over the last two decades in part because the massive accumulation of public debt.

A policy of compensation, however, may still provide some savings. One may well be the long-overdue redefinition of the Crown's financial role vis-à-vis Aboriginal bands. The general fiduciary responsibility of the Crown to Aboriginal people is "to protect them in the enjoyment of their Aboriginal rights and in particular in the possession and use of their lands."[2] Building from a now-discredited notion of wardship, the federal government slowly but steadily

expanded the range of social welfare payments. As the 1985 *Nielsen Task Force* reported:

> The large portion [of Indian spending] devoted to status Indians and Inuit is commonly attributed to federal obligations under the treaties of the Indian Act. In fact, only 25 per cent of these expenditures can be directly attributed to these obligations. The remainder goes largely to services of a provincial and municipal nature and stem from decades of policy decisions designed to fill this void which have, by convention, come to be considered as though they were rights.[3]

If the federal and provincial governments through payments of compensation are fully meeting their constitutional "fiduciary responsibility," all other payments not strictly required by treaties must be considered as discretionary. They must be viewed by the same standard of equity and equality as applied to all other public payments to individuals and groups. Aboriginal people who are poor deserve the same public assistance as any other Canadian would expect to receive. At the same time, as income and means-testing applies to a range of benefits, there should be no exemptions on any basis and certainly not one based on some quasi-racial qualifications.

Moreover, as Aboriginal bands achieve self-government—in whatever form—one would expect them to assume the appropriate level of responsibility for social welfare spending. This is particularly true as bands assume ever-greater abilities to levy taxes.

Treatment of existing leases and compensation

Despite the size and mountainous nature of B.C.'s Crown land, very little of it is not covered by some lease, license or tenure, including timber rights and tree farm licenses, oil, gas and mineral exploration and extraction permits, grazing permits and road and pipeline right-of-ways. According to a 1992 Price Waterhouse study of the cost of land claims, resource industries dependent on access to Crown land, accounted for 200,000 jobs and $17.5 billion in annual revenues, one quarter of B.C.'s Gross Domestic Product.

Chief Justice Lamer does not address compensation for leaseholders directly in his decision. In his inattention to this critical issue, he is matched by the two governments and Aboriginal negotiators in the B.C. Treaty process who have been less than forthcoming as to how existing lease and license holders would be treated in the event of expropriation of their rights. All sides concede that some license holders may

be expropriated. All sides concede that there should be fair compensation. The 1993 Cost-Sharing Memorandum of Agreement between the provincial and federal governments calls for the two levels of government to split the cost of compensating expropriated Crown land leaseholders. Yet suspicions persist as to the intentions of the governments, the closer the moment of actual expropriation nears. Why?

The reason is simple: the past behaviour of both governments. The federal government in canceling the Pearson Airport contract and the provincial government in canceling the ALCAN Kemano completion project, both resisted paying fair compensation except under extreme legal pressure. Both ultimately asserted that the legislature holds the prerogative to expropriate without fair or any compensation.

That position, however, has increasingly little legal justification. Osgoode Hall law professor Patrick Monahan has cogently argued that the Rule of Law has come to be interpreted in Canada as covering the contracts that governments enter into with private parties.[4] As licenses and leases are contracts, the federal and provincial governments are bound by the Rule of Law to pay compensation when these agreements are abrogated. Monahan states in his conclusion:

> This paper has argued that governments should be bound to the same moral standards as private citizens when its comes to the making and breaking of promises. Yet, at first blush, such a requirement might be thought to unduly limit the ability of the government of the day to achieve its preferred public policy objectives. In fact, however, the suggested limitations will operate to the long-term benefit of the state, rather than to its detriment. If governments are permitted to repudiate contracts at will, the state is effectively barred from undertaking permanently binding commitments. Anyone who is contemplating contracting with the government will be aware of the fact that, no matter how solemn the promise, the government can turn around the next day and "skip out" on the contract. This risk may lead the other party to decide that it would be better off investing its resources elsewhere, in jurisdictions which do offer protection for contractual expectations; alternatively, the private party may demand that the government pay a premium in order to discount the risk of future opportunistic behaviour by the state.

Rule of Law constitutional protection of contracts with governments, if substantiated in the courts, is one bit of good news for Canadians who are rightfully concerned over the lack of constitutional protection of property rights.[5] Aboriginal people, at least, can look forward to some constitutional protection of lands held by Aboriginal title.

Government and Aboriginal rents and other opportunism costs

Government rents are taxes defined broadly. The bulk of government rents fall upon economic activity rather than the direct rent charged for access to Crown lands. The September 1997 *Quarterly Report* from B.C.'s Ministry of Finance and Corporate Relations predicts that provincial taxation on economic activity (personal and corporate income tax; sales taxes; and capital taxes) should bring in $6.624 billion and natural resource rents (petroleum and natural gas royalties; timber sales; and water rentals) will bring in only $945 million. Looking over the history of recent provincial revenues, natural resource rents are consistently about 15 percent of economic activity taxes and about 10 percent of total provincial revenues.

Let's then ask the question, "Would the full application of Aboriginal title give bands the ability to levy government rents and, if so, which ones?"

Delgamuukw specifies that the provincial government and certainly any private enterprise must consult and presumably receive the permission of the title-bearing band in order to use the resources on Crown land subject to Aboriginal title. In practice, this would lead to a classic exchange-of-hostages scenario. (In that scenario, both sides want their hostages back but fear that if they move first, the other side will renege.) The band, seeking to maximize its income, would seek the highest amount the market will bear in exchange for its permission. The provincial government, seeking to protect its income, would seek to surrender as little "rent" as possible by shifting or adding costs on the license-seeker or taxpayers in general.

This could lead to three possible outcomes:

- higher rents on access to Crown lands with the provincial government and the title-bearing Aboriginal band each levying rent;
- the same level of rents with the provincial government and title-bearing band either sharing the rent or one crowding out the other; and
- lower rents with the provincial government and title-bearing band lowering or vacating their respective rents in order to induce economic activity.

In the absence of an explicit market mechanism to determine rents on access to Crown land, e.g. an auction system, trial-and-error will determine which scenario will occur. Likely both the provincial government and the title-bearing band would at first seek to protect their

revenues and each charge a rent. This could raise the cost of the resources to unprofitable levels and thereby reduce use, decreasing economic exchanges.

It is important to remember that any rent on land is a monopoly rent—with the monopoly position held by the lease-seeker. As Adam Smith writes in *The Wealth of Nations*

> The rent of land, therefore, considered as the price paid for the use of the land, is naturally a monopoly price. It is not at all apportioned to what the landlord may have laid out upon improvement of the land, or to what he can afford to take; but to what the farmer can afford to give.

Assuming then that the existing rents on Crown land have already reached the level at which lease-seeker will pay no more, the provincial government and title-bearing band must negotiate between themselves the splitting of rents with the overall level of rents either remaining constant or even lower.

The title-bearing band has a strong direct lever vis-a-vis the provincial government. Presumably without its permission, any economic development using Crown land resources could not proceed. However the Aboriginal band may be most in need of rent revenues. As a result, the band may seek a faster and less lucrative rent-sharing agreement.

The provincial government has weaker levers, but it does possess them. Victoria could either threaten not to approve a project or, in the extreme, seek Ottawa to alienate the land from Aboriginal title. This latter course would probably involve a lengthy legislative and legal battle with uncertain prospects for success. On the other hand, the provincial government may be in less immediate need of the rent revenue and, therefore, inclined to bargain longer to better its position in the final rent-sharing agreement.

Remember the full extent of the provincial government's exposure to lost resource rents is only 10 percent of its total revenue. Of course if some companies cannot access resources then their taxable income will also decrease, as will that of its employees. In time, however, the province would lose significant revenues, as much business and personal income tax revenues come from natural resource activity. The situation could become one of playing revenue "chicken."

In that game of chicken, Aboriginal bands have the disadvantage of not having the power to tax income except that of their own members. (Presumably, all federal transfers are being used to support essential activities.) It is an unanswered question of considerable importance

whether Aboriginal bands can now freely set sales taxes, such as tobacco and real estate taxes on reserves and "conditionally surrendered" land.[6] If so, that might alter the balance.

Both sides, nonetheless, have the opportunity to block the other's rent seeking through a veto on a proposed resource development. As with any hostage negotiation, the ultimate fate of the hostages lies in *how* and *for how long* the two parties negotiate.

Indeed, it is a major thesis of this paper that exclusive focus on the direct government/Aboriginal rent misses the major portion of uncertainty and cost being created by the *Delgamuukw* decision—the cost of negotiations.

Transaction costs

A clearer evaluation of the economic impact of the *Delgamuukw* decision requires close attention to what economists call transaction costs.

Nobel laureate Ronald Coase advanced forcefully the economic importance of transaction costs in his two seminal articles (1937; 1961). Coase's work focused on the contract, the individual building block of economic exchange. Specifically he examined the costs of reaching and enforcing contracts. In the Coasean sense, transaction costs are defined as "the costs of measuring the valuable attributes of what is being exchanged and the costs of protecting rights and policing and enforcing agreements."[7] In terms of economic relationships—contracts, firms and markets—any actions, information or perceptions (or their lack of) that "impedes the definition, monitoring and enforcement of an economic transaction is a transaction cost." [8]

The cause of transaction costs lies in two major factors:

(1) ill-defined property rights; and

(2) incomplete and unequal information.

Following on Coase's approach, Yale economist Oliver Williamson points to two causes of pervasive transaction costs that are steeped in human nature:[9] "bounded rationality" (we think we act rationally, but often don't); and chronic opportunism (we promise, but don't always deliver).

Property rights

The economic purpose of property rights is to make the revenue-generating contracts and sales more economical to arrange. Such laws serve to reduce incidences such as the following:

- misunderstanding and conflict as to who can do what, with what;
- an inability to exchange one resource for another;

- stranding assets within the public domain, thus tempting individuals to seek to capture them through political means; and
- enticing political and bureaucratic interests to auction off access to public property at an accelerated rate, thus risking the economic and environmental losses associated with the "tragedy of the commons."

For Coase, the key to reducing transaction costs and achieving economic efficiency lies in defining defensible property rights. Property rights make possible allocative efficiency (complete benefits over complete losses) and technical efficiency (maximum possible output for given resources.) Coase asserts that it matters little who owns how much property, as long as somebody owns it and he or she has the ability to transact at a low cost.

For the reason of property rights alone, Coase holds that institutions matter. In particular, the law and the courts serve to clarify property rights when ownership is unclear or disputed. If the laws are clear and the courts well administered, then the transaction costs of assigning and defending property rights will be relatively low. If not, these costs will escalate.

Application to Delgamuukw

Delgamuukw has complicated the property right regime in B.C. and complexity is expensive. Lamer has re-defined both the substance of Aboriginal title and the rules of evidence to determine its presence.

Delgamuukw has in essence unbundled and reassigned the provincial government's rights to Crown land. Most particularly, the decision has made conditional on the approval of Aboriginal titleholders the government's ability to grant licenses to other users. At the same time, the decision does not assign to Aboriginal titleholders a full bundle of rights such as described by fee simple ownership. One can predict that this mixture of provincial and Aboriginal property rights over Crown land will prove to be unstable. To begin with, it will take at least a generation to map fully the extent of Aboriginal title in B.C., whether or not it is done by negotiation or litigation.

How does Lamer's *sui generis* property regime rate according to economic theory?

From an economic perspective, this *sui generis* property regime has severe problems. Ideally, Lamer should have chosen to grant Aboriginal title in fee simple ownership. From Adam Smith onwards, economists have shown that land will be better cared for and used more productively if owned in fee simple. Fee simple ownership creates incentives and reduces the transaction cost of exchanges.

The history of land tenure in British Columbia for the last 100 years has been of a struggle to create approximations of fee simple ownership in the form of tenures and licenses to overcome the inherent limitations of government ownership.

Even if initially inequitable to grant ownership of 95 percent of the B.C. land mass to 4.9 percent of the population, the sale and exploitation of that land would in time come to benefit all British Columbians. Remember that it is the use of the land and not its ownership that creates the economic exchanges leading to wealth. It would, in the long run, have made more economic sense for Aboriginal people to own all provincial Crown land, as long as they did so in traditional fee simple ownership.

Unfortunately, Lamer has placed a number of restrictions on how Aboriginal people may exercise their Aboriginal title, despite granting exclusivity of use. First and foremost, Aboriginal people cannot sell their interest in the land except to the Crown. This perpetuates the regime of section 89 of the *Indian Act* detailing how the real and personal property of Aboriginal people living on reserves cannot be alienated, pledged, or mortgaged except to the band or the Crown. Ostensibly, this protects Aboriginal people from losing their property. The effect, however, is to isolate Aboriginal people from the broader economy. Without the ability to pledge assets, they cannot receive financing—except through the government—for such everyday items as a car or a refrigerator. As a result, Aboriginal people on reserves were, and are, effectively denied access to consumer capital markets.

Mortgaged property, of course, is land at risk: failure to pay off the loan would lead to the asset being seized. Risk, nonetheless, is at the heart of economic growth. If Aboriginal people are prevented from risking their assets, they are prevented from achieving their full economic potential.

(Aboriginal individuals might argue that once they have regained effective Aboriginal title, the Court's restrictions could be ignored. If no one protests, then no court challenge to a mortgage would go forward.)

In addition, the *Act* imposes high administrative costs on many Aboriginal economic activities through a myriad of supervisory and approval processes. One look at the listings under INAC in the federal government phone book disabuses all claims of administrative efficiency. Some of these regulatory functions are now being delegated to band governments, but the effect is still the same. Government is government with all its justifications for the "inevitability of planning," in the words of Frederich Hayek. It will continue to seek to subjugate individual economic decisions to political control through manipulation of collective levers. Political restraint is rare.

The impairment of risk and the imposition of controls lead to a secondary effect, the loss of commercial reputation. Uncertainty over the ability to recover assets erodes confidence in Aboriginal enterprises. As a result, banks, suppliers, and retail merchants are reluctant to enter into commercial arrangements except when the federal government offers explicit guarantees. The laborious, and often politicized, process of securing such guarantees just adds more costs to doing business.

Aboriginal businesses do exist and do succeed. The reason for success more often lies in the ability of individual Aboriginal business leaders to thwart federal regulations than to secure federal largesse. Indeed, the attendant "moral hazard" risks to such government "risk-free" capital, one suspects, explains in part why too many Aboriginal economic development projects fail.

Second, Lamer's ruling restricts how Aboriginal bands may use the title-bearing land. They cannot use the land except in ways that are compatible with pre-contact practices. They cannot use the land in ways that would reduce the values making it subject to Aboriginal title in the first place. No strip mining, parking lots or possibly logging may be allowed on certain parcels. Such restrictions sound environmentally and culturally friendly, but are predicated on a very paternalistic notion of Aboriginal society. In essence, Aboriginal society, at least in its economic activity, is to be held within the bounds of its traditional practices. I read this restriction as a warning that the economic activity of Aboriginal bands is not supposed to evolve beyond a certain limit to be determined by the courts. The practical consequence is to give a veto to those whose interest lies in no commercial development of land. Again though, Aboriginal bands may choose to not recognize these strictures.

Third, the communal nature of Aboriginal title, though seemingly embraced by the Aboriginal band leadership, potentially skews the benefits toward the favored few in the Aboriginal political hierarchy. It also creates incentives for the "tragedy of the commons" effect, the neglect and over-exploitation of communal land, and the added negotiation costs to deal with the nominally consensual nature of band politics. The latter is particularly troublesome because of the possibility of projects being held hostage to the individual and family jealousies that afflict all communities.

There is a great deal said and written about cooperation and consensus as the means through which to advance economic growth. That is not how the world works. Economic growth is fundamentally dependent on risk—with its consequences of winners and losers. A market economy invariably changes people's lives. Some like it; some don't. Complete agreement simply is not possible. If consensus in a

community is a requirement for economic exchanges, the result is probably no economic exchanges.

Incomplete and unequal information

Imbalances in information either *ex ante* or *ex post* an economic exchange can create opportunities for one party to take advantage of the other. In this way, information directly influences the efficiency of economic exchanges. If costs and/or benefits are hidden from one party or the other, they may enter unknowingly into inefficient exchanges. What may have started out as an efficient exchange degenerates during the course of the contract into an inefficient one, due to the behavior of the parties. Most commonly, parties may not know until well after the fact whether an exchange was efficient or not and therefore fail to adjust prices or some other factor in subsequent contracts.

As with property rights, institutions matter in the alignment of information to prevent abuses. Numerous laws, such as consumer protection laws, have been written to protect parties from information abuses. However imperfectly, the civil courts allow for parties to seek damages when an information abuse has occurred. The government itself is constrained from abusing its informational advantage by the Rule of Law, which restricts its ability to act arbitrarily.

Application to Delgamuukw

Applying all this to the discussion of *Delgamuukw* is fairly straightforward. If the cost of negotiating, monitoring and upholding economic exchanges using resources subject to Aboriginal title exceeds the benefits of those exchanges, then the exchanges will not take place—no matter how reasonable the direct rent may appear.

The question, then, is: "Has the Delgamuukw decision made the nature of the Aboriginal title on the Crown lands of British Columbia so complex, and the process of delineating it so potentially expensive, that the transactional costs of market exchanges based on the resources of these lands will exceed the market benefits?" That is, despite the interest of all parties to do business, will the costs of conducting business become too expensive?

For Coase, the cause of most so-called market failures does not lie in the inability either to provide certain goods (e.g., lighthouses) or to include externalities in the price of a good (e.g., pollution). The reason lies in high transaction costs that prevent private actors from negotiating a mutually acceptable contract.[10] Coase assumes economic actors can and will exchange anything if the cost of reaching a contract does not exceed the potential gain from the transaction.

Signaling costs

One of the ways that participants in an economic exchange overcome informational disparities is to signal their true position through a variety of means. Companies that wish to signal that they would not take advantage of their customers will advertise their commitment to service. Automobile repair shops will offer a money-back guarantee if you're not satisfied in 30 days.

Has the *Delgamuukw* decision removed the incentive from either the government or Aboriginal negotiators to signal their willingness to negotiate workable treaties? Or alternatively, "Has *Delgamuukw* so changed the potential outcome of land claims that neither side has sufficient understanding and support in their respective constituencies to risk sending a "good faith" signal?"

If the First Nations Summit's January 31 "Statement to Minister Stewart and Minister Cashore," was any indication, genuine "good faith" signals appear to be some way off in the future. The statement is confrontational in its tone and in its recommendations. As a result, the possibility of stalled negotiations certainly exists.

For example, the Summit document interprets Lamer as describing Aboriginal title as "similar to the concept of jurisdiction." Lamer certainly gives weight to Aboriginal title on Crown lands, but does not accord it jurisdiction outside of the framework of the Crown's sovereignty. Lawyers can debate the fine points of the law here, but from an economic perspective, precisely such confusion over who holds jurisdiction is a cause of future conflict and aborted economic exchanges.

The Summit called for an immediate interim freeze on any further alienation of land and resources. It is uncertain whether this means no new licenses and permits should issued or that all new licenses and all existing licenses should be frozen. In either case, such a freeze would quickly bring paralyze parts of the resource economy. Who would risk assets in expectation that the freeze would be lifted shortly? Stranded assets would be liquidated or abandoned.

The next step proposed by the Summit is to negotiate province-wide interim agreements and to determine how the treaty process "will be brought into line with the requirements of *Delgamuukw* and the report of the Royal Commission on Aboriginal People." This includes the complete funding of Aboriginal negotiators and the cancellation of all loans to date for that purpose.[11] "Excessive delay or failure" by the governments of Canada and B.C., the Summit stated, will be "interpreted as a breach of good faith and will contribute to the break down of the treaty process." While the Summit added, "The governments should not put us in a position to prove Aboriginal title," they note the number

of cases continuing to come forward. The point is clear: litigation is an option and the governments can expect to "lose" more cases.

Certainly, the position of the Summit is a bargaining posture. The question is whether the very option of litigating all Aboriginal title now precludes "good faith" bargaining. That is, does the signaling of litigation overshadow the signaling of cooperation?

The risk is that the signaling of litigation in support of an aggressive interpretation of *Delgamuukw* will be interpreted by the non-Aboriginal public as cause for an equally aggressive reaction of non-cooperation.

Negotiation costs

The effect of all these factors is to contribute to the prospect of even higher negotiation costs. Just what are the current costs? Who really knows? The cost of negotiation, split between the federal and provincial governments across a bewildering variety of departments and ministries, cries out for review by the respective Auditors General. The formal costs of treaty process are estimated at about $20 million a year, but the associated costs to business and individuals might reach as high as $100 million a year, given there nearly 50 claims at various stages of negotiation.

Few would dispute that the negotiation costs of the B.C. Treaty process are high and the results mixed, as measured against even the expectations of the participants. As Erling Christensen, Executive Director of Native Issues Monthly, wrote:[12]

> the B.C. First Nations Summit, a treaty working group, has passed a resolution asking the Treaty Commission to go back to the federal and provincial government and inform them that funding is not adequate and the four year level be paid out over two years. This would adequately fund the process. At present, the process is under-funded by at least 50%.

It is difficult not to believe the negotiations have become a "rent-seeking" exercise on the part of politicians, bureaucrats, and consultants.

At the heart of the escalation of transaction costs associated with the B.C. treaty process are several fundamental flaws which *Delgamuukw* fails to address. These include:

- uncertainty of desired results;
- a large number of bargaining agents with ill-defined mandates;
- large, undefined assets under negotiation;
- weak incentives for timely completion; and
- numerous and unspecified opportunities for re-negotiation.

Where to from here?

A clear indication that *Delgamuukw* has significantly raised the potential level of transaction costs on economic exchanges dependent on Crown land resources is the question now being asked, "Will it be less expensive in the long-run to litigate or negotiate the scope and application of Aboriginal title?" This is remarkable since, as a rule, negotiation is always considered less expensive than litigation.

Given all the costs of the B.C. treaty process—in particular the transaction costs—it is a legitimate question to ask. Indeed, should we consider another means to resolve Aboriginal land claims.

There are two scenarios to resolve the situation:

- a litigation strategy; and
- a revised negotiation strategy.

(I assume a legislated solution such as Australia has done recently would be struck down in the Supreme Court because of the constitutional protection afforded Aboriginal title.)

Litigation strategy

Despite the natural aversion most of us have towards litigation, there are serious and compelling reasons for the provincial and federal governments to consider using the courts to define the scope of Aboriginal title in British Columbia. Indeed, given their interests, it is their optimal strategy. (Short, of course, of legislating a one-size-fits-all treaty.)

The first is certainty, itself. A court process will give the final word on the extent of a band's Aboriginal title. A final judgment will not be subject to judicial review, as might any negotiated treaty whether the plaintiffs are Aboriginal or non-Aboriginal. A court judgment would also enjoy a political finality that no treaty process can.

This is in part due to the ability of judges to better assess the legal arguments and evidence, oral or otherwise, put before him or her. Judges are the scientists of property rights and if ever there was a need for analytical rigor it is in the area of Aboriginal title. There are serious questions about the ability and propriety of government contract employees in negotiating deals on Aboriginal title of such scope and magnitude. Besides the obvious question of conflict-of-interest, government negotiators may be in violation of the Rule of Law.

Despite the economic criticisms leveled against the courts, they do help to reduce the pure transaction costs of incomplete and unequal information and the human tendency not to do what we promise. They are a means to achieve in the real world the preconditions of full communication, defined property rights, complete agreements and certain

fulfillment of contracts. For instance, the enforcement of property rights and contracts requires a third party when compliance is no longer possible through negotiation.

Two factors adversely characterize court solutions: cost and delay. Though it is difficult to assess, given the current dysfunctional nature of the B.C. Treaty process, it would be less expensive and faster to litigate Aboriginal title. This is particularly true if the resulting treaties were to be subject to judicial review, as would likely happen.

One recognizes that, according to informal estimates by the federal Department of Justice, there are currently 500 Aboriginal cases before the Courts across Canada, each potentially costing up to $1 million to litigate. One-third of all British Columbia's Appeal Court judges have been assigned to Aboriginal cases and 15 percent of the Supreme Court's time over the next two years is budgeted for Aboriginal issues.

Still the quality of the process and the finality of the result recommend the litigation of Aboriginal title, particularly when the alternative is the questionable B.C. Treaty process. The litigation of Aboriginal title still leaves open the necessity of negotiations to apply the judgments of the courts.

A revised negotiation process

From an economic perspective of promoting economic exchanges, negotiations remain preferable to litigation. I argue that the Coase theorem provides a means to resolving the application of Aboriginal title to provide the greatest range and depth of economic exchanges.

Negotiation is the optimum strategy both for Aboriginal and non-Aboriginal citizens as economically rational actors.

The Coase theorem states that an economy will achieve full efficiency, *whatever the initial distribution of property,* if the costs of transacting a contract are zero. Princeton economist Avinash Dixit describes it this way:

> If all participants in the economy could be brought together, if initial ownership rights were assigned among these participants, and if they could costlessly make fully specified and fully binding agreements, then the outcome should be an efficient economic plan leaving only the division of spoils to be determined by the bargaining strengths of the participants.[13]

In practical terms, the Coase theorem requires a major revision of the B.C. Treaty process. In essence, it calls for the privatization of the process in so far as it deals with economic growth. Bluntly, Aboriginal bands should bypass the federal and provincial governments and nego-

tiate directly with the individuals and companies seeking to use resources on Crown land they claim under Aboriginal title. Once an Aboriginal band and, let's say, a forest company, reach their own agreement on the extent and terms of logging a particular area, they can present that agreement to the federal and provincial government. In other words, the company and the band reach a private agreement on the details of an economic exchange.

For a forest company, what matters is the amount it pays in rents and transaction costs, *not to whom that money flows*. It matters not to the success of an economic exchange whether the provincial government or an Aboriginal band is the recipient of access rents.

Private agreements also have the advantage of flexibility. For instance, the participants can bind themselves to treating resources and other assets as private property. Self-imposed sanctions allow the parties to negotiate around ill-defined property rights and other uncertainties. (This raises the question of whether Aboriginal bands can be held liable in courts for their contracts based on lands bearing Aboriginal title. Civil liability is not an absolute necessity if other means are employed to reduce the risk of opportunism, e.g. performance bonds, staggered payments and the like.)

With the agreement between the Aboriginal band and the company in hand, the Aboriginal negotiators can present then present their own revenue-sharing proposal to the provincial government. Victoria or Saskatoon can then work out the numbers for itself in terms of lost resource rents versus the gain of not having to pay compensation, continued business and individual income tax; or the savings from turning over to the private sector and the Aboriginal band costs such as road construction, reforestation and environmental monitoring. It should be noted that all of these forestry-related costs to the province have for some time equaled or exceeded the province's direct resource rents from Crown lands. A provincial government would also take into account that the federal government has offered to pay half of foregone resource revenues in British Columbia, an offer it would surely extend to other provinces.

These private agreements would also help to clarify the economic circumstances of Aboriginal bands, thus providing critical information to the necessary self-government government negotiations, perforce held government-to-government.

The point is a simple one. As long as Aboriginal bands are locked into negotiations with governments, they are held hostage to government interests, which are largely to protect their own revenues and jurisdictional authority. That is a recipe for high and potentially destructive transaction costs. If Aboriginal bands are negotiating with

private users of Crown resources, the critical issue is a wealth-creating economic exchange. Because they have a bottom line, business negotiations proceed with an efficiency unknown to political negotiations.

If the goal of Aboriginal people is economic growth rather than a fruitless pursuit of government recognition of some kind of Aboriginal sovereignty, then they should focus their attention on society's wealth creators rather than its status providers.

The risk exists, somewhat faint to my thinking, that the diversion of formerly provincial government rents to Aboriginal bands will severely hamper the fiscal ability of the provincial government to carry out its responsibilities. The reply is twofold. First, the provincial government is already doing too much and some retrenchment would make considerable economic sense. Second, as the Aboriginal community begins to derive more and more of its income from private wealth creation rather than public transfer payment, they will come to appreciate more fully that beyond a certain level government debt and expenditures represents a drag on the overall economy. As their attention focuses increasingly on economic growth as opposed public redistribution, they will not jeopardize new-found wealth to cling to the fraying safety of "wardship."

At the end of the day, Aboriginal people may find their best interest lies in moving beyond the stilted economics of *Delgamuukw* to more accepted economic principles for creating wealth.

Notes

1 For a background to the treaty process, see Owen Lippert, "Out of our Past: A New Perspective on Aboriginal Land Claims in B.C.," The Fraser Institute, 1995.
2 Brian Slattery, "Understanding Aboriginal Rights" (1987), 66 Canadian Bar Review, page 753.
3 Task Force on Program Review cited in Melvin H. Smith, Q.C., *Our Home or Native Land*, (Crown Western: Victoria, 1995), page 240.
4 Patrick Monahan, original manuscript, "Is the Pearson Airport legislation unconstitutional?: the rule of law as a limit on contract repudiation by government," 1996.
5 Critical market efficiencies rest upon the Rule of Law prevailing over the Rule of Man in the exercise of government: the greater the discretion of politicians and bureaucrats, the greater the opportunity for the misallocation of collectively-held resources. For reasons good and bad, politicians and bureaucrats, when faced with decisions beyond the application of existing law, will concentrate benefits on swing voters and well-organized interest groups and will disperse the costs among all taxpayers in the hope that a small marginal tax or debt liability increase will provoke little response. This is the "Public Choice" dilemma. The more the Rule of Law binds politicians and bureaucrats, then the less opportunity exists for either special favours or, conversely, special discriminations and punishments. The strengthening of the Rule of Law, therefore, lowers the chance of an arbitrary allocation of public resources for typically non-optimal purposes.
6 See Chief Manny Jules, "First Nations and Taxation," in eds. Stephen B. Smart and Michael Coyle, *Aboriginal Issues Today: A Legal and Business Guide*, (Self-Counsel Press: Toronto, 1997), pp. 154-167.
7 North 1990a, p. 27.
8 Avinash Dixit (1996) *The Making of Economic Policy: A Transaction-Cost Politics Perspective*. Munich Lectures in Economics 37 (Cambridge, MA: MIT Press, 1996), p. 37.
9 Williamson, 1985, pp. xii-xiii.
10 Coase's view that transaction costs are the primary cause of market failure should not be interpreted as denying other factors could not be present such as collective action problems.
11 Under the B.C. Treaty process, bands were given loans to support negotiations under the requirement that they would be paid back out of the proceeds of the ultimate settlement.
12 "Secrecy, Communications and Politics: The B.C. Treaty Process in Review," *Native Issues Monthly*, September 1994, page 5.
13 Dixit, 1996, p. 37.