

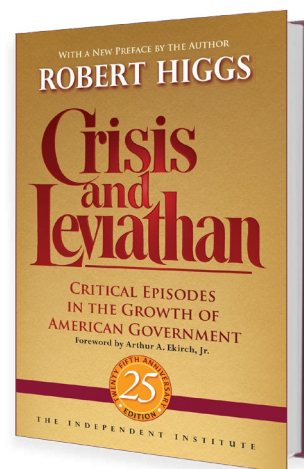
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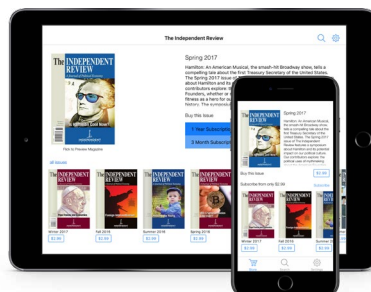
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# Institutions and Economic Development on Native American Lands

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JORDAN K. LOFTHOUSE

**N**ative American lands are often rich in natural and cultural resources. Paradoxically, these lands are often the poorest parts of the United States. Native Americans own private businesses at a much lower rate per capita compared to other Americans, and the businesses they own produce less income on average than the businesses owned by all other racial groups (Miller 2001). As of 2010, 28.4 percent of American Indians and Alaska Natives were below the official poverty line, compared to 15.3 percent for the nation as a whole. Roughly 22 percent of Native Americans live on federally recognized reservations or other specially designated areas (U.S. Bureau of the Census 2011).

Previous economic scholarship has demonstrated an institutional basis for Native American poverty. Poverty is blamed largely on formal governance structures, especially inefficient property-rights regimes and excessive bureaucratic governance (McChesney 1990; Cornell and Kalt 1995; Anderson and Parker 2008, 2009; Akee and Jorgensen 2014; Regan and Anderson 2014; Russ and Stratmann 2014). Although previous scholarship has emphasized the role of formal institutions, market-process theory as it relates to Native American economies has been neglected in this literature.

This paper attempts to fill the gap by bringing market-process theory and entrepreneurship into the broader discussion of the institutional effects on Native

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American economic development. Institutions, as the formal and informal rules by which people interact, are critical to economic development anywhere in the world. Institutions are fundamental to economic development because certain institutions tend to facilitate mutually beneficial exchange, entrepreneurship, and innovation. Other institutions, however, may impede economic relations between people, or they may direct people to act in socially wasteful manners (Baumol 1990; North 1990; Murphy, Shleifer, and Vishny 1991, 1993; Acemoglu, Johnson, and Robinson 2001, 2002, 2005; Acemoglu and Johnson 2005; Boettke, Coyne, and Leeson 2008; Sobel 2008; Acemoglu and Robinson 2012).

The entrepreneurial market process is inextricably linked with the institutions that shape the private and public spheres. Within the market-process framework, people in the market react to their constantly changing circumstances. In this state of flux, they can become entrepreneurs and innovators by using their unique, subjective, and tacit knowledge to find new ways of fulfilling human desires (Hayek 1945, 1978, 1988; Mises 1949, [1936] 1981; Kirzner 1973). Institutions can sometimes create barriers or raise costs to participating in the market process. Economic growth and development are the direct result of the competitive entrepreneurial market process, and the quality of institutions that govern social action is the ultimate determinant of individuals' willingness to engage in entrepreneurial activity.

This paper explicitly adds market-process theory to the existing literature related to institutions and entrepreneurship on Native American reservations. This addition is important because it gives greater insight into the intimate connections between institutions, entrepreneurship, and economic growth. Institutional contexts lead entrepreneurs to direct their attention in either wealth-creating or wealth-destroying ways. When institutions guide individuals to be alert to arbitrage opportunities that are privately and socially beneficial, they can engage in productive entrepreneurship, which subsequently determines how economic growth and development will unfold in a dynamic world (Holcombe 1998; Boettke and Coyne 2003, 2009). Without an explicit acknowledgment of market-process theory, the institutional explanation for Native American economic development lacks the holistic view it deserves.

Institutions impede entrepreneurship, the market process, and economic development on Native American reservations through three overarching channels: (1) the federal land trust, (2) a dual federal-tribal bureaucracy, and (3) legal and political uncertainty. Those channels generally raise barriers to mutually beneficial exchange, entrepreneurship, and innovation. In particular, they generally increase transaction costs, rent seeking, and bureaucratic delay, which impede many Native Americans from engaging in private enterprise. This paper uses comparative institutional analysis and case studies to illustrate how the federal land trust, the dual bureaucracy, and institutional uncertainty create barriers and high transaction costs to private enterprise and other forms of entrepreneurship on Native American lands. It pulls examples from a number of different reservations and acknowledges the institutional differences across reservations. It takes a very broad view of the formal

institutions that are common to most federally recognized tribes, even though reservations across the United States have great diversity regarding institutions and levels of wealth. The federal land trust, dual federal–tribal bureaucracies, and legal/political uncertainty are common to many tribes regardless of other differences in institutional structures that are unique to each tribe.

First, the federal trust system allows the federal government to hold the title for parcels of land owned by a tribal government or for individual Native Americans. Due to this system, private-property rights are often ill defined and convoluted. When private-property ownership is not well defined and enforced, Native Americans face higher costs of engaging in the entrepreneurial market process.

Second, due to the long history of federal–Native relations, a dual bureaucracy of federal and tribal officials now has broad discretion to oversee and regulate economic enterprises. Federal officials in many agencies and tribal officials have the power to oversee how land is used, which types of businesses are allowed, who will receive money, how business will be regulated, and so on. Relatively large amounts of bureaucratic red tape increase the costs of engaging in market enterprises, entrepreneurship, and innovation on Native American lands.

Third, legal and political uncertainty and complexity caused by formal institutions have been two of the greatest barriers to economic development. Uncertainty regarding taxation schemes, judicial jurisdiction, incorporation codes, and access to the capital market creates potential barriers to potential Native entrepreneurs as well as to off-reservation entrepreneurs who wish to enter reservation markets.

Understanding the history of Native American policy is critical to understanding how institutions have affected entrepreneurship and economic growth; however, this paper cannot adequately explain the nuances that are necessary for a full historical perspective. I have attempted to include the historical context that is necessary to understand a few key institutions as they affect entrepreneurship and economic growth in Indian Country.

In the first section, I present a theoretical framework for how institutions affect entrepreneurship and the market process, which subsequently has an impact on economic development. In the second section, I discuss specifically how the three channels described earlier hamper the market process and impede economic development on Native American lands. I conclude with the implications of this research.

## **Institutions Affect Entrepreneurship and the Market Process**

Institutions influence what activities people may engage in and whether those activities will be wealth creating or wealth destroying. Institutions are the formal and informal rules that determine economic, political, and social outcomes. Economic development occurs only in contexts where institutions have the characteristics necessary to facilitate such development (North 1990; Acemoglu, Johnson, and Robinson 2001, 2002, 2005; Acemoglu and Johnson 2005; Acemoglu and Robinson 2012).

Some institutional arrangements guide entrepreneurs toward productive market activity, while other institutions guide entrepreneurs to unproductive activities such as rent seeking. Institutions that help entrepreneurs focus on productive market activities are more likely to generate higher rates of economic growth (Baumol 1990; Murphy, Shleifer, and Vishny 1991, 1993). With institutions that decrease the profitability of unproductive entrepreneurship, entrepreneurs are more likely to be productive by creating new wealth and enhancing society's overall well-being (Sobel 2008). For formal institutions to be successful, they must comport with the informal institutions; otherwise, it is likely that the formal institutions will be useless at best or harmful at worst (North 1990, 2005; Boettke, Coyne, and Leeson 2008).

The importance of institutions is made more explicit with an understanding of the market process. The market process is a spontaneous order of mutually beneficial exchange that is embedded within an institutional environment (Hayek 1978, 1988; Kirzner 1985, 2002). One of the major prerequisites for a well-functioning market is the institution of private-property rights. Markets cannot work effectively if property rights are not clearly defined and protected, which requires some basic standard of the rule of law (Mises 1927). If an economic system is based in private-property ownership, the rationally self-interested owners function as speculators who work toward the highest return on their capital as possible (Mises [1936] 1981). Property-rights regimes and formal governance structures are constituent parts to a larger, more comprehensive approach to Native American economic development.

A key component of the market process is the entrepreneur, who is alert to profit opportunities. As entrepreneurs look for and exploit opportunities to fulfill human wants more efficiently, they allow people to cope reasonably well with changing conditions through a process of discovery and coordination (Mises 1949; Kirzner 1973). Entrepreneurs exist in political or market settings, so institutions shape the type of entrepreneurship that will emerge and whether it will be productive or redistributive (Baumol 1990; Boettke and Coyne 2003; Sobel 2008).

One of the most important functions of markets is to coordinate a diverse set of plans. This coordination takes place because markets and market prices disseminate subjective and dispersed knowledge so that market errors and allocative inefficiencies tend to be resolved. Formal institutions that allow for large amounts of government intervention in markets can cause discoordination and spur negative unintended consequences (Kirzner 1985). Therefore, markets cannot coordinate people's actions as efficiently when government interventions distort those markets. Unintended consequences from government policies may then prompt calls for more government interventions. These next interventions may lead to further problems. As governments become increasingly involved in resource allocation, those interventions further distort market signals that emerge from market exchange and cause a misallocation of resources, which are diverted from their more highly valued uses (Ikeda 1997).

The role of institutions and the entrepreneurial market process are inextricably linked. Entrepreneurs can find and exploit profit opportunities under a wide range of institutions. People can also engage in mutually beneficial exchange under many types of institutions. However, some institutions are better than others at facilitating mutually beneficial exchange and directing entrepreneurial attention in socially productive rather than socially destructive ways. Institutional frameworks that facilitate the rule of law and secure property rights enhance economic development, while also expanding people's ability to lead the sort of lives that they value (Boettke and Subrick 2003). Economic development is therefore rooted in institutions that allow the market process and entrepreneurs to satisfy human desires more fully.

Institutions are fundamental for entrepreneurial action because only certain institutional environments incentivize entrepreneurs to discover new resources, substitutes for existing resources, or trading partners to obtain resources. In addition, only certain institutional contexts incentivize entrepreneurs to discover new technological approaches to problems. Therefore, a society's economic development or economic stagnation is rooted in individuals' ability (1) to bet on ideas and (2) to find ways to finance those bets. The quality of institutions that govern social action is the ultimate determinant of individuals' willingness to engage in entrepreneurial activity (Boettke and Coyne 2009). An environment that facilitates entrepreneurial activity is a by-product of institutions, not a cause (Boettke and Coyne 2003). Thus, economic growth and development are the direct result of the competitive entrepreneurial market process (Holcombe 1998).

Therefore, institutions that facilitate productive entrepreneurship are those that clearly define property rights, secure property rights, provide the rule of law, encourage positive-sum activities, and discourage zero-sum or negative-sum activities. Institutions that obstruct the entrepreneurial market process are those that convolute property rights, distort market prices, create credible commitment problems, and allow political actors to arbitrarily interfere in economic affairs. The following section highlights three departures from the institutions that facilitate productive entrepreneurship in the market process.

## **Institutions That Inhibit Economic Development on Native American Lands**

### *The Federal Trust System and Property Rights*

One of the most important ways that the federal government and tribal governments interact is through the federal trust system. The modern federal trust responsibility is a fiduciary obligation to protect tribal lands and resources as well as an obligation to enforce federal laws on Indian lands (U.S. Bureau of Indian Affairs [BIA] n.d.). The trust is meant to protect Indian trust resources, enhance tribal self-government, and raise standards of living through social and economic programs. All federal agencies

have the responsibility to honor the trust (Allen 1989). The federal government holds approximately 56.2 million acres (about 88,000 square miles) in trust for Native Americans (U.S. Bureau of the Census 2011). Despite the federal trust, many reservations remain pockets of poverty within the world's wealthiest country.

The market process relies on the institution of private property to function, but on Native American reservations private-property rights are often complex and convoluted due to the federal land trust. This complexity raises the costs of participating in the market process and engaging in entrepreneurial activity on reservations. The federal land trust also inflates the power of tribal and federal bureaucracies to intervene in the market process, which increases the transaction costs of entrepreneurial activity. The current institutional structures of property rights and bureaucratic governance have deprived Native Americans of the fundamental prerequisites for a market society, thus limiting their economic development.

The modern federal trust emerged through two centuries of federal policies.<sup>1</sup> Although the history is nuanced, this paper focuses on the two major policies that have shaped the federal trust system: the Dawes Act of 1887 and the Indian Reorganization Act of 1934 (also known as the Wheeler-Howard Act or the "Indian New Deal").

In 1887, Congress passed the Dawes Act, also known as the General Allotment Act, to limit tribal sovereignty and to force assimilation. The Dawes Act allowed the federal government to allot parcels of reservation land to individual Native Americans. Federal officials expected Native Americans to adopt Euro-American agricultural practices on their allotted land.<sup>2</sup> Land that federal officials deemed as "surplus" was sold to white Americans for settlement (McChesney 1990; Thompson 1997; Anderson and Parker 2009; Lehman 2010; Akee, Jorgensen, and Sunde 2015).

Allotment through the Dawes Act did little, however, to improve the immediate welfare of Native Americans (Hacker and Haines 2005). The process of allotment often left Native Americans with the least-productive lands (Anderson and Lueck 1992; Miller 2001; Newton 2005). In addition, allotment and the federal trust system destroyed the informal land rights that Native Americans had had for generations. The federal government's attempt to impose alternative institutions with different values, morals, and rules caused Native Americans to suffer economically for generations (Carlson 1981; McChesney 1990; Roback 1992; Anderson and Parker 2009).

In 1934, Congress passed the Indian Reorganization Act (IRA), which ended allotment. The combination of the Dawes Act and the IRA became the foundation for the modern trust system. The IRA changed the previous decades of federal Native American policy in at least three significant ways. First, it allowed Native Americans who

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1. Before colonization, many Native Americans lived under systems of private property and mutually beneficial exchange. Historically, many American Indian tribes recognized various forms of permanent or semipermanent private rights in land (Miller 2001).

2. The Dawes Act stipulated that the federal government would hold allotted land in trust for twenty-five years. The federal government would retain the legal title until individual Native Americans proved that they were "competent" to manage their own land (McChesney 1990).

held full legal title to their land to retain the title. Second, it ended allotment and allowed the federal government to hold land in trust indefinitely. Because the federal government could hold land in trust indefinitely, there are still repercussions over private-property rights today. For example, Native Americans are subject to trust constraints over alienation, leasing, and encumbrance if their land was still in trust when Congress passed the IRA. Third, the act restored some tribal properties that were within the original reservations (McChesney 1990; Anderson and Lueck 1992; Mika 1995). It is important to note that not all reservations were allotted, and some reservations, especially in Oklahoma, were treated by special legislation.

The federal government's various policies have caused four distinct categories of property rights with respect to Native American lands: (1) tribal trust lands, (2) allotted trust lands, (3) restricted fee lands, and (4) fee-simple lands. First, on tribal trust lands the federal government holds the legal title, but tribal governments manage, allocate, and regulate the land. Tribal governments may allow individuals or corporations to use tribal trust land, subject to the oversight of federal and tribal officials. Tribes cannot sell any tribal trust lands without explicit federal permission. Tribal trust lands comprise about 45 million acres (Miller 2001).

Second, allotted trust lands are owned by individuals, but the federal government holds the title of the land in trust for these individual Native Americans and their heirs. Allotted trust lands comprise about 10 million acres (Miller 2001). On allotted trust lands, a phenomenon called "fractionation" has emerged, affecting approximately one-quarter of Native American land. When the federal government ended allotment under the IRA, it held the land in trust for the original allottees *and their descendants*. After several generations, hundreds or thousands of people may co-own the same parcel of land. Fractionation is especially complex because these co-owners own a percentage share of that land, not any distinct area of it.

Third, some Native American lands are classified as having a restricted status, also known as restricted fee. Restricted-fee lands are owned by tribes or by individuals. Tribes or individual Native Americans hold the title to a parcel of land, but the secretary of the interior must approve any alienating or encumbering of that land.<sup>3</sup>

Fourth, fee-simple lands, also known as fee-patent lands, are owned outright by individual Native Americans and are not held in trust. Land in fee can be used as collateral for a loan, whereas trust land usually cannot be used for collateral. Land-owners can sell their fee land without U.S. Bureau of Indian Affairs (BIA) approval. Fee land corresponds to the normal conception of private-property rights for most Americans. The amount of fee-simple land on each reservation can vary and depends on each reservation's unique history of allotment. Of all land under the BIA, approximately 75 percent are in tribal trust, 20 percent are in individual trust, and 5 percent are fee simple (Anderson and Parker 2011). Between 1 and 2 percent of land on the Navajo

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3. Some attempts to reform this regime have been attempted, but none has succeeded. See the American Indian Empowerment Act of 2011.



Reservation (the nation's largest reservation) is fee-simple land, which is scattered throughout the reservation (Listokin 2001). The Yakima Indian Reservation in Washington is 20 percent fee-simple land because of allotment.<sup>4</sup>

The federal trust system is a key institution that affects the way that private-property rights are defined and enforced. Many reservations have defined and enforced property-rights regimes, but only a small fraction of each reservation is individualized private property. The complexity of property rights on Native American lands poses institutional barriers and transaction costs to entrepreneurial action. The sovereign status of tribes is still evolving, leading to uncertainty over the nature of their control over land and other natural resources. Private enterprise and economic development are being stifled in the absence of simple private-property rights (Anderson, Benson, and Flanagan 2006). The institution of the federal trust and its accompanying bureaucratic costs and complexity have contributed to the rampant poverty on Indian lands in spite of the abundance of natural resources and federal welfare payments.

Each reservation across the United States has a unique composition of the four categories of land ownership listed earlier. For example, some reservations consist mostly of tribal trust land, whereas others are largely allotted trust land. Some reservations contain very little trust land, and others have roughly equal parts of each type of land. Despite the heterogeneity across Indian Country, tribal trust lands, allotted trust lands, and restricted-fee lands, wherever they may exist, raise the transaction costs of using property and engaging in entrepreneurial activity because of additional government involvement.

Trust lands raise the transaction costs of using private property and engaging in entrepreneurial activity in at least specific two ways. First, the nonalienation aspect of the land trust means that off-reservation lending institutions cannot use land as collateral on loans, which is one of the most common means of collateral in the United States. Because the United States holds the legal title to Indian trust land, Native Americans on trust lands must gain the federal government's permission to use their allotments as collateral to mortgage, lease, or develop the land (Miller 2001). Thus, the additional transaction costs pose barriers to potential entrepreneurial activity.

Recently, however, various tribes have been successful at circumventing the collateral problem, leading to on-reserve lending by off-reserve lending institutions. For example, some tribal governments have begun using leasehold mortgages and long-term lease income as collateral on loans.<sup>5</sup> At a macrolevel scale, there are still problems with the current situation of collateral, but on a more microlevel some tribes are having considerable success at addressing those problems that have been a barrier for decades.

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4. *County of Yakima v. Confederated Tribes and Bands of Yakima Indian Nation* (502 U.S. 251 [1992]).

5. See *Oglala Sioux Tribal Leasehold Mortgage Code*, Oglala Sioux Tribe Ordinance 93-16, amended by Ordinance 95-01, Law and Order Code, chap. 46 (last amended 1996; new ordinances received 2002); *Mortgages on Trust Lands*, Lac du Flambeau Band of Lake Superior Chippewa, Indians Tribal Code, chap. 84 (1997); Listokin et al. 2017.

The federal government has also implemented several initiatives to increase mortgage lending on trust lands, such as the Section 184 Indian Home Loan Guarantee Program, the Section 502 Direct Loan Program, and the Native American Veteran Direct Loan Program. The Indian Home Loan Guarantee Program is the most used program to support tribal trust mortgage lending (Listokin et al. 2017). More than twenty-six thousand loans have been guaranteed under this program since it began in 1995. However, the U.S. Department of Housing and Urban Development's Office of Inspector General (2015) found that there has not been adequate oversight of the Section 184 program, which has increased overall risk to the program.

Second, the land trust inhibits a robust real-estate market from emerging, which implies that there is no efficient mechanism for allocating land use. Without the private ownership of land, it is impossible for a true market economy to emerge, and, thus, economic development is necessarily hindered as long as such an institution remains. Because of the combination of the federal land trust and a bureaucratic allocation mechanism, a true housing market cannot emerge, and other related industries are limited, such as the construction industry. In this case, the first-best solution would be to create a true market for reservation land, but as long as the nonalienation rule exists, the allocation of land resources will continue to be inefficient (Rosser 2005). On allotted trust land, fractionation has become a significant barrier to entrepreneurial activity. Because land is co-owned by many people, fractionation raises the transaction costs of using allotted trust land, especially leasing the land for any kind of economic development. Prior to the 1990s, leasing allotted trust land that was fractionated required the co-owners' unanimous consent. Unanimous consent, even for relatively small groups, has high transaction costs because of the tragedy of the anticommons (Heller 1998). Congress passed the American Indian Agricultural Resource Management Act of 1993, the Indian Land Consolidation Act of 2000, and the American Indian Probate Reform Act of 2004 to reduce the high transaction costs of leasing allotted trust land that suffers from fractionation. Despite those marginal improvements, bureaucratic oversight of allotted trust land maintains relatively high transaction costs (Russ and Stratmann 2014).

Some contemporary comparative literature challenges the assumption that well-defined and well-protected private-property rights are a prerequisite for economic growth in Native communities. The economists Fernando Aragon and Anke Kessler (2018) find that stronger forms of private-property rights related to lawful possession, designated land, and permits have no significant impact on household income or employment outcomes for Indigenous Canadians. However, Aragon (2015) has also found that modern Canadian treaties that clarify ownership of land and natural resources have increased real income and real wages. Krishna Pendakur and Ravi Pendakur (2018) find that some legislative reforms regarding property rights and financial authority led to income gains for Indigenous Canadians, but not all reforms led to income gains. These Canadian studies do not directly apply to the U.S. context, but they do highlight the complexity surrounding the property rights on Native

American lands and their relationship to market processes. Property-rights reforms are not a panacea for economic growth on Native American lands. The institutional details involved in property-rights reforms are crucial, and other factors may diminish the benefits from these reforms, such as legal-political uncertainty, rent seeking, and excessive bureaucratic discretion.

### *Dual Bureaucracy*

In the modern day, federal and tribal officials have broad authority and discretion regarding trust lands and other public policies. The pervasiveness of bureaucratic influence throughout the economic sphere raises the costs of engaging in entrepreneurial activity and private enterprise. Reducing bureaucratic barriers and lowering the transactions costs would improve economic outcomes for individual Native Americans and tribes as a whole, regardless of cultural attitudes toward private property. This section provides evidence of how the dual bureaucracy affects the market process.

The relationship between the BIA and tribal governments has become increasingly complex. The various property-rights regimes and the various responsibilities of the BIA and tribes have emerged from the drastic changes in Native American policy. The combination of all these factors has made the interactions between the federal government and tribal governments complex and ill defined in many ways. The BIA has a duty to consult with the tribes in a government-to-government relationship, but it also has a legal responsibility for fulfilling the trust obligations to “protect tribal property and resources” (U.S. BIA 2000). The doctrine of self-determination inherently comes into conflict with the BIA’s trust responsibility, meaning that federal and tribal officials may be at odds in some circumstances when individual decision makers in both entities attempt to manage resources that are under their dual jurisdiction.<sup>6</sup>

The IRA allowed tribes to adopt constitutions or other governing documents. Most tribes have governments modeled on the federal system of dividing powers between legislative, executive, and judicial branches. The legislators and chief executive are elected in most tribes, but there is a relatively large amount of diversity in tribal constitutions. Some tribes, such as the Navajo Nation, have an unwritten constitution. Other tribes are theocracies or operate under corporate governance structures. For tribes with written constitutions, some have adopted an indirectly elected chief executive in a parliamentary-type system, while others have adopted a directly elected chief

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6. Within the BIA’s various offices, specific divisions focus on economic development, workforce planning and control, and management of natural resources, among other responsibilities (U.S. BIA 2015). The Office of Trust Services of the U.S. Department of the Interior deals mainly with land-related trust issues. In addition, it helps manage, develop, and protect natural resources (U.S. Department of the Interior, Office of Trust Services n.d.). Several other federal agencies make policies regarding Native Americans, including the Department of Education, the Department of Housing and Urban Development, the Department of Health and Human Services, and so on. The White House Council on Native American Affairs is meant to improve coordination among the various executive departments, agencies, and offices that have responsibilities over Native Americans (Executive Order No. 13647, 3 C.F.R. [2013]).

executive in a presidential-type system. These constitutions stipulate how tribal governments will legislate civil and criminal laws, impose taxes, determine tribal citizenship, regulate certain activities, and exclude persons from tribal lands (Cornell and Kalt 1995; Akee, Jorgensen, and Sunde 2015).<sup>7</sup>

The governance institutions for Native Americans become slightly more complex when factoring in the influence of state governments. In general, state governments' ability to legislate, regulate, and tax Native American lands is relatively limited, but there are a few exceptions, such as some judicial jurisdictions and gambling in certain circumstances, among others (Roback 1992; Anderson and Parker 2008; Regan and Anderson 2014; Akee, Jorgensen, and Sunde 2015; Akee, Spilde, and Taylor 2015).

Even under the modern federal trust system and a historically high degree of self-determinism, many reservations still lack economic growth. Conflicting goals between tribal officials and federal officials as well as conflicting goals within tribes have slowed the resolution of economic problems (Mika 1995). Due to Congress's constitutional obligation to Native Americans, the federal government has assumed an active role in managing or regulating many aspects of life on a reservation. Thus, the emergent institutions have had many unintended consequences that have stifled economic development for Native Americans across the country.

Some tribes have struggled with governance issues, but others have successfully formed corporate entities, such as casinos, gas stations, and oil companies, to successfully promote economic development. For example, the Indian Gaming Regulatory Act of 1988 has allowed some tribes to use gaming operations to transform reservations' economies. Casinos have become a large source of revenue and a source of employment (Akee, Spilde, and Taylor 2014, 2015). From 1990 to 2000, areas with gaming decreased their poverty rates slightly more than nongaming areas (Taylor and Kalt 2005). Despite some successes through the gambling industry, the federal land trust and the dual bureaucracy still pose barriers to individual entrepreneurship.

Tribes function as both firms and states in an entangled sense because many of them run business ventures, but they also have the coercive powers of government to tax, legislate, and regulate. Tribes have highly entangled political economies because politics and economic enterprises are intertwined and inseparable in these contexts (Wagner 2016). Leonard Carlson (1981) found that prior to the Dawes Act, tribal governance functioned relatively well, but the evolution of formal property rights and governance structures over the twentieth century has obscured how people in the private and public spheres engage in economic enterprises. The entangled nature of economic enterprises on Native American lands among federal, tribal, and other private actors makes the analysis of economic development on Native American lands difficult.

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7. Before the 1970s, the BIA administered most of the programs and services for Native American tribes, but through the Indian Self-Determination and Education Assistance Act of 1975 and the Tribal Self-Governance Act of 1994, Congress granted tribes more authority to create and administer their own programs and services (U.S. BIA n.d.). Since self-determination began in the 1970s, various tribes have taken over many functions from the BIA.

Although many tribes have depended on federal agencies for decades, other tribes in recent years have been reforming and improving their institutions. Many tribes are being recognized for improving and streamlining the bureaucratic barriers imposed on individuals and tribal governance. Since 1998, dozens of tribal government programs have received awards for excellence from Harvard University's Honoring Nations program (Harvard Project 2015a). A substantial body of evidence suggests that tribes these days are running first-class programs in policing, child welfare, court systems, resource management, education, economic development, and other fields. In some cases, some tribes are outperforming mainstream equivalents in the efficiency of their public policies (Bean 1978; Confederated Salish and Kootenai Tribes 2004; Berry 2009; Tomblin 2009; Harvard Project 2015b, 2016).

Because the costs of market entry are relatively high on trust lands, the informal economy has become an important source of income on many reservations, especially the Navajo Nation. Much of the informal economy on the Navajo Nation is sustained through familial ties. In parts of the nation near towns or tourist destinations, Navajo people have created an informal economy to sustain themselves because this reservation, like others, suffers from bureaucratic constraints that impose high costs on potential entrepreneurs (Rosser 2005).

Ryan Yonk, Sierra Hoffer, and Devin Stein (2017) analyze the disincentives to business development on the Navajo reservation and find three primary factors that drive the low levels of business ownership and entrepreneurship. First, potential business owners face a highly bureaucratic, complicated business license application process, which increases the cost of participating in the formal economy. Second, the Indian land trust system limits the Navajo people's ability to own and use land as a resource for economic development. Third, access to capital and lending opportunities is severely limited, thus hampering the Navajo people's ability to engage in the market process. Although this research focuses solely on the Navajo Nation, the most important and widely applicable point to Native Americans at large is the institutional barriers to market participation.

Transaction costs, rent seeking, and bureaucratic delay are an outgrowth of the unique formal institutions common to most Native American reservations. In the presence of high transactions costs, potential entrepreneurs may not engage in opportunities to find and implement plans that increase human welfare. With rampant rent seeking, entrepreneurs may be diverted from socially beneficial, positive-sum actions to socially wasteful, negative-sum actions. The rent seeking inherent to highly bureaucratic systems has led to the allocation of resources through the political process. Especially in the presence of federal-tribal policies and programs for state-led economic development, the rent-seeking process of bureaucratic allocation perpetuates perverse incentives. In addition to the rent-seeking dilemma, the government planners in charge of economic development lack the relevant knowledge to create long-term, sustainable economic progress (Mathers 2012).

Bureaucratic delay may also deter potential entrepreneurs because of the transaction costs associated with wasted time. For instance, many reservations are

poor precisely because bureaucratic red tape and other transaction costs associated with land tenure lead to underutilization of reservation resources, thus perpetuating a cycle of poverty (Anderson, Benson, and Flanagan 2006; Russ and Stratmann 2014). Despite some improvements on internal governance of reservations, many Native Americans remain trapped in poverty because of pervasive nature of bureaucratic administration. If future policy approaches neglect the role of private-property rights, the market process, and economic calculation, economic development will continue to be stunted.

Many tribal officials have learned to gain federal funds through a perverse type of entrepreneurship that is redistributive, not productive. “Economic development” has come to mean gaining more federal grants rather than producing and increasing the stock of goods and services. The federal funding perpetuates a dependent relationship that is difficult to break. Ross Swimmer (1989) finds that reservations more closely connected to outside communities have higher economic performance, whereas Native Americans on isolated reservations have relatively few places to spend their other income and few people to exchange with. Tribes that are more integrated with off-reservation economies have higher individual income, employment, and quality of life as well as lower alcoholism. Entrepreneurship is less likely to take place in the presence of bureaucratic control and a lack of private-property rights.

Federal and tribal officials could make their management more beneficial in a limited number of ways. First, officials could remove many of the constraints on use to reservation lands. Second, the federal government’s trust relationship must be limited so that tribes and individuals can actively manage trust resources. Third, technical assistance for economic development should not come from the BIA bureaucracy but should instead come from the private sector as entrepreneurs see fit (Swimmer 1989). These suggestions would effect only marginal improvements, however, and reservations will continue to suffer from limited development as long as private-property rights are bureaucratically managed.

In the past few decades, the pattern of change across various reservations is increasingly complex. Some tribes have created vibrant economies due to gaming (Akee, Spilde, and Taylor 2014, 2015). Other tribes have improved their members’ material well-being without gaming, such as through natural resource development, despite the absence of substantial private-property rights. Today, many reservations have exhibited significant divergence, with some tribes stagnating economically, but others moving ahead.<sup>8</sup> Making generalized statements about all of Indian Country can be problematic, but scholars need to look at the commonalities and differences between property-rights regimes and institutions to understand how entrepreneurship is affected on those lands.

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8. Although some tribes have experienced financial success, the Indian-related spending in the federal budget has remained relatively constant or increased only slightly in recent years. Looking at total federal spending across all agencies, the federal government has increased spending from \$18.1 billion in fiscal year 2012 to \$19.7 billion in fiscal year 2016 (U.S. Department of the Interior 2016, 2017).

Some of the striking examples of vigorous economic development in Indian Country include the Winnebago Tribe, Cochiti Pueblo, and Chickasaw (Cornell and Kalt 1995; Harvard Project 2003, 2006). Each of those tribal governments have discovered ways to overcome the problems associated with convoluted property-rights regimes and institutions that raise transaction costs on entrepreneurial activity. Their solutions include community-development funds and home-loan programs that help individuals overcome institutional barriers to economic development.

Some government entities appear to be facilitating productive entrepreneurship. For example, the Federal Reserve Bank of Minneapolis runs the Center for Indian Country Development (CICD). One of the CICD's programs encourages tribal governments to establish laws that use tribal customs where they exist and merge those customs with the Uniform Commercial Code (UCC). This is especially helpful for business transactions because it helps reduce uncertainty in capital markets by making the legal relationships between lenders and borrowers more well defined and standardized. The UCC establishes a relatively consistent legal environment for commercial transactions between parties in different states. By comportsing with the UCC, Native American reservations can reduce the transaction costs of commerce (Uniform Law Commission and Center for Indian Country Development 2017).

### *Legal and Political Uncertainty*

One of the greatest barriers to economic development on reservations is erected by legal and political uncertainty and complexity, which are caused by the unique formal institutions that govern Native American land. Potential entrepreneurs may be uncertain about how government actions will affect their decisions. The imposition of new taxes or the confiscation of private property are specific kinds of uncertainty that affect an individual's economic decisions (Higgs 1997).

Federal laws apply to reservations, except when those laws violate a tribe's specific treaty right. Tribes make their own laws and taxation schemes as well as engage in commercial ventures. Due to the common-law sovereign-immunity doctrine, tribes are immune from suit unless Congress gives authorization. Potential entrepreneurs may be hesitant to engage in economic enterprises directly with tribes because they may not be able to bring a suit if a contract is breached.

One of the most important ways that entrepreneurs and businesspeople face uncertainty on reservations is through the various taxation schemes. The complexity and uncertainty regarding taxation may disincentivize potential entrepreneurs. For example, individual Native Americans pay all federal taxes, with limited exceptions for income directly derived from trust property. Tribal governments are generally immune from federal taxes (26 U.S.C. §7871 [2010]; Rev. Rul. 67-284 1967-2 C.B. 55 [July 1967]). However, tribes must pay gambling-related excise and occupational taxes under 25 U.S.C. §§2701–2721 (*Chickasaw Nation v. U.S.* 534 U.S. 84 [2001]). Under 25 U.S.C. 465 (2011), state and local taxation does not apply to trust land.

However, in *Carcieri v. Salazar* (555 U.S. 379 [2009]), the Supreme Court ruled that state and local taxation can apply on lands that were taken into trust if a tribe was not federally recognized until after 1934.

Lessees of tribal land are taxed by the tribe on most reservations. Many tribes tax retail sales by non-Indians, and many of them tax retail sales by Native merchants as well. In general, any non-Indian may be subject to taxes when engaging in economic transactions with a tribe or its members on a reservation. State taxation is decided by legal incidence of tax, not economic incidence. For example, in 1976 the Supreme Court ruled that states may collect taxes on sales made by Native Americans on reservation land to non-Native American or members of the particular nation (*Moe v. Confederated Salish and Kootenai Tribes of the Flathead Reservation*, 425 U.S. 463 [1976]). Other tax laws are even more complex. For example, the Eleventh Circuit Court struck down rental taxes on non-Indian lessees of permanent improvements of tribal trust land (*Seminole Tribe of Florida v. Stranburg*, 799 F.3d 1324 [2015]). In the same ruling, however, the court upheld the State of Florida's ability to tax utility services delivered to tribes. That same year the BIA promulgated a new regulation that did not allow states or counties to tax permanent improvements, leaseholds, and activities on leased tribal land (25 CFR §162.017). Potential entrepreneurs must navigate a labyrinth of federal, state, and tribal regulations and case law to know which kinds of taxes apply to which people on which land before they begin any economic venture. On the margin, these high transaction costs are likely to discourage potential entrepreneurs from engaging in economic ventures on Native lands.

Because of each tribe's unique legal structure, choosing a business structure has significant consequences for a tribal government and tribal businesses. Potential business owners must confront several considerations. If businesses are tied directly to the tribal council, then political considerations are likely to factor into long-term business decisions. Different types of business structures affect the tax status of a business entity and how sovereign immunity applies. The type of business structure may also affect the certainty and predictability in the legal framework chosen to organize an economic venture (Atkinson and Nilles 2008).

With these overlapping jurisdictions and various taxation schemes, economic transactions on tribal land or with tribal agencies can become complicated and costly. Non-Indians can secure some protection by contracting directly with a federally chartered tribal corporation or agency, but the complexity and uncertainty of engaging in commercial transaction on Native American land can be large disincentives (Kalt et al. 2008).

In the past, one barrier to Native American economic development was a lack of tribal business-incorporation codes (Erllich 1980). Tribes have generally regulated businesses regarding marketplace activity, taxation, and licensing, and many are now addressing the business-incorporation process. Today, potential business owners can choose to incorporate within the tribal government, become a tribally chartered corporation, receive a federal charter through section 17 of the IRA, become a state-law corporation, or become a limited-liability company (Atkinson and Nilles 2008). A



number of tribes have established codes governing business incorporation, secured transaction codes, and other procedures, using tribal law to facilitate business creation on tribal lands, with significant results. For example, the Mille Lacs Band of Ojibwe and the Citizen Potawatomi Nation have created policies to lower the costs and increase the certainty surrounding business creation on tribal lands (Harvard Project 2000; Citizen Potawatomi Nation, Public Information Office 2016; Citizen Potawatomi Nation 2017).

Incorporation codes reduce costs and increase certainty because they define the rules of the game, which would promote the investment of nonreservation capital. Without incorporation codes, entrepreneurs on reservations have limited business opportunities because of the legal limitations on the formation of limited partnerships, corporations, cooperatives, and nonprofits (Erlich 1980). Thus, Native entrepreneurs face high costs when engaging in the market because they have limited options for collateral and because outsiders perceive tribal laws negatively as complex, uninviting, and unpredictable. The implementation of incorporation codes has been a marginal improvement for many reservations, but it does not necessarily solve the inherent issues with the convoluted nature of property rights and governance structures within the federal trust system.

Some tribes are attracting outside investment and entrepreneurs because they have created robust institutions that outsiders trust. For example, the Hualapai Nation has created an Enterprise Board to fulfill the role of technical adviser and operational manager for development matters on the reservation (Caliguire and Grant 1993). In addition, the Viejas Band of Kumeyaay Indians became the majority owner of Borrego Springs Bank in 1996, which has served the tribal government, Native-owned businesses, and non-Native individuals. The bank has enhanced the tribe members' economic self-sufficiency and opened up more access to capital markets for potential entrepreneurs and homeowners (Harvard Project 2002). Future policies and court cases may help bring more certainty and predictability for many more reservations.

## Conclusion

Native Americans live under fundamentally different institutions than other Americans. The federal land trust shapes Native American economic life through bureaucratic control of land and other resources. The complex property-rights regime of the federal land trust stifles mutually beneficial exchange, hampers the market process, and allows government officials to intervene heavily into economic affairs. In addition, the dual bureaucracy of federal and tribal officials increases transaction costs in general because of the broad authority and discretion that these officials have to make public policy. Under those unique institutions, the federal government has created an environment of uncertainty and high costs that pose significant barriers to entrepreneurial action, thus limiting economic development at large.

Some of the literature criticizes the positive focus on capitalism and its related economic outcomes and effects. Some scholars (e.g., Pasternak 2015; Schmidt 2018)

have argued that the positive focus on capitalism is problematic and antithetical to Indigenous views about land, property, and markets. These scholars bring up valid concerns regarding changes in formal governance institutions as they relate to Indigenous peoples' issues in Canada. These concerns highlight the fact that one-size-fits-all solutions are not likely to solve the complex issue that is economic development. These concerns also illuminate that unintended consequences can result from changes to formal institutions. Any policy changes that are made to Native American governance institutions must consider the complexity of institutional change.

Although this paper contains no overt policy recommendations, a reader may be left thinking that the best thing for Indians would be to eliminate the added layers of federal and tribal bureaucracy and eliminate many of the restrictions on Indian property rights. However, many Native Americans may oppose such proposals because they may appear superficially similar to the rejected policies of "termination" and "relocation" that took place from the 1950s to the 1970s. If Native Americans perceive that such reforms are an attempt to destroy Indian culture or loot Indian resources, those reforms are likely to fail.

This analysis has several implications. First, even with more self-determination and better bureaucratic planning, economic development on Native American lands will be limited because of costly barriers to entrepreneurial action and market entry. The trust system limits private-property ownership, and bureaucratic planners do not have the ability to mimic the outcomes of the market process. The land trust impedes market participation and skews economic calculation, which will continue to slow economic development for Native Americans. Second, reservations may be worse off than other economies in some regards because the dual bureaucracy adds an extra layer of intervention to distort the market process. The complex legal relationships between the federal government and the tribes create uncertainty, further raising the costs from the dual bureaucratic system. Third, and perhaps most important, poverty for Native Americans is unlikely to be resolved if the current institutions remain unchanged, regardless of government-sanctioned economic-development policies and other welfare policies. Understanding the economic implications of Native American institutions is crucial for those concerned with Native people's well-being. Appreciating the insights from market-process theory may be the key to alleviating the omnipresent poverty that plagues many Native American lands.

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