TO TAX TRIBES OR NOT TO TAX TRIBES? *THAT* IS THE QUESTION

by
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As a first approximation, a tax on a buyer has an impact that is identical to an alternative tax of equivalent size that is imposed on the seller. Students in an elementary microeconomics class quickly learn that fact, but Montana v. Blackfeet Tribe *and* Cotton Petroleum v. New Mexico *imply that few justices or judges sitting on our courts have attained a similar level of economic sophistication. In view of the canons of construction of Indian law, and the understandings of the tribes when concluding treaties with the United States,* Blackfeet Tribe *quite properly repulsed Montana's attempt to tax tribal royalties from on-reservation extraction of minerals. In contrast,* Cotton Petroleum *permitted New Mexico to tax the companies that held mineral extraction leases on tribal land. The two holdings, handed down less than five years apart, are mutually inconsistent. The inconsistency provides an incentive for tribal governments to enter lines of business for which private ventures would have been more efficient. By so doing, the tribes will be able to withhold some tax revenues from states, though at the cost of less efficient on-reservation enterprise and a consequent reduction in employment.*

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I. INTRODUCTION

The symposium brochure for Lewis & Clark Law School's Symposium—Indigenous Economic Development: Sustainability, Culture, and Business, noted quite rightly that "grinding poverty and lack of economic activity on reservations is a fact of life for almost all American Indians."[1] That naturally inclines a sympathetic mind to seek extraordinary initiatives for reservations in order to correct those problems. After all, the initiatives that were attempted in the past seem to have failed.

Alas, extraordinary initiatives aimed at reservation problems are neither new nor likely to prove to be a solution—the residue of extraordinary initiatives attempted in the past are more likely the problem. A new round of extraordinary initiatives will be no more successful in achieving their stated goals than the repeated rounds of extraordinary initiatives over the past many decades; rounds that have sometimes succeeded in enriching particular narrow interests have left ordinary reservation citizens to fall ever further behind.

Contrast the stagnation of the typical reservation with the dynamic improvements to be seen in China over the last couple of decades. The Chinese economy is booming today not because the Chinese government dreamed up blinding new initiatives but instead because it finally stepped aside sufficiently to unfetter garden variety private initiatives that for decades have been commonplace throughout the first world. Even before those decades, the minority of Chinese who managed to migrate to first world economies improved their lot more rapidly than the world average, just as many Amerindians have found success off-reservation.

Thus, the fundamental task is not to discover blinding new insights to implement on reservations, but instead to discover ways to permit reservation citizens to implement techniques that have already proven their worth off-reservation. A few unremarkable initiatives can be seen to possess obvious promise even to those passing through reservations, and surely a plethora are observable to those who live there on a daily basis. But sustaining economic development requires preventing those initiatives that are attempted from being nipped in the bud. That has proven an order of magnitude more difficult on reservations than off them, just as it was until recently cripplingly difficult for private Chinese entrepreneurs to sustain initiatives in the face of governmental hostility and interference. That has characterized the fundamental problem facing reservation economies from the day the first one was founded, just as it is the fundamental problem that faces any third world economy.

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[1] Brochure from Lewis and Clark Law Review Spring Symposium—Indigenious Economic Development: Substainability, Culture, and Business (Spring 2008) (on file with Lewis & Clark Law Review).

Thus the fundamental problem is not to get things started but to prevent things from being stopped. There are many obvious things that need doing on a reservation for which a clientele ought to be available, given a nurturing environment. But when potential tribal entrepreneurs anticipate being arbitrarily stopped they are not motivated to get started, however obvious the task. A focus on finding things to get started is pushing on a string; a focus on finding ways to keep things from being stopped is the way to pull.

Through no fault of tribal citizens, most reservations are indeed third world nations.[2] As the "Asian tigers"—Malaysia, Singapore, Hong Kong, Taiwan, and so on—have discovered, in a way that can actually be advantageous, the problems to be faced are not problems of first impression; an awful lot can be learned simply by looking to third world nations that have become first world nations across the same time span that Amerindian reservations have languished. Look at Iceland and Norway, for instance, and also to Japan. Contrast the history of West Germany with that of the East, or the history of South Korea with that of the North. Success in all of those economies has required governments that were willing to get out of the way, and facilitate bottom-up initiatives from citizens who intimately understand which of their problems most urgently require attention; and who are in position to discern promising ways of attacking those problems. The most disastrous economic failures of recent decades, such as Albania, North Korea, and Zimbabwe, have not originated despite government programs but because of government programs intent on implementing top-down initiatives directed at what the capitol's elites preferred.

Many threats face a budding reservation enterprise, and many of them come from governments—tribal governments, the U.S. government, and the governments of the state(s) within which a reservation lies.[3] Not to dismiss the very real problems that originate from within some tribal governments, state and national governments will be the focus here. That state governments are so threatening to tribal citizens is quite an irony considering that most reservations predate their states and thus are the senior sovereign where the territories coincide. Tribal citizens were not even citizens of the United States until well into the twentieth century. Instead, Amerindian tribes were regarded by the U.S. as foreign nations occupying territories that were surrounded by land the U.S. wished to exploit in new ways.

Until well after the Civil War, the purpose of reservation formation was not to enable outsiders to govern indigenous life, but simply to draw

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[2] *See, e.g.*, U.S. CENSUS BUREAU, U.S. DEP'T OF COMMERCE, AMERICAN INDIAN, ALASKA NATIVE TABLES FROM THE STATISTICAL ABSTRACT OF THE UNITED STATES: 2004–2005 at 38–39, 451 (2005), http://www.census.gov/statab/www/sa04aian.pdf.

[3] David D. Haddock & Robert J. Miller, *Sovereignty Can be a Liability: How Tribes Can Mitigate the Sovereign's Paradox*, *in* SELF-DETERMINATION: THE OTHER PATH FOR NATIVE AMERICANS 194, 196–201 (Terry L. Anderson et al. eds., 2006).

understood boundaries in order to reduce intercultural friction. To a tribe, its new reservation would have seemed a hole in the map of the United States rather than some peculiar stain atop it.

Thus, when a tribe acquiesced to withdrawal into a reservation enclave, the members had no reason to expect that some other political entity, and certainly no still unborn one such as a state, would subsequently be in a position to intrude into tribal affairs. Indeed, to this day states cannot intrude on tribal affairs except in the manner and to the extent one or another branch of the U.S. government has authorized them to do so, though to be sure such intrusions have often been authorized.[4] Such intrusions were no doubt another unanticipated deviation from tribal expectations, but *Lone Wolf v. Hitchcock*[5] put in black and white what had become clear well before that decision was handed down.

> The contention [that Congress could not violate treaty terms] in effect ignores the status of the contracting Indians and the relation of dependency they bore and continue to bear towards the government of the United States. To uphold the claim would be to adjudge that the indirect operation of the treaty was to materially limit and qualify the controlling authority of Congress . . . and to deprive Congress . . . of all power to act, if the assent of the Indians could not be obtained.[6]

Certainly, when the U.S. concludes a treaty with Canada or China, popular perception on each side is that treaties do indeed "materially limit and qualify the controlling authority of" the signatories.[7] But inter-sovereign dealings often lack an impartial third-party enforcer with adequate coercive authority, so ultimately many treaties must rely on credible threats.[8] With regard to treaties between tribes and the U.S. government, in other words, minnows were facing the proverbial 900 pound gorilla with little but the gorilla's good will or indifference to protect them. Alas, that gorilla is unreliable.

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[4] "The Constitution vests the Federal Government with exclusive authority over relations with Indian tribes. As a corollary of this authority, and in recognition of the sovereignty retained by Indian tribes even after formation of the United States, Indian tribes and individuals generally are exempt from state taxation within their own territory." Montana v. Blackfeet Tribe of Indians, 471 U.S. 759, 764 (1985) (citation omitted).

[5] 187 U.S. 553 (1903).

[6] *Id.* at 564.

[7] *Id.*

[8] *Cf.* John Umbeck, *Might Makes Rights: A Theory of the Formation and Initial Distribution of Property Rights*, 19 ECON. INQUIRY 38, 48–49, 57 (1981); David D. Haddock, *Force, Threat, Negotiation: The Private Enforcement of Rights*, *in* PROPERTY RIGHTS: COOPERATION, CONFLICT, AND LAW 168, 186–89 (Terry L. Anderson & Fred S. McChesney eds., 2003).

II. *MONTANA V. BLACKFEET TRIBE* AND *COTTON PETROLEUM V. NEW MEXICO*

Four years after deciding *Montana v. Blackfeet Tribe of Indians*[9] the U.S. Supreme Court handed down *Cotton Petroleum Corp. v. New Mexico*.[10] The facts were similar to the extent that the original plaintiff in each case challenged the ability of a state to levy taxes on revenue arising from mineral production on a tribal reservation.[11] At the same time, the facts were distinct. In *Blackfeet Tribe,* Montana had attempted but failed to tax that part of the revenues that had been credited (though not yet paid) to the Blackfeet (Pikuni) and other tribes within Montana.[12] In contrast, New Mexico succeeded in taxing that part of the revenues that was due to nonmember mineral production companies as compensation for their on-reservation activities.[13] The companies that New Mexico taxed had been invited onto the reservations by the respective tribes in order to locate deposits, drill wells and dig mines, lay pipelines and build rail spurs, export and market minerals, etc., activities that are essential before revenues could be earned by the tribe.[14]

The *Cotton Petroleum* decision found that non-tribal companies involved in withdrawing minerals from the reservation were taxable by the state.[15] Beginning with the Indian Reorganization Act,[16] a pronounced legislative and judicial inclination for half a century had been toward strengthening the jurisdictional separation of Amerindian tribal governments and the governments of states that surround reservations. *Williams v. Lee*,[17] a notable benchmark in that evolution, had comprised an anchor for Court rulings for thirty years before *Cotton Petroleum* was decided. While *Blackfeet Tribe* had continued that sovereignty-enhancing trend by repulsing Montana's attempt to intrude on Blackfeet prerogatives,[18] *Cotton Petroleum* reversed course, permitting New Mexico levies against on-reservation activities by nonmembers without requiring tribal acquiescence.[19]

Indeed, though a non-tribal enterprise, Cotton Petroleum operated solely on the Jicarilla Apache reservation, which abuts the Colorado state

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[9] 471 U.S. 759 (1985).

[10] 490 U.S. 163 (1989).

[11] *Cf. Blackfeet Tribe*, 471 U.S. at 761; *Cotton Petroleum Corp.*, 490 U.S. at 170.

[12] *Blackfeet Tribe*, 471 U.S. at 761–62.

[13] *Cotton Petroleum Corp.*, 490 U.S. at 168.

[14] *See id.*

[15] *Id.* at 186.

[16] Indian Reorganization Act of 1934, 48 Stat. 985 (codified as amended at 25 U.S.C. §§ 461–479 (2006)).

[17] 358 U.S. 217, 223 (1959).

[18] Montana v. Blackfeet Tribe of Indians, 471 U.S. 759, 768 (1985).

[19] *Cotton Petroleum Corp.*, 490 U.S. at 186.

line.[20] Though increased sovereignty is a mixed blessing for any government that rules a small, impoverished domain,[21] *Cotton Petroleum* gave no hint that a systematic reevaluation of sovereignty's benefits accounted for the reversal.[22] Nor did the Court seem to appreciate the economic implications of the pair of cases.[23] That economic parallel will be the subject below.

III. ON-RESERVATION ACTIVITIES AND STATE TAXES

Though the wisdom of any state tax is an important policy issue for legislators, unless interstate commerce issues or allegations of fraud are raised, most judicial rulings merely clarify murky grey areas between taxed and untaxed items, thus defining boundaries whose location had been ambiguous. Most such cases are resolved before reaching the Supreme Court. To understand how *Blackfeet Tribe* and *Cotton Petroleum* rose to the highest tribunal in the land, one must first understand that though tribal governments are subordinate to the United States Congress, they are subordinate to state governments only under strictly limited circumstances where Congress has explicitly acted to make them so.[24]

It goes largely unrecognized by the citizenry-at-large that, as noted above, a tribal reservation is a hole in the sovereignty of its surrounding state, except for the few exceptions that have been put in place by the U.S. government or that have resulted from tribal-state accords.[25] That Hopi lands (for instance) comprise a part of Arizona is largely a mapmaker's fiction.[26] Most Arizona law is inoperative on Hopi, and whether any particular Arizona statute, precedent, or executive order applies there raises the most intricate and controversial legal issues that must of necessity be resolved on the basis of actions by the United States. government. If that seems an inappropriate intrusion on state rights, consider that tribal sovereignty predates the sovereignty of surrounding states.[27] States typically are required upon admission to the Union to

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[20] *Id.* at 166.

[21] *See* David D. Haddock, *Foreseeing Confiscation by the Sovereign: Lessons from the American West*, *in* THE POLITICAL ECONOMY OF THE AMERICAN WEST 129, 129–30 (Terry L. Anderson & Peter J. Hill eds., 1994); David D. Haddock & Robert J. Miller, *Can a Sovereign Protect Investors From Itself? Tribal Institutions to Spur Reservation Investment*, *in* 8 J. SMALL & EMERGING BUS. L. 173, 177 (2004).

[22] *Cotton Petroleum Corp.*, 490 U.S. at 173 n.9.

[23] *See id.* at 173–75.

[24] Montana v. Blackfeet Tribe of Indians, 471 U.S. 759, 764 (1985).

[25] *See* McClanahan v. State Tax Comm'n of Arizona, 411 U.S. 164, 170–71 (1973).

[26] *E.g.*, Act of Aug. 15, 1953, Pub. L. No. 83-280, 67 Stat. 588 (codified at 18 U.S.C. § 1162 and 28 U.S.C. § 1360 (2000)).

[27] The Royal Proclamation of 1763, *in* DOCUMENTS RELATING TO THE CONSTITUTIONAL HISTORY OF CANADA, 1759–1791, at 163 (Adam Short & Arthur G Doughty eds., 2d ed. 1918) formalized an exclusive power of the national sovereign—

acknowledge the tribal reservations that lie within the state boundary and to concede that state sovereignty is severely constrained over tribal territory.[28]

Irrespective of treaty stipulations, however, the United States government can act in ways that are disagreeable to the tribes, as articulated by the Court in the aforementioned *Lone Wolf v. Hitchcock*.[29] The power of unilateral treaty abrogation does not extend to the states, however, so unless the United States has acted to the contrary, a tribe and its members ordinarily are immune to state tax liens against on-reservation activities because the tribe, not the state, is sovereign there.[30]

Because many reservations are tiny and thus easily accessible to nonmembers residing just beyond the periphery, the courts have carved out a few exceptions without prior Congressional authorization. It was held, for example, that a state can tax when a purchase occurs on a reservation solely for the purpose of evading a state tax that is valid at a nonmember's residence.[31] Sales to tribal members remain technically immune to the state tax.[32] As a practical matter, however, it would cost a reservation enterprise more than it was worth to document a member–nonmember distinction for small sales.[33]

Highly taxed by most states, tobacco was a leading irritant.[34] Some tribal governments attracted nearby nonmembers to reservation smoke shops by imposing a tribal tax that was substantially lower than the state tax.[35] Nonmember sales sometimes swamped those made to tribal

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Great Britain at the time—over the tribes. Though the states resisted, an effort was made to continue the policy under the Articles of Confederation, as illustrated by Article IX of the Treaty of Hopewell with the Cherokees, U.S.-Cherokees, Nov. 28, 1785, 7 Stat. 18, which stated that "the United States in Congress assembled shall have the sole and exclusive right of regulating the trade with the Indians, and managing all their affairs in such manner as they think proper." Under the U.S. Constitution, "The Congress shall have Power . . . To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." U.S. CONST. art. I, § 8, cl. 3. Also *see* Robert N. Clinton, *The Dormant Indian Commerce Clause*, 27 CONN. L. REV. 1055, 1092–94 (1995).

[28] Though in many ways both states and tribes are subordinate to the national government under the Supremacy Clause, the nation is subordinate to states in the (receding) areas where powers reserved to states govern. It is unsurprising that such a Gordian Knot in the law results in perpetual struggle between states and tribes regarding which is the paramount sovereign in any particular situation. That knot leads to a Supreme Court caseload that is quite out of keeping with the demographic or economic size of reservations.

[29] 187 U.S. 553, 565 (1903).

[30] Montana v. Blackfeet Tribe of Indians, 471 U.S. 759, 764 (1985).

[31] Washington v. Confederated Tribes of the Colville Indian Reservation, 447 U.S. 134, 135–36 (1980).

[32] *Id.* at 158.

[33] *See id.* at 157–58.

[34] *See id.*

[35] *Id.*

members.[36] Artificially elongated shopping trips seem wasteful, absorbing real resources merely to transfer revenue between taxing authorities, so the Court authorized the states to collect their tobacco taxes from nonmembers even when sales occur on reservation territory.[37]

Though interesting, it is beyond the present scope to examine judicial reluctance to similarly authorize one state to project its taxing authority over enterprises in other states when the state's citizens purchase low-tax cigarettes there. The volume of cigarettes flowing from New Jersey (and even North Carolina) into New York City or from Indiana into Chicago, vastly exceeds the flow across reservation borders.[38]

In 1924 Congress passed the Indian Oil Leasing Act which explicitly permitted nondiscriminatory state taxes on royalties accruing to Amerindians as the result of mineral withdrawals from reservation territory.[39] Though treaty abrogation may strike one as reprehensible, it was a well-established practice by 1924.[40] There was no longer a legal question whether such state intrusion on tribal sovereignty was ever permitted; Congress—the 900 pound gorilla—had clearly told the tribes that, whether or not permitted by treaty or other preexisting understanding, that level of state intrusion would have to be tolerated. But had the intrusion survived subsequent Congressional legislation that streamlined tribal mineral leasing though remaining completely silent regarding state taxes? For reasons elaborated momentarily, in *Blackfeet Tribe* the Court decided that it had not.[41] There had been a time when Montana legally could tax Blackfeet royalties from new leases, but the Court decided that time had passed.[42]

Could a state then tax mineral extraction companies, such as Cotton Petroleum, that had been engaged by tribal governments to make the severances that formed the basis of the tribal royalties? Although some such companies operate exclusively within reservation borders while

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[36] *Id.* at 145.

[37] *Id.* at 161.

[38] Many commentators believe that competition among governments is highly beneficial, as it is among private firms, and might well justify the otherwise needless expenditure of a few real resources. *Cf.* Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416, 421–24 (1956); David D. Haddock, *Sizing Up Sovereigns: Federal Systems, Their Origins, Their Decline, Their Prospects*, *in* ENVIRONMENTAL FEDERALISM 1 (Terry L. Anderson & Peter J. Hill eds., 1997). The courts rarely take a stand consistent with that belief, however, holding it to pose a political issue beyond the powers of the judiciary. Nor is the question germane to this Article; mineral extraction occurs on a reservation rather than the surrounding territory not because the location affords a convenient way to evade other governments' taxes, but because nature has sited exploitable minerals there.

[39] Indian Oil Leasing Act of 1924, Pub. L. No. 158, 43 Stat. 244 (codified at 25 U.S.C. § 398 (2000)).

[40] *Cf.* Lone Wolf v. Hitchcock, 187 U.S. 553 (1903).

[41] Montana v. Blackfeet Tribe of Indians, 471 U.S. 759, 766–67 (1985).

[42] *Id.* at 766.

others that operate out-of-state operate nowhere within the borders of the taxing state except on a reservation, non-Indians (including fictive persons such as non-tribal corporations) are not tribal citizens.[43] Whether these companies were then necessarily subject to state sovereignty regarding their on-reservation activities was an open question. In *Cotton Petroleum*, the Court held that the reservation hole in state sovereignty was too shallow to shield the companies, who were thus simultaneously subject to tax liens by both sovereigns.[44] As to non-tribal companies employed to help extract tribal resources, the Court decided that the mapmakers actually have it right—Hopi *is* part of Arizona.[45]

The pair of cases has perplexed many commentators because no Congressional action explicitly compelled a halt in the previous sovereignty-strengthening trend. The anomaly is greater than those observers have known. Assuming, as seems likely, that states, tribes, companies, consumers—everyone that is except lawyers, judges, and thus courts—are interested in the revenues that they pay and receive and the output that is produced, and not elastic and filamentary legal distinctions, then according to rudimentary economic theory *Cotton Petroleum* seems precisely to undo *Blackfeet Tribe*. And what I mean by rudimentary is, well, rudimentary. As will be shown by the elementary economic model below, each case dealt precisely with the distribution between state and tribe of economic rents from mineral deposits located under tribal land.[46] An implication of the model is that the cases reached diametrically opposing outcomes. *Blackfeet Tribe*, in brief, seems to have died before its fifth birthday.

Unfortunately, a slightly more sophisticated model that relies on public choice theory indicates that *Blackfeet Tribe*'s ghost remains abroad, and it is not an apparition that should be forced onto the tribes.[47] Throughout the United States, specialized private companies undertake nearly all mineral extraction, hinting that other forms of organization are less efficient. However, even after *Cotton Petroleum* it remains clear that a tribe-owned company is exempt from state taxes.[48] If the avoidable tax is less than the inefficiency arising from the use of a tribe-owned extractor, the incoherence of *Cotton Petroleum* coupled with *Blackfeet Tribe* could motivate creation or acquisition of mineral extraction companies that

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[43] *Id.* at 761.

[44] Cotton Petroleum Corp. v. New Mexico, 490 U.S. 163, 189 (1989).

[45] *Id.* at 163.

[46] *Id.* at 168–70; *Blackfeet Tribe*, 471 U.S. at 761.

[47] Though earlier works are now seen to have been precursors, James M. Buchanan and Gordon Tullock, *The Calculus of Consent: Logical Foundations of Constitutional Democracy*, is the seminal work leading to the widespread application of public choice theory, by now a well established interdisciplinary branch of economics and political science. *See* JAMES M. BUCHANAN & GORDON TULLOCK, THE CALCULUS OF CONSENT: LOGICAL FOUNDATIONS OF CONSTITUTIONAL DEMOCRACY (1962).

[48] *Blackfeet Tribe*, 471 U.S. at 764.

tribal governments would then be forced to manage. For reasons to be detailed below, mineral withdrawals from reservations would likely become more costly than withdrawals beyond tribal borders, though the increased cost would have to be less than the taxes the state otherwise would have collected or the tribe would have no incentive to undertake the burden of managing the company. But every cent of tax a tribe saved would be a cent that a state would not receive, so the tribe's savings would be a transfer rather than an economic gain.

To take the argument to extremes, assuming that tribal extractors were no more able to optimize than other unspecialized entities, if all mineral extraction on reservations were undertaken by tribe-owned enterprises, the cost of extraction would increase but no government would receive any additional tax revenue. As there would be no tax revenue to balance the higher extraction costs, such a result would represent a Pareto deterioration that could have been avoided through a more discerning approach by the Court. In fact, that danger could have been avoided had the cases been decided consistently—either that states could tax tribal royalties or the private company severances from which those royalties derived, or that the states could tax neither. However, in the spirit of the initial understanding between tribes and the United States and the canons of construction of federal Indian law, the latter decision would seem to be appropriate.

IV. STRUGGLING OVER SHARES OF MINERAL WEALTH

The year 1924 saw far-reaching changes in federal Indian law. As one small part of those changes Congress provided that "the production of oil and gas and other minerals on [tribal] lands may be taxed by the State in which said lands are located in all respects the same as production on unrestricted lands . . . ."[49] That put the matter quite clearly. But fourteen years later Congress acted to "obtain uniformity . . . of the law relating to the leasing of tribal lands for mining purposes,"[50] but neither authorized state taxation of tribal mineral extractions nor explicitly repealed the 1924 Act's authorization.

It might seem that where the latter statute was silent former state powers would remain intact. But the Supreme Court's canons of construction of Indian law require that "ambiguous expressions must be resolved in favor of the Indian parties concerned . . . and Indian treaties must be liberally construed in favor of the Indians."[51]

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[49] Indian Oil Leasing Act of 1924, Pub. L. No. 158, 43 Stat. 244 (codified at 25 U.S.C. § 398 (2000)).

[50] S. REP. NO. 75-985, at 2 (1937); Indian Mineral Leasing Act of 1938, 25 U.S.C. § 396 (2000).

[51] Charles F. Wilkinson & John M. Volkman, *Judicial Review of Indian Treaty Abrogation: "As Long as Water Flows, or Grass Grows Upon the Earth"—How Long a Time Is That?*, 63 CAL. L. REV. 601, 617 (1975).

> In construing any treaty between the United States and an Indian tribe, it must always . . . be borne in mind that the negotiations for the treaty are conducted, on the part of the United States, an enlightened and powerful nation, by representatives skilled in diplomacy, masters of a written language, understanding the modes and forms of creating the various technical estates known to their law, and assisted by an interpreter employed by themselves; that the treaty is drawn up by them and in their own language; that the Indians, on the other hand, are a weak and dependent people, who have no written language, and are wholly unfamiliar with all the forms of legal expression, and whose only knowledge of the terms in which the treaty is framed is that imparted to them by the interpreter employed by the United States; and that the treaty must therefore be construed, not according to the technical meaning of its words to learned lawyers, but in the sense in which they would naturally be understood by the Indians.[52]

Since substantial tax revenues were at issue, the inevitable question was bound eventually to arise of whether the states' 1924 taxing authorization survived the silence of the 1938 Act. Thus, in time, as Montana taxed royalties that the Blackfeet were receiving from non-tribal lessors who were extracting minerals from the reservation, the tribe pointed to the canons of construction.[53] Noting that it "consistently has held that it will find the Indians' exemption from state taxes lifted only when Congress has made its intention to do so unmistakably clear," the Supreme Court ruled in *Blackfeet Tribe* that taxes such as Montana's were unenforceable unless and until the states could obtain clear Congressional reauthorization.[54] The taxing provision of the earlier act was inconsistent with the intent of the Indian Reorganization Act of 1934.[55] Insofar as the 1938 Act was intended to harmonize Indian leasing laws, Congress could not have intended the 1924 Act to cover leases under the 1938 Act. That legislative history suggested to the Court's majority that one Congressional goal of the 1938 modification had been "to ensure that Indians receive 'the greatest return from their property,'" a purpose that "would be undermined if the 1938 Act were interpreted to incorporate the taxation proviso of the 1924 Act."[56]

The tribes, of course, do not locate and extract minerals themselves. Mineral exploration and production is highly technical, and like virtually every other landowner (including the United States Government), tribes lease their mineral rights to specialized companies that employ experts who are highly skilled in those arts. The companies pay a royalty for the

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[52] Jones v. Meehan, 175 U.S. 1, 10–11 (1899).

[53] *Blackfeet Tribe*, 471 U.S. at 766.

[54] *Id.* at 765.

[55] Indian Reorganization Act of 1934, 48 Stat. 985 (codified as amended at 25 U.S.C. §§ 461–479 (2006)).

[56] *Blackfeet Tribe*, 471 U.S. at 767 n.5.

privilege.[57] Like Montana, New Mexico imposed a tax on minerals extracted from tribal lands.[58] Unlike Montana's, New Mexico's tax was levied not directly on the tribes, but on non-Indian mineral extraction companies that were operating on reservation land.[59]

Cotton Petroleum sued to block New Mexico's tax.[60] In *Cotton Petroleum,* the Supreme Court held that the state's tax, unlike Montana's, was not preempted by federal law, as it was not a tax on any tribe.[61] Though recognizing that a tax on extraction companies would reduce their ardor for dealing with the tribes somewhat, the majority was no longer so convinced of Congressional intentions to ensure that Amerindians received the greatest return from their property, but now thought that the dissent in *Blackfeet Tribe* had the better of it, that Congress had intended to guarantee tribes only "a fair return on properties leased for mineral production."[62]

Often analysis of a legal case will argue that it was rightly decided or that it was wrongly decide; however the initial burden here is different. As will be demonstrated below, as a positive matter, *Cotton Petroleum* has undone *Blackfeet Tribe,* unless tribes undertake mineral extraction on their own, which would be a worse economic result than either of the ways the cases could have been decided consistently. For decades, the relevant theoretical point[63] has been drummed into undergraduate students beginning with principles of microeconomics courses. It should take no more than a month before a diligent economics novice has mastered the point.

This pair of cases hints maddeningly that even such an elementary point has yet to penetrate Supreme Court reasoning. The Court noted that "the District Court found that the 'economic and legal burden of paying the state taxes falls on Cotton or its buyers' and that '[n]o economic burden falls on the tribe by virtue of the state taxes.'"[64] Though the Court later conceded a possibility that the taxes on Cotton might "have at least a marginal effect on the demand for on-reservation leases, the value to the Tribe of those leases, and the ability of the Tribe to increase its tax rate,"[65] it contended that "[a]ny impairment to the federal policy favoring the exploitation of on-reservation oil and gas resources by Indian tribes that might be caused by these effects, however, is simply too indirect and too insubstantial to support Cotton's claim of

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[57] Cotton Petroleum Corp. v. New Mexico, 490 U.S. 163, 168 (1989).
[58] *Id.* at 168–69.
[59] *Id.* at 169.
[60] *Id.* at 170.
[61] *Id.* at 186.
[62] Montana v. Blackfeet Tribe of Indians, 471 U.S. 759, 771 (1985).
[63] *See infra* Part V.
[64] *Cotton Petroleum Corp.*, 490 U.S. at 171.
[65] *Id.* at 187.

pre-emption."[66] In fact, the impact is identical to that which had been disallowed in *Blackfeet Tribe*, but anything seems possible when you don't know what you're talking about.

Certainly, those attempting to understand economic laws can make mistakes, but well-reasoned economic analysis describes how the world works in the situation analyzed, not how one might prefer that it work. The world will work the same whether or not the courts choose to be willfully ignorant of that description. Like the laws of physics, but unlike manmade laws, economic laws are beyond repeal.

There is assuredly a good deal of *ad hoc* semantic grooming that might distinguish the two cases. But those legal distinctions could not have been overwhelming *ex ante* or the second case would never have reached a very busy Supreme Court. Hence, some other considerations must have driven the decisions. Operational coherence ought to have been one, but was not. Avoiding a threat of inefficient extraction of minerals with no offsetting benefit to anyone ought to have been another, but again was not.

V. ANALYZING TAXES ON EXTRACTIONS

The energy market today is worldwide, with monstrous pipelines and tankers transporting a continuous stream of fuel halfway around the world. Vast numbers of separate owners of mineral rights like the Blackfeet Tribe offer the raw material for sale. On the other side of the market are thousands of separate extractors, big integrated companies with names like BP, Agip, Elf, Texaco, Shell, and Total, to be sure, but also little niche companies with names like Cotton Petroleum, names that very few people even recognize. Sellers like the Blackfeet Tribe and buyers like Cotton Petroleum have no measurable influence on energy prices, and thus as to them the cases may be modeled within the context of what, from the parties' perspective, is a competitive industry.

Thus, the demand that the Blackfeet Tribe faces for its offerings is horizontal, as illustrated by D_0 in Figure 1.[67] The Tribe's supply, though probably inelastic, will be upward sloping.[68] In part, that slope may reflect that the tribe wishes to spend revenues over time and prefers to pool risk over both mineral prices and interest rates. But the slope will surely reflect that an oil field poses more inconvenience to tribal members at some places than at others. For instance, a field located in a remote and barren part of the reservation would impose lower opportunity costs on members than one sited in the middle of prime agricultural land.

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[66] *Id.*

[67] The demand price for the various tribal holdings should be interpreted as adjusted for location, predicted quality, and the anticipated difficulty of withdrawal.

[68] A perfectly inelastic tribal supply would make the analysis below somewhat simpler if less general, but would change nothing of importance below.

Drilling in residential areas would be more disruptive still. Thus, all else equal, the reward that would entice a tribe to lease rights in the former area would be less than that required in the latter. S_0 illustrates the supply curve on the figure. Under the circumstances shown, in the absence of any state taxes whatsoever on tribal minerals, the tribe would permit the severance of Q_0 units in exchange for a per unit reward of P_0.

Suppose now that the state unexpectedly attempted to impose a tax of T per unit on withdrawals from the reservation. The world price of petroleum would not change notably because the portion of world production that the state would be taxing would be trivial—output from the tribal field is minuscule in comparison with that of Saudi Arabia, or even Great Britain. Thus the tax would merely lower net per unit tribal receipts to P_0-T. Given the lowered reward, the tribe would prefer to withhold a few properties where oil production would impose the highest opportunity cost on them. Consequently, the tribe would want to permit only Q_1 units to be severed. While it is true that in the short run the tribe would be unable to reduce sales under lease agreements that were in force prior to imposition of the tax (unless there were some contract clause permitting alterations), in the long run the tax would affect offerings as shown. That illustrates the facts that were litigated in *Blackfeet Tribe*.[69]

[69] Montana v. Blackfeet Tribe of Indians, 471 U.S. 759 (1985).

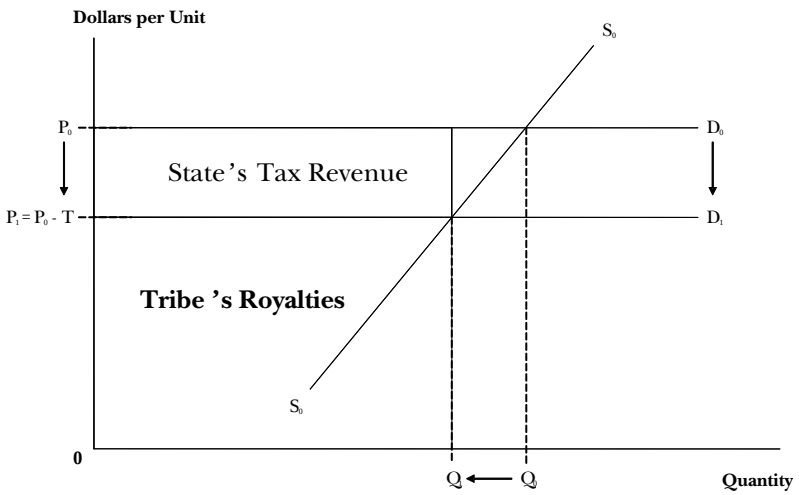

Figure 1. Equivalence of Tax Effect

Suppose instead that the state imposed an equivalent tax on the extraction company. Distinguishing the short from long run again is important. In the short run, though the tribe would have escaped losing revenues to the state, the state would have imposed that loss on the extraction company, so the situations are momentarily distinct, a temporary phenomenon that seems to have confused the justices. Competitive bidding would have driven royalties high enough that a small company such as Cotton Petroleum would have been earning only a normal return.[70] But now the company would have to bear an additional and unexpected cost, the tax, that would reduce returns below a normal level, below the level that the same resources could have earned in their best alternative employment, such as out-of-state.[71]

Such a result would not prevail once the tax became expected. Equivalent properties can be obtained elsewhere, and in the long run extraction company resources would leave the reservation if they could not expect as attractive a return there as elsewhere. So at any time following imposition of the tax, the intensity of interest in the tribe's new offerings would be reduced. In the long run, then, the extraction company would be unaffected; competitors' slackened interest would stop the royalty bidding short by exactly the amount of extra cost, the tax, so that the winning bidder's expected return on investment would remain normal and its resources would remain in this employment.

In brief, mineral extraction companies would adjust their royalty offering downward by the amount of their new tax obligation. Diagrammatically, the demand as seen by the tribe would be lowered to

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[70] *Cotton Petroleum Corp.*, 490 U.S. at 206 (Blackmun, J., dissenting).

[71] Suppose that such an event had been anticipated, at least in a probabilistic sense. There is no reason in principle that a lease contract could not specify that any future taxes would be netted off the company's royalty obligations to the tribe. In that event, the short run and the long run merge, and the immediate tax target would never be material. The state quite obviously would be taxing the tribe—at least that is obvious to an economist—merely collecting the funds through an intermediary.

D_1. Assume that a state endeavors to tax minerals at its revenue maximizing level. The state can only collect the same revenue as under the direct taxation initiative if the tax on the company amounts to the same as that attempted against the tribe in the first example. Thus, the new offer to the tribe would fall to P_1 in the figure and the tribe would reduce permitted severances to Q_1. That illustrates the facts that were litigated in *Cotton Petroleum*, and putting semantics aside, it is seen by inspection that the result would be precisely what would have arisen from a tax on the tribe itself.[72]

In the long run, therefore, all of the relevant sums would be identical under a tax on the extraction company or under a direct tax on the tribe. The dollars going into tribal and state coffers would be the same.[73] The reduced willingness of the tribe to lease would be exactly the same under either tax.[74] Even the profits of the extraction companies would be unaltered in the long run, being normal under either tax. Because output would be Q_1 with either tax, the impact on consumers would be identical. Only the trivial stylistic distinction between discussing the left side of the diagram, the movement of tribal net receipts per unit output from P_0 to P_0-T, versus discussing the right side of the diagram, the shift of the demand curve as seen by the tribe from D_0 to D_1, differs between the cases. Functionally, then, given that Montana's tax was a tax by the state on the tribe, then so is New Mexico's.

VI. TRIBAL EXTRACTION COMPANIES

Given the *Blackfeet Tribe–Cotton Petroleum* incoherence, starting tribe-owned extraction companies may become enticing for reservation governments. If Montana could tax Blackfeet royalties directly, that route would hold no attraction. Nor would the route hold attraction were New Mexico powerless to tax Cotton Petroleum for severances from tribal lands. The tribes were not engaged in mineral extraction before *Cotton Petroleum,* even though reservation governments were hungry for viable reservation enterprise. That implies that the tribes believe that they cannot extract minerals as efficiently as the specialized companies that handle the task for virtually everyone else. But if tribal comparative disadvantage were less than the state tax avoided, that initiative would be justified from the tribe's viewpoint. This would not be the first time that the Court, no doubt unwittingly, has forced onto Amerindians more costly production methods than are employed all around them.[75]

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[72] *See Cotton Petroleum Corp.*, 490 U.S. at 208.

[73] In the long run the tribe will earn $(P_0 - T)Q_1$ under either tax, as distinct from tribal revenues of P_0Q_0 before any tax was imposed. With either tax the state will receive Q_1T in tax revenues.

[74] Quantity falls from Q_0 to Q_1 either way.

[75] David D. Haddock & Thomas D. Hall, *The Impact of Making Rights Inalienable*, 2 SUP. CT ECON. REV. 1, 17–18 (1983).

On a larger stage, of course, tribal extraction companies would entail waste, the use of more resources than is necessary to extract minerals, merely because that offers avoidance of the impact on the tribe of state tax obligations imposed on non-tribal companies. That inefficient outcome would have been avoided had the cases held that states might choose to tax either the tribes or companies that extract tribal minerals, or that the states can tax neither.

There is an alternative way to state the same point. To the extent that tribal extraction companies issue from the legal incoherence, states will lose the taxes that *Cotton Petroleum* says they can collect.[76] The tribe, however, will regain only a part of the funds the states have lost. Part of the tribe's tax savings will have to go to subsidies for their company. That subsidy is worthwhile to the tribe if it amounts to only a part of the taxes saved. But the deeper point is that monies that could otherwise have gone to either the tribe or the state will be wasted to nobody's benefit.

Though there have been periods of greater Court activism, it would seem implausible that the Court of the latter 1980s was actually trying to induce reservation governments to begin their own mineral extraction enterprises. There is no language to that effect in the opinions, nor would it have been seen by most of the involved justices as a proper exercise of judicial authority. Forcing specific economic enterprises onto reservation governments would have been seen by people like Rehnquist and Scalia as a legislative issue, and probably an unwise policy to boot. And it is difficult to think of any other instance in which the Court seems to have been urging reluctant tribes to enter a particular industry, especially one that is so highly specialized and hence unsuitable.

Clearly at least some of the involved justices are concerned about high reservation unemployment, but tribe-owned mineral extraction companies would probably exacerbate that problem. What is at issue before the law is ownership of the company, not employment within it. The tribes were already in a position to bargain for employment opportunities for members as a condition of leasing to one or another of the competing extraction companies, and I assume that they pursued that course to the extent that the tribal government thought desirable. But employing tribal citizens—as it no doubt does—does not make Cotton Petroleum a tribal enterprise; tribal ownership does, even if the distribution of employment between members and nonmembers remains unchanged. If, as argued above, a tribal company were less efficient, the amount of mineral production on the reservation would decrease. That is to say, the tribal enterprise might produce more than Q_1 but surely less than Q_0. If production fell, so would the total number of jobs. If the distribution of jobs between members and nonmembers remained unchanged, that would amount to a reduction of opportunity on the reservation. The proper issue then would not seem to concern

[76] *Cotton Petroleum Corp.*, 490 U.S. 163.

employment, but how to invest scanty tribal resources. It would be counterproductive for the Court to induce a tribe to invest in a business that the tribal government had seen as unpromising.

Why did mineral extraction seem unpromising given that tribes do finance other enterprise? That, of course, is their business; an observer can only speculate. A couple of possibilities come readily to mind, however.

First, mineral extraction companies are clearly not identical; we know from casual observation that some are giants, others pigmies, and still others lie between. Some are highly integrated while others pursue narrow specialties. There must be a reason for the variability. One presumes that some companies are relatively more adept at dealing with one sort of problem that might be encountered in some leased fields, and other companies are better at dealing with other problems that are encountered in other fields. Expertise in solving some rare but difficult problems could easily result in a smaller company than skills for coping with run-of-the-mill problems. Ownership of various rights in mineral lodes often changes hands repeatedly during a field's life. Some companies might be adept at locating viable fields, and then sell the fruits of that knowledge to a second company that is better at opening a field for development. The latter might later sell the rights to another company that can better manage relatively stable periods of prosaic midlife operations, with still another transfer brings in a company more expert at stripping any useful residuals from nearly depleted fields before closing them down. Finally, another enterprise might hold the dormant rights while awaiting changes in market price or extraction costs that would return the field to economic viability. If so, a tribe would benefit by having various companies evaluate its several parcels in order to utilize whichever enterprise seemed best able to exploit each block during each period. A tax-sheltering tribal monopoly would offer no such flexibility.

Second, many people believe that management is more innovative and diligent if it is disciplined by the market for corporate control.[77] Experts in the relevant field of activity will buy shares of an underachieving company, replace incumbent managers with better ones, and benefit from the resulting increased share prices. Ownership that cannot be alienated without sacrificing significant tax advantages provides little of that discipline. Instead, tribal government would have to monitor company management intensively and directly. Should one expect government officers (tribal or otherwise) to become experts in business, the business of mineral exploration and extraction in particular, or would tribal citizens be better served if officers spent their time mastering tasks that governments more traditionally undertake? Ought one expect the monitoring, largely hidden from the view and

[77] Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 119 (1965).

understanding of uninvolved tribal voters, to be immune to the temptations that so often corrupt government enterprise both on and off reservation?

There may be other reasons that tribes refrained from investing in mineral extraction, but the crucial point is that they did. Who is the Supreme Court to tell them that they were wrong? The Court should aspire to expertise in legal interpretation, not portfolio micromanagement.

VII. CONCLUSION

Can the incoherence of the two cases be rationalized? Perhaps it can. Although the cases were decided only four years apart, two justices retired and were replaced during that span. Though each case was decided by a six-to-three vote, only O'Connor voted with both majorities. The other justices voted on only one case, or voted in a manner that is consistent with sound economic principles.[78]

Fair enough. So perhaps the majority viewpoint had changed with membership, and the new majority believed that the earlier decision, however recent, had simply been wrong. That would be insufficient to explain the discrepancy between the cases; members of the Court often cast votes that they find disagreeable if precedent is against them, because they venerate legal predictability. People make investments that are aligned with what they take the law to be. If the law alters course radically after investments have been sunk, some investors will regret having invested in the first place.

Thus, chronically repeated disappointment of investors diverts expenditures from saving and investing for the future toward present consumption, as many third-world nations should have learned by now (though many of them clearly have not). But perhaps in this instance the *Cotton Petroleum* majority perceived that the *Blackfeet* decision had been so very inconsistent with their world vision that sacrificing some legal stability was an evil they were willing to embrace. Though a mistake in view of the intent of the Indian Reorganization Act and the canons of construction of federal Indian law, it would have been better for the Court to overrule *Blackfeet Tribe* rather than pretending that *Cotton Petroleum* could be aligned with the earlier holding.

Overruling *Blackfeet Tribe* would have clearly signaled the weakened tribal sovereignty to Congress and the public. And, perhaps most

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[78] Montana v. Blackfeet Tribe of Indians, 471 U.S. 759, 760 (1985); *Cotton Petroleum Corp.*, 490 U.S. at 165 (Blackmun, Brennan, and Marshall voted with the majority in *Blackfeet Tribe* but comprised the dissent in *Cotton Petroleum*. Rehnquist, Stevens, and White were the dissenters in *Blackfeet Tribe* but joined the majority in *Cotton Petroleum*. Kennedy and Scalia, who voted with the majority in *Cotton Petroleum*, replaced Burger and Powell, who had voted with the majority in *Blackfeet Tribe*. O'Connor voted with both majorities).

importantly, overruling *Blackfeet Tribe* would have eliminated any incentive for tribes to enter an unsuitable line of business. Overruling their own recent opinion would indeed have reduced public perception of the stability and predictability of law, but no more so than does a bogging incoherence.

Overruling *Blackfeet Tribe* outright, or ruling in favor of Cotton Petroleum—that was the choice the Court should have confronted. But considering their complete silence on the analogous economic issues presented by the two cases, perhaps the justices were simply ignorant of fundamental, if elementary, microeconomics. Perhaps they honestly, if erroneously, believed that they were fine-tuning the law rather than overturning it. If the Court's integrity, at least, is to be respected, the alternative of judicial ignorance is the default that must be accepted.

Due to the extremely technical nature of the industry, it seems unlikely that a tribe will be induced to form or purchase a mineral exploration company, but there is nothing in this pair of cases that limits the impact to mineral exploration. The same law applies to firms in much less intricate industries, raising a very real danger that simply to avoid state taxation tribes will be induced to move into businesses which would be better managed in private hands. Sustaining development requires predictable law, but this pair of cases cannot cut the mustard.

Predictable legal rules regarding state intrusions on tribal affairs—now there is an innovation Amerindian reservations could really use.