

NUNAVUT, GREENLAND AND THE POLITICS OF RESOURCE REVENUES

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A cynic's assessment of Ottawa's approach to sharing natural resource revenues with its three northern territories might go like this: Yukon got the least attractive deal, the Northwest Territories got a much better one — but Greenland got the best deal of all. Left on the sidelines, Nunavut has had to content itself with an advance look at the terms on offer, including the comparatively generous terms Greenland obtained from Denmark. Should Nunavut try to match Greenland's revenue-sharing deal for itself?

Avec un brin de cynisme, on pourrait qualifier comme suit l'approche d'Ottawa touchant le partage des revenus des ressources naturelles avec ses trois territoires du Nord : le Yukon est le parent pauvre de l'entente, les Territoires du Nord-Ouest s'en tirent beaucoup mieux, mais c'est le Groenland qui a raflé la mise. Particulièrement négligé, le Nunavut a dû se contenter d'un aperçu des modalités à l'étude, notamment les généreuses dispositions que le Groenland a soutirées au Danemark. Devrait-il s'en inspirer pour conclure son propre accord de partage des revenus ?

Two of the three northern territories now exercise, or will soon exercise, jurisdiction over their lands and natural resources — Yukon from 2001, and the Northwest Territories (NWT) probably from 2013, when it formalizes its 2010 devolution agreement-in-principle with Ottawa. This is profound political change for the North. Devolution means first and foremost that the territories' own elected legislators, not distant southern ministers, make decisions in the local interest over the use and development of lands and resources. Perhaps no less importantly, it also means a share of the substantial revenues those lands and resources may generate.

Unlike its peers, Nunavut has not yet even begun devolution negotiations, and it is keen not to be left behind. But as a territory and not a province, Nunavut enjoys only the status that Parliament sees fit to grant to it, and it cannot do much more than try to cajole Ottawa to the table. "The Yukon negotiations stretched out over seven years. In the NWT, it has taken nearly a decade. It is time for Nunavut to begin our formal negotiations," declared Premier Eva Aariak, the very day after the NWT announced it had reached its devolution agreement-in-principle. She might have rounded out her complaint by mentioning Greenland, Nunavut's Arctic neighbour and cultural cousin, which obtained jurisdiction over its own lands and resources from Denmark in 2009 — and which did better than Yukon and the NWT, at least on the revenue side of the bargain.

As a consequence of assuming self-government within the Danish Kingdom, Greenland obtained jurisdiction over not only its abundant onshore mineral deposits — gold, lead, zinc, iron, rare earths, rubies and so on — but also virgin offshore oil and gas fields that the US Geological Survey estimates contain a tremendous 40 to 50 billion barrels of oil equivalent, more than either Norway or the UK have yet produced from the North Sea after 40 years of drilling. Resource companies have taken note. Spending on mineral and petroleum exploration in Greenland has recently grown at a galloping rate, from nearly nothing in 2002 to about US\$600 million in 2010. With revenues from the future development of its natural resources now set to flow directly into its treasury, Greenland can reasonably hope to benefit handsomely in the coming decades.

Had Denmark not handed this potential stream of wealth to Greenland, it would have flowed directly into its own treasury, offsetting the large Danish grant that makes up over half of Greenland's annual budget. But despite the tough talk — Denmark's chief negotiator stated bluntly that "Greenland can't both earn a bundle on oil and keep its block grant" — Denmark agreed to reduce the grant by just half of Greenland's resource income, and subjected the first 75 million Danish krone (\$13 million) collected annually to no corresponding reduction at all. Leaving aside the cost of running a resource-management system, this arrangement

means that Greenland's total budget can grow limitlessly in proportion to resource revenues, yet it will never fall below the level of Greenland's regular, inflation-indexed grant.

The NWT did not get such favourable terms from Ottawa when it concluded its devolution agreement-in-principle 18 months later. Not only did Ottawa push off any question of sharing revenues from

NWT, and effectively fixing a standard for resource-revenue sharing with the territories. Even if Nunavut did plan to try to match Greenland's 50-50 split with Denmark, it might wonder how much negotiating room really remains.

Nunavut's poverty in the midst of plenty explains why it is determined to get a good fiscal deal from Ottawa. Despite fairly bursting with all the

ta than any province. This disparity only naturally reflects Nunavut's hugely inadequate tax base, but high-profile spending overruns such as the 2010 Nunavut Housing Corporation scandal inevitably suggest to southern Canadians that Nunavut mismanages federal dollars and is a drain on Confederation. A fiscally fair devolution deal could do much to blunt this criticism for Nunavut and Ottawa alike.

Nunavut also has special motivation for the best possible fiscal deal from devolution. The 1993 Nunavut Land Claims Agreement made the Inuit of Nunavut, through Nunavut Tunngavik

Incorporated (NTI), private owners of nearly 18 percent of the territory's land surface and 2 percent of its subsurface, including a number of its most commercially prospective mineral deposits. Revenues from Inuit-owned lands accrue to NTI, not Nunavut. NTI also has a right to 50 percent of the first \$2 million of any resource revenues collected from public lands, plus 5 percent of any additional resource revenues. NTI considers this considerable share of the territory's natural wealth as Inuit patrimonial property — and explicitly not for funding public services. Instead, NTI has called on Ottawa to allow Nunavut to keep all resource revenues generated in the territory — a deal that would not only outdo Yukon's and the NWT's, but also Greenland's.

Whatever purely fiscal advantages Greenland's deal offers, Nunavut would still do well to consider the political context carefully before advocating it at the table with Ottawa. Devolution is not the same as decolonization, and bargaining over resource revenues is both a political and a fiscal game. Following four years of political preparatory work by a joint commission on Greenlandic self-government, Denmark and Greenland together explicitly took the long view toward

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the NWT's own considerable offshore oil and gas fields, it also capped the revenues the NWT could freely collect from its onshore resources. So long as the NWT's resource income does not exceed 10 percent of the territory's "gross expenditure base (GEB)" — a hypothetical figure that serves as a proxy for the NWT's annual spending needs — Ottawa will reduce the NWT's territorial formula financing (TFF) grant Greenland-style, by only half the value of that income. Above that limit, Ottawa will reduce the TFF grant dollar-for-dollar. This cap effectively limits the NWT's fiscal upside to 5 percent of its GEB, worth about \$61 million today, or about \$65 million taking account of Ottawa's separate \$65-million boost to the GEB to cover the cost of running a resource-management system in the NWT.

Yet when it was agreed, the NWT's deal significantly improved on Yukon's, which was fixed at a hard cap of \$3 million of mineral revenues added to the 20 to 40 percent of minor onshore oil and gas revenues Yukon had already obtained some time before. Not long after the NWT announced its deal, Yukon publicly called on Ottawa to renegotiate. Ottawa agreed six months later, offering Yukon the same treatment as the

treasures it is possible to dig from the earth — gold, silver, copper, zinc, iron, uranium, diamonds, oil, gas and more — Nunavut depends on federal grants for nearly its entire annual budget. "If Nunavut can gain control of its own resources, especially minerals, oil and gas, over time it will become less dependent on southern Canada," Premier Aariak has written. A question-and-answer sheet on devolution available from her office sounds an even more optimistic note: "Enabling Nunavut to share the revenue from its own resources will reduce the burden on southern taxpayers and eventually enable Nunavut to be a net contributor to Canada's wealth."

The idea that Nunavut could one day put more into Confederation than it takes out is not a flight of fancy. Nunavut's entire 2011-12 TFF grant of about \$1.2 billion is less than half of the resource income that Newfoundland and Labrador, the newest net-contributing or "have" province, is projected to collect the same year. Nunavut has similar and perhaps even greater fiscal potential — especially if it can keep offshore oil and gas revenues, like Newfoundland does through the Atlantic Accord. Nunavut's fiscal dependency has often caused complaint, as it receives far more in federal transfers per capi-

Greenland's potential emergence as an independent, postcolonial state, with full sovereign rights over its own lands, resources and the revenues that flow from them. Nunavut, like Yukon and the NWT before it, will conduct its devolution negotiations in the very different political context of the territory's evolution as a subsidiary government within Confederation.

Consider again the implications of Greenland's deal. If in any year total resource income amounts to twice the value of Greenland's annual grant, Denmark will not provide the grant that year. In effect, assuming a generally steady increase in Greenland's resource income, the deal provides Denmark a way partly to finance a withdrawal from underwriting Greenland's budget, however long that may take in reality. With some good fortune, Greenland's own fiscal capacity could grow to replace Denmark's grant as the two nations gently go their separate ways. The 50-50 revenue split with Denmark is the price Greenland pays for the protection of the grant until it can be phased out.

By contrast, Nunavut and Ottawa see devolution as a step toward Nunavut's political maturity within Canada. At the same time, they agree that devolution should result in a net fiscal benefit for the territory, to help it along the way. For its part, Nunavut tends to interpret devolution to mean greater self-reliance within Canada — a somewhat hazy notion, but one that Premier Aariak connects to the traditional Inuit value of *namminiq makitajumarniq*, providing for one's self and one's community through prudent stewardship and use of the land and its resources. In contemporary terms, self-reliance involves growing out of Nunavut's current position of utter dependence on federal grants through the development of Nunavut's own natural wealth. Yet self-reliance is at least as much a political as a fiscal

notion, since Nunavut should not prefer a simple payoff from resource development in its territory without jurisdiction over its pace and scope. Even if it did, Nunavut is not likely to convince Ottawa to agree to devolution as a sort of preemptive raid on the national resource endowment whenever Nunavut needs to pay for new infrastructure or another social program.

If self-reliance is truly Nunavut's aim in negotiating devolution, then it seems sensible for Nunavut to align conceptually the fiscal self-reliance it will gain from a share of resource revenues with the political self-reliance it will gain from more province-like power over resource development. It

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would also strengthen Nunavut's negotiating hand to propose specific revenue-sharing terms that neatly align these political and fiscal contexts, creating a coherent devolution package whose parts mutually support each other and which Ottawa could less easily divide and bargain down separately. Greenland's self-government agreement with Denmark has this coherent and self-supporting quality, matching eventual political independence with an enhanced and at least theoretically sufficient own-source fiscal capacity. That is the true lesson that Nunavut should take away from Greenland's deal — not just the appealing fiscal math.

However coherent a devolution package Nunavut were to propose, once actually at the table it will find itself navigating the inevitable trade-offs between the best possible revenue-sharing formula from a purely fiscal perspective, and other politically desirable aspects of devolution, such as jurisdiction over offshore oil and gas. All the same, devolution entails by definition that Nunavut becomes more like a province politically, so examining what it would mean for Nunavut to become more like a province fiscally suggests a way to put the lesson of Greenland's revenue-sharing deal to good use.

Unlike territories, which receive the TFF grant, provinces participate in the Equalization Program, through which Ottawa provides unconditional fiscal transfers to less prosperous provinces whose "fiscal capacities" to raise own-source revenues fall below the national average for all 10 provinces. On the current Equalization formula, resource revenues are excluded from measuring the individual provincial and 10-province standard fiscal capacities either fully or at a 50-percent discount — whichever results in the greater transfer. This either-or clause reflects a somewhat unsatisfactory compromise between the resource-rich "have" provinces, which prefer that none of their lucky natural windfalls be redistributed through Equalization, and the "have-not" provinces, which prefer that resource-rich provinces share some of their lucky natural windfalls. The current government's 2006 pre-election promise entirely to exclude resource revenues from Equalization accounts for the bias toward the resource-rich provinces, but Ottawa did at least impose a rule ensuring that no province can collect both resource revenues and Equalization transfers if its fiscal capacity would exceed that of the weakest "have" province.

The example of Equalization raises two important considerations for Nunavut. First, a revenue-sharing deal with Ottawa need not — and possibly ought not — involve Nunavut's TFF grant diminishing like the NWT's does as a simple mathematical function of Nunavut's income, irrespective of Nunavut's revenue-raising capacity rel-

ries could make on resource revenues, especially from oil and gas, would improve their creditworthiness.

Considering provincial Equalization and borrowing powers together, a politically and fiscally coherent resource-revenue sharing formula for Nunavut might begin to take shape along the following lines:

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ative to the other provinces and territories. Relative fiscal standing in Confederation can and does matter in determining the extent of federal support. Second, there is precedent, however controversial, for protecting the level of Nunavut's TFF grant from diminishing at all as resource revenues increase — or at least by no more than half their value. Were it a province, Nunavut would certainly fall into the “have-not” category, suggesting that its TFF grant might arguably be ring-fenced from its resource income.

Territories also differ from provinces in that they cannot legally borrow without restriction. Ottawa caps Nunavut's debt at \$400 million, while a province can borrow as much as the market and its voting public will bear. No market exists for Nunavut debt, so it is unclear what sort of interest rates the territory could obtain. However, Moody's assigns the credit rating of Aa1 to the NWT, on par with Manitoba, Ontario and Saskatchewan. In its analysis, Moody's approvingly notes the NWT's prudent fiscal framework — including its limited debt load, set at a maximum of \$800 million by federal law — high employment and high GDP per capita. But with about 80 percent of the NWT's revenues attributable to its TFF grant, there may also lurk an assumption that Ottawa would not permit the territory to go bust. However that may be, it seems clear that any claim the territo-

- Nunavut collects all revenues generated from its natural resources;
- Ottawa correspondingly reduces Nunavut's TFF grant by:
 - No more than half of Nunavut's resource income, if Nunavut's revenue capacity as measured under TFF plus resource revenues do not together exceed the 10 province standard fiscal capacity; or
 - No more than half of Nunavut's resource income, as well as the difference by which Nunavut's revenue capacity as measured under TFF plus resource revenues together exceed the 10 province standard fiscal capacity;
- Ottawa gradually raises Nunavut's debt limit according to some schedule relating it to Nunavut's additional resource income and creditworthiness; and
- Nunavut and Ottawa commit to renegotiate this fiscal arrangement once Nunavut's TFF grant touches zero.

The second, bifurcating clause does the work. Essentially, it situates this deal midway between Greenland's and the NWT's. In less compact terms, it states that so long as Nunavut's revenue capacity — including no more than half of resource revenues as per Equalization — puts it in the company of the

“have-not” provinces, Nunavut's TFF grant declines Greenland-style by no more than half of its resource income. Once Nunavut becomes like a “have” province in the sense that its revenue capacity exceeds the 10 province standard, its TFF grant will also decline NWT-style by that excess amount.

It is possible to estimate roughly what this deal would mean for Nunavut in dollar terms. For fiscal year 2011-12, Ottawa calculated Nunavut's revenue capacity under TFF rules at \$123 million, net of a 30-percent incentive designed to give territories room to increase their own-source revenues without automatically shrinking their TFF grants by a similar amount. This incentive applies whether or not a territory collects resource income — the rationale for it is the same that drives the general agreement that territories should obtain some net fiscal benefit from devolution.

Given Nunavut's current population, its revenue capacity amounts to about \$3,675 per capita, just under half the 10-province standard of \$7,436 per capita for 2011-12. Using the Equalization rule that resource revenues count toward Nunavut's revenue capacity only at a 50-percent discount — in other words, that TFF declines by only half of resource income — the difference of \$3,761 per person would allow the territory to take in about \$123 million in resource revenues, or double what Nunavut could expect under the NWT's deal. Above that amount, Ottawa would claw back the full value of every additional dollar from the TFF grant. Interestingly, the NWT and Yukon also do substantially better on the above deal than they do on their own — the fiscal upside for the NWT would be about \$92 million, and for Yukon about \$139 million, before every additional dollar of resource income results in an equivalent clawback from their TFF grants.

Now, the deal above is only a sketch. It would require much more work, possibly at the negotiating table itself, to flesh out a number of key details:

- Should the deal incorporate the advantage that resource-dependent provinces enjoy under the present Equalization rules, as well as under separate deals such as the Atlantic Accord? If so, then:
 - One option would be to reduce TFF by less than half of Nunavut's resource income, or even none. If none, Nunavut's resource income could grow to \$246 million before full clawback from TFF. Reducing TFF by less than half of resource income would also reflect the expenses Nunavut would incur to attract development — for example, in addressing the territory's massive infrastructure deficit.
 - A more flexible option would be to reduce TFF on a graduated scale that increases with Nunavut's resource income. The scale could begin at zero and reach 100 percent when the TFF falls to zero.
 - A third and somewhat different option would be to set the trigger for full clawback from TFF higher than the 10 province standard — say, at some annual calculation of Nunavut's per-capita expenditure need, reflecting the heavy expenditure burden Nunavut would face even at the 10 province standard.
- Could Ottawa make room to offer a greater share of resource revenues — and cover some of the costs of its own civil and military activities in Nunavut — by reducing or disallowing royalty offsets against federal corporate income tax on profits

from Nunavut-based resource development?

- Should Nunavut's revenue-capacity measurement be adjusted by some northern or Nunavut-based price index?
- On what schedule should Nunavut's debt limit increase, and should the limit respond to credit ratings?
- Should the Equalization rules prevailing at the time of agreement apply, or should the rules current in any given year apply?

However Nunavut and Ottawa agree to answer these questions, so long as the sketch above forms the core of any resource-revenue sharing deal, Nunavut will find itself with a fiscally advantageous devolution agreement that matches the political objectives on which both parties can potentially agree: the evolution of Nunavut into a self-reliant, fiscally responsible, socio-economically better-developed and more province-like member of Confederation.

It is worth asking at this point what value such a conceptually tidy arrangement would have in practice.

From the territories' point of view, negotiating the devolution of lands and resources should be all about playing the long game. It is not just that their potential resource endowments are extraordinarily large and as yet only partially known. Yukon took over two decades, and the NWT over three, to graduate from basic responsible government to devolved jurisdiction over their onshore resources. It may take just as long or longer for them to take the next major step in their political evolution, such as to obtain jurisdiction over offshore oil and gas.

The NWT's deal may not be packaged as neatly, but any fair evaluation of its worth must surely turn at least partly on how well it secures a reasonable share of the NWT's actual medium-term resource-revenue potential. On these criteria, the deal appears fairly sound. According to estimates by the NWT Department of Finance, the NWT would have collected about \$209 million in resource income in

the five years prior to its agreement-in-principle — well under its full potential over the same period of closer to \$300 million — and would have hit its revenue cap just twice in the 10 years prior. Why should aligning the fiscal and political contexts of devolution matter if sufficient fiscal upside were on the table?

A second look at the NWT's deal illustrates why it should. Provincial Equalization was a model for sharing resource revenues between the NWT and Ottawa, and both parties agreed that any future renegotiated formula should continue to correspond with Equalization Program treatment of resource revenues. The NWT Minister of Finance, Michael Miltenberger, confidentially reported to the NWT Legislative Assembly:

The arrangements contemplated in the AiP [the devolution agreement-in-principle] are completely consistent with what the Provinces would receive under the Federal-Provincial Equalization program. Under Equalization, 50 per cent of a Province's resource revenues are excluded from the equalization

calculation, and the net fiscal benefit is subject to a cap.

Therefore, no Province receiving Equalization receives better treatment for their resources than is contemplated in the draft Devolution AiP.

But Miltenberger was overstating his case somewhat. As we have seen, provinces can exclude all resource revenues from the Equalization calcula-

tion if it provides them with a greater federal transfer. And the cap to which their total benefit is subject is the fiscal capacity of the weakest “have” province — that is, a cap relative to one of their peers. The NWT’s cap is set at a round 10 percent of its GEB — a mere fraction of a hypothetical and somewhat historically arbitrary proxy for the NWT’s expenditure needs. This distinction suggests that one of Ottawa’s primary political impulses at the negotiating table was to limit the potential future cost of devolution to the federal treasury, rather than to help propel the NWT along the track of its political evolution within Confederation. Ottawa’s practice of dealing with fiscal matters at a separate table once political matters have been settled only strengthens that impression. The overall result was an agreement that appears to have aligned Ottawa’s presumable political and fiscal objectives first and foremost, not the NWT’s.

From the territories’ point of view, negotiating the devolution of lands and resources should be all about playing the long game. It is not just that their potential resource endowments are extraordinarily large and as yet only partially known. Yukon took over two decades, and the NWT over three, to graduate from basic responsible government to devolved jurisdiction over their onshore resources. It may take just as long or longer for them to take the next major step in their political evolution, such as to obtain jurisdiction over offshore oil and gas. Even a minor increase in each territory’s revenue cap, prompted perhaps by future resource development promising cumulative revenues greater than the current deals allow, could take years of haggling with Ottawa to achieve.

The realities of the negotiating process, the agenda Ottawa brings to the table and the precedent set by

the NWT and Yukon devolution deals will doubtlessly combine to fence in the fiscal and political outcomes Nunavut can feasibly achieve through devolution. However, despite these challenges, devolution negotiations are more likely to succeed if both parties share a sense of purpose. Resting on years of groundwork by a joint commission on self-government, Greenland’s fiscally advantageous resource-revenue sharing deal seems to reflect real political understanding with Denmark. Nunavut and Ottawa should try to find their own common ground.

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