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**Induced Institutional Innovation in Response to Transaction Costs: The Case of the
National Native Title Tribunal**

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Abstract:

The theory of induced innovation says that technological innovations which economize on relatively scarce inputs will be invented and adopted. Hayami and Ruttan have hypothesized that this model also holds for institutional innovations. Williamson suggests that economic organization, such as vertical integration, is the result of transaction cost minimization. Coase discusses the transaction costs of negotiation versus the court system to solve externality problems.

These various threads of the literature are brought to bear on the issue of innovations over time in relation to the National Native Title Tribunal. Mining companies have developed guidelines for negotiation with Aboriginal claimants. In Western Australia, regional agreements have been created which have the potential to greatly reduce transaction costs compared to negotiations between individual claimants and other agents such as mining companies. In addition to the reductions in transaction costs from a negotiated settlement rather than litigation, there are other advantages of negotiation, whether bilateral or regional. These include improved “quality” of settlements, improved relations between the negotiating parties, and more timely resolution.

Introduction:

The Mabo decision of 1992 represented an upheaval in the property rights system in Australia since it abolished the legal doctrine of *terra nullius*. This doctrine held that no one had property rights to land prior to the arrival of the British in 1788. The Mabo decision held that native title could exist where it had not been extinguished by government acts such as the granting of freehold title. The magnitude of this change was bound to result in enormous transaction costs both in understanding the ramifications of the decision, conflict between affected parties, and also developing new institutions in line with the decision. This paper examines transaction costs associated with the Native Title Act of 1993 and the resulting institutional innovations which economize on transaction costs. A broad definition of institutions will be used which includes both organizations and the rules of society that govern behavior.

The Induced Innovation Theory developed by Hayami and Ruttan (1985) maintains that technologies are invented and adopted which economize on relatively scarce resources. They also suggested that changes in institutions can be induced by factors such as changes in technology (first suggested by Marx), factor endowments, or product demand. The supply of institutional innovations is viewed as depending on the cost of achieving social consensus which may be reduced by advances in social science knowledge. Institutional changes are

thus seen as endogenous to the system. Hayami and Ruttan indicate that changes may be dramatic or incremental and that:

In some cases the demand for institutional innovation can be satisfied by the development of new forms of property rights, more efficient market mechanisms, or evolutionary changes arising out of direct contracting by individuals at the level of the community or the firm. (p. 97)

Gordon (1994) defines transaction costs as the expenses of organizing and participating in a market or implementing a government policy. Transaction costs consist of both *ex-ante* and *ex-post* costs, those occurring before and after the actual transaction (Williamson 1985). Examples of types of transaction costs include: search and information costs, bargaining and decision costs, and monitoring and enforcement costs (Dahlman 1979). Foster and Hahn (1993) mention direct financial costs of engaging in trade, costs of regulatory delay, and indirect costs associated with the uncertainty of completing a trade. Some costly tasks associated with administering public laws and programs are: design of detailed regulations, development of application procedures, review of applications, and sending out of checks (Stiglitz 1986). It is important to note that transaction outlays do not constitute total transaction costs (De Alessi 1990). In some cases transaction costs may occur in the marketplace for the most part. Necessary tasks may be performed by hiring a lawyer, broker, or consulting firm, rather than being performed by the agent. In other cases, transaction outlays may be a very small component of total transaction costs.

While Coase pioneered work on transaction costs beginning in 1937, Oliver Williamson has further developed the concept, especially as it relates to the firm. Williamson (1985, 1993) explains economic organization, such as vertical integration and territory restrictions, as being the result of transaction cost minimization. It is an evolutionary versus technological approach in that, over time, institutions develop that minimize transaction costs. Transaction costs can thus induce institutional innovation. Hayami and Ruttan (1985) do not mention this as a source of demand for institutional innovation while Williamson (1985) focuses on transaction costs in the context of firm organization. Coase (1960) discusses transaction costs with respect to the choice between bargaining and litigation to resolve environmental externalities. This idea is applied to the case of developments with respect to native title in Australia.

Background:

Major events related to the native title issue have resulted in both dramatic and incremental institutional changes. The Mabo decision of 1992 precipitated legislation in the form of the Native Title Act of 1993. To limit the uncertainty produced after the Mabo court decision and to limit litigation on native title questions, the Native Title Act provides a process, the National Native Title Tribunal (the Tribunal), to facilitate recognition of native title by agreement rather than via court action (French 1997). This represents a major institutional innovation which decreases transaction costs. The Tribunal began operation in January of 1994. The Wik decision of 1996 raised the specter of native title claims on pastoral leases. Previously it had been assumed by many that the granting of pastoral leases extinguished native title. Amendments to the Native Title Act were put forward in 1997. John Howard's 10 Point Plan to limit the scope of native title and reduce the complexity of the current process was passed in amended form in July 1998. The Native Title Amendment Act of 1998 became effective in September.

In order to discuss the incremental changes that have occurred, and the rationale for further legislative changes, a brief summary of the role of the Tribunal and the mediation process as discussed in French (1997) and the Annual Report of the National Native Title Tribunal (1998) will be helpful. This section explains the situation and procedures before the recent amendments to the Native Title Act. The Tribunal receives native title applications and accepts them under most circumstances. Acceptance of an application only means acceptance into an administrative process. Applications are recorded on the Register of Native Title Claims which is a condition for the right to negotiate with mining companies regarding tenements. The number of claimant applications has increased from 82 in 1994-95 to 804 in 1997-98 (NNTT 1998). The Tribunal is to notify interest holders of a claim. Ideally this is done on an individual basis but often a variety of public media are used. There may be hundreds or even thousands of interest holders who may potentially be involved in mediation.

Once an application is accepted, a Tribunal mediation team is formed. Communication may occur between the mediation team and the interested parties and directly between the parties. Assistance provided by the Tribunal may include developing relationships with stakeholders, holding meetings, providing information on the process including agreement options and templates, identifying procedural and substantive issues, engaging mediation consultants, organizing parties into groups to simplify negotiation, and facilitating the resolution of conflicting aboriginal claims via the formation of working

groups (NNTT 1998, French 1997). Once the parties negotiate a determination, it is sent to the Federal Court for a consent order. Agreements about future development may occur independently of a formal determination of native title. If no agreement can be negotiated, the issue is decided through the adversarial and costly legal process in Federal Court (French 1997).

Future Acts refer to potential government actions that may affect native title such as the granting of mining leases or mining exploration tenements (a type of lease). The government must give notice of the proposed act. Ninety-eight percent of Future Act notifications were in Western Australia, primarily for mineral tenements. The number of Future Act applications has increased from 1 in 1994-95 to 194 in 1997-98 (NNTT 1998). Native title confers the right to negotiate terms, not a right to veto future acts. If no agreement is reached in the specified timeframes, one of the parties may apply to the Tribunal to conduct an inquiry and make a determination about whether and under what conditions the act may be done (French 1997).

If there will be minimal disturbance associated with the Future Act, an expedited procedure may be used. Notification occurs, and if no objections are filed, the tenement is issued. If an objection is lodged and upheld, the normal negotiation process takes over. In Western Australia, 85 percent of the tenement notices involved the expedited procedure and 57 percent of those didn't involve an objection. Objection rates have been increasing (from 0 in 1994-95 to 1706 in 1997-98) since the Tribunal is required to consider possible, not likely damage in deciding whether to uphold an objection (NNTT 1998). Under the Native Title Act and in light of the Wik decision, over 80% of Western Australia is now under native title claim (Humphry 1998).

Induced Institutional Innovations:

The formation of the agency is itself an example of an institutional innovation which reduces transaction costs. A stated goal of the Tribunal is to “promote practical and innovation resolution of applications under the Native Title Act of 1993” (NNTT 1998, p. 18). The Tribunal can thus also be seen as an institution that is designed to supply institutional innovation. A recent document by the Law Reform Commission “identified native title mediation as a unique alternative dispute resolution practice with many benefits including lower cost, practical solutions, and ownership of outcomes by the participants” (NNTT 1998, p. 23). Another advantage of negotiated settlement can include improved relationships between the parties since they have interacted face to face and haven't gone through the adversarial process. This also provides a basis for improved interaction between

parties in the future (Allan Padgett, personal communication). Colby (1998), discussing water transfers in the United States, indicates that lingering bitterness between parties in the Wind River case means that voluntary agreements cannot be reached over issues arising subsequent to the court case. Mediation versus the judicial system may also result in improved quality of the agreements since it can be more comprehensive and is designed to meet the needs of both parties. Colby (1998) also indicates that voluntary agreements are likely to be more stable than when issues are resolved through the court.

The adversarial process is time consuming in addition to the actual costs involved. The Delgamuukw case in Canada is an extreme example. It took 3 years to get into court, 3 years for evidence to be taken, with a total of 369 days of sitting. It was the largest civil case in Canadian history. It is estimated that the Gitksan spent \$8 million with a similar or larger amount spent by the government (Skerritt 1998). The Miriuwonong-Gajerrong case in the Kimberly region of Australia was sent to the Federal Court in February 1995, hearings were completed in 1998, and a decision in their favor was reached in November, 1998. The Western Australian government has spent \$3.36 million while the Aboriginal and Torres Strait Islander Commission (ATSIC) has spent \$1.3 million (NNTT 1998). In contrast, the Cape York Heads of Agreement was estimated to cost \$20,000. Time limits involved with the Future Acts serve to reduce transaction costs by concentrating effort and providing pressure for negotiation.

Another goal of the Tribunal is to provide information on the native title process to stakeholders and the community, reducing transaction costs of information acquisition by the parties. One example is the development of model agreements which lower the information costs involved with drawing up agreements. These are available on the Tribunal website. Another is a Geographical Information System (GIS) that is able to overlay land tenure, native title claims, and administrative regions. If this system is made public as hoped, it will decrease time spent by Tribunal staff fielding questions (NNTT 1998). Tribunal staff hold seminars to explain procedures to Indigenous and non-Indigenous stakeholders and also conduct negotiation training. Related to the Tribunal's work is a 1998 document called "Working out Agreements: A Practical Guide to Agreements between Local Government and Indigenous Australians" It was developed by the Australian Local Government Association in cooperation with the Aboriginal and Torres Strait Islander Commission.

Some evidence is provided by French (1997, p. 40) that there is progress in the mediation process. "There was a time, about two years ago, when complaints were made in some quarters that the mediation process was open ended and should be subject to time

constraints. To the extent that that complaint emanated from governments it is rarely heard now.... The Tribunal is asked more frequently not to terminate mediation and only infrequently to refer cases to the Court.” A Tribunal audit found that there have been 1,100 native title and Future Act related agreements in the first four and a half years of its operation. A key factor has been an acceptance of the need for negotiation on the part of mining companies.

In the Kalgoorlie gold rush era at the turn of the century, Aboriginal people were prohibited from working in the mining industry or staking mining claims. The relationship between mining companies and Aboriginal peoples has improved over the last 20 years according to Aboriginal individuals that were surveyed by the CSIRO (Chamber of Mines and Energy of Western Australia 1996). This has accelerated in the 1990’s. The Chamber of Mines and Energy of Western Australia developed or commissioned several reports on relationships between the mining industry and Aboriginal groups¹. While the industry’s motives are not entirely altruistic, these publications represent a positive step. Marcus Solomon, a lawyer for mining interests, indicated that they are coming to accept native title negotiations as a part of business, similar to environmental regulations (ABC 1998a). On the other hand, mining interests have been generally in favor of amendments to the native title act that serve to decrease the right to negotiate.

Regional agreements had the potential to lower transaction costs under the Native Title Act but the legislation (Section 21) wasn’t properly constructed to provide security for those agreements (Padgett, 1997). Nevertheless, regional agreements have progressed in Western Australia. A group of 20 mining companies from the Goldfields has formed the Mining Company Forum. They have worked out a number of agreements related to mining exploration with the North East Independent Body, a group of about 20 native title claimants. The claimant body has agreed not to object to the expedited procedure for Future Acts and “...overlapping claims and multiple sets of the right to negotiate are not an issue” (NNTT 1998, p. 38). This type of innovation is especially relevant in Western Australia because of the large number of small mining companies. According to Gorman (1998), 64%

¹ “Relationships Between the Mining Industry and Aboriginal Communities – A Way Forward” was the result of a survey of Aborigines and mining industry staff. Two other reports related to Aboriginal employment “A Guide to Aboriginal Employment in the Mining Industry” and its companion publication “Aim for One Workforce – A Guide to Aboriginal Employment and Enterprise Development in the Mining Industry”. Another publication was “Forging Links – Policies and Strategies for Strengthening Relationships Between Mining Companies and Aboriginal Communities” which emphasized the need for cooperation at the local level.

of the mining companies involved in agreements she examined had assets under \$10 million and small companies have less time and resources to allocate to the negotiation process.

A variety of factors may make the process more complicated for both the mediated and legislated paths (French 1997). These include (p 37) “the number of parties, the number of those with common representation, the likely time taken to reach agreement, the area under claim, and the nature and extent of non-native title interests” and other factors. Some innovations have been developed by the Tribunal to reduce transaction costs associated with native title. To deal with the issue of conflicting and overlapping claims, the Tribunal has formed working groups of the native title claimants. The dramatic increase in the number of applications without a concomittant increase in resources has necessitated the development of a policy of triage or differential application of resources according to the likelihood of success of the mediation process.

State and Territory governments have caused delays in many cases, thus increasing transaction costs (Ambelin Kwaymullina, personal communication). In 1998, the state of Western Australia asked that 60 applications be referred to Federal Court, although to date only 24 have been referred. Since a Federal Court decision in 1996 the government is required to negotiate in good faith with native title parties and the Tribunal has developed good faith indicators. Olga Havnen (ABC 1998b) indicates that governments need to be involved in the development of regional agreements because they must be involved with enforcement of the agreements. Under Section 34 of the Native Title Act, agreements are tripartate, including claimants, mining companies, and government. In some states (although not Western Australia) the government has provided benefits such as employment and infrastructure as part of agreements (Gorman 1998). In some cases, government failure, such as the delaying tactics mentioned above, has been circumvented by the private sector.

The Native Title Amendment Act 1998 includes some provisions that can be interpreted as decreasing transaction costs associated with the native title process which according to Humphry (1998) has become unworkable. According to French (1997) however, not all changes to the Native Title Act serve to decrease transaction costs. In a November 1998 article in the Australian, French compared the emergence of State-based native title regimes to the time when railroad gauges differed from state to state. He indicated that differing rights for claimants will add complexity to the native title process, even though native title springs from one common law principle. Before the amendments were passed, French indicated that transaction costs such as “the cost to the Court, the applicants, the government involved and therefore to the public purse” (p. 38) are not explicitly mentioned

in the proposed legislation as a factor the Court must consider (French 1997). Under the new legislation, native title claims will be lodged in Federal Court, rather than with the Tribunal and French suggested that this would complicate the process. He also suggested that provisions which would essentially establish a threshold test may increase transaction costs by increasing information requirements and increasing disputes within a native title group, or decrease transaction costs by limiting overlapping claims. Marcus Solomon indicates that the threshold test is generally viewed as a positive development both from the industry and Indigenous perspectives (ABC 1998a). Rick Farley indicated that the lack of a threshold test, in which claimants need the approval of the community or elders to lodge a claim, has resulted in problems for industry but also divisiveness in Aboriginal communities (ABC 1998b).

If native title is thought of as a common property resource, collective action of rival claimants has the potential to reduce transaction costs and conflict and improve prospects of a successful claim. French (1997, p 34) puts this in non-economic terms saying "...there is also a powerful incentive to continuing consultation and the ongoing management of conflict or divergent interests within the group". The amended Act would promote the creation of representative bodies for Aboriginal groups. This would serve to decrease overlapping claims since only one body would be recognized for a particular area. Functions to be performed by these bodies include: "facilitation and assistance in researching and preparing native title applications, certification of native title applications for the representation area, provision of dispute resolution and mediation facilities for intra-Indigenous conflict, ensuring that all notices received about the area are properly relayed to constituents, and that the body is recognized as a party to any Indigenous land use agreements in respect of the particular area" (French 1997, p 62).

One institutional innovation in the legislation was to enable Indigenous Land Use Agreements, or ILUAs, which is discussed in Smith (1998) and summarized below. This concept was first proposed by Justice French and the goal is to facilitate the agreements process. There are three types of agreements, 1) Body Corporate Agreements (a body corporate is established after a successful native title determination), 2) Area Agreements (with a native title group), and 3) Alternative Procedure Agreements. The parties in ILUAs have greater control over both process and outcomes. It is possible to craft ILUAs when a native title determination has not been made and in some specific agreements, parties may give up the right to native title, thus decreasing uncertainty. These agreements are flexible in that they can be implemented in stages or tied to sequential future agreements. The range of

land use issues that can be addressed is more broad than under the previous legislation. Coverage may be regional which may reduce transaction costs involved with coordinating Aboriginal groups and government administration of the agreement. ILUAs may also more fully recognize Indigenous rights and interests and incorporate their land use and management practices and institutions. Depending on the ILUA type, Indigenous agencies may be parties to the agreements and the government does not have to be a party to some types of agreements. Therefore this institutional innovation has the potential to improve the quality of agreements reached and also reduce transaction costs.

The Native Title Amendment Act also clarifies what types of titles and leases extinguish native title (Humphry 1998), thus decreasing uncertainty. The Future Act provisions do not apply on land where native title has been extinguished.

Model of Transaction Costs

In the case of native title, the magnitude and types of transaction costs will differ depending on whether there is a negotiated agreement or litigation. In the case of a negotiated settlement, costs would include time spent by all parties in formal and informal meetings, time spent by Tribunal staff, consultants fees, costs of acquiring and processing information, costs involved with site clearance such as anthropologists time, travel costs, costs of delay, and monitoring and enforcement costs. Many of these transaction costs, particularly in the case of native title claimants, are not out of pocket expenses. If a native title claim is referred to the Federal Court, transaction costs would include lawyers fees, costs of expert witnesses, time spent by parties in meetings, costs of acquiring and processing information, costs of delay, and monitoring and enforcement costs. In the latter case, a larger proportion of transaction costs will be out of pocket expenses or transaction outlays. Some types of costs appear in both negotiated and litigated outcomes such as information, delay, and monitoring and enforcement costs. One would expect information costs to be higher in the litigated outcome due to the burden of proof and this as well as the court schedule, would also result in greater delays. Given the improved relationships, as well as the improved quality of a negotiated outcome, monitoring and enforcement costs should be lower than in the litigated case where one party may feel the outcome was not “fair”. Because of the short period of time that the Native Title Act has been in effect, it is not yet possible to determine what enforcement issues will occur in the future.

In the case of Future Acts, the alternative to a negotiated outcome is arbitration, rather than being referred to the Federal Court. One would expect transaction costs to be intermediate between the negotiated and litigated cases.

A related issue is the determinants of transaction costs associated with native title. These may include time, trust, institutions, uncertainty, information accessibility, size of claim, and number of claimants. One would expect that experience over time would lower the costs of negotiated agreements in much the same way that learning by doing is hypothesized to reduce production costs as the number of items produced increases. Transaction costs thus have a dynamic aspect. There are fixed costs associated with learning about native title and the negotiation process but a mining company would be able to build on this in future negotiations. In addition to this factor, changes in institutions and information accessibility, primarily by the Tribunal, have reduced transaction costs over time. Trust and a willingness to engage in the process lower transaction costs involved with negotiation due to decreased delays, increased acceptance of information presented by the other party, and less detail required in the agreement. Mining companies, taking a pragmatic approach, have typically been more willing to engage in negotiation than state governments.

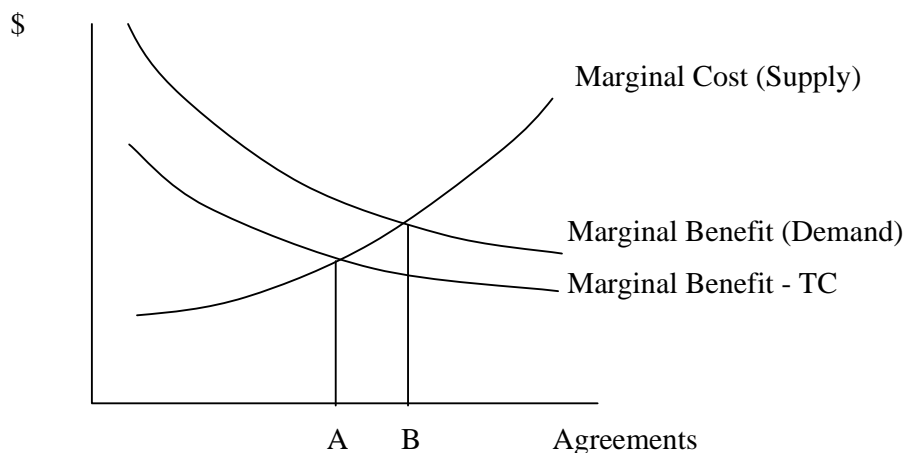
Laws and institutions that limit overlapping and conflicting claims, place time limits on negotiation, allow regional agreements, improve coordination, and generally facilitate negotiation, would decrease transaction costs. Uncertainty about the process and future changes would tend to increase delays and increase the time spent gathering information and crafting detailed agreements. The Tribunal has provided information on the Native Title Act and the negotiation process, which would decrease information costs and reduce uncertainty for negotiating parties. Other things equal, one would expect size of area under negotiation to be positively related to transaction costs both due to the higher economic value as well as a greater diversity of land uses and larger number of interests involved. Multiple claimants and the existence of overlapping claims is seen by the Tribunal as a major complicating factor in negotiated settlements. In the case of pastoralists, there is less money available for costs associated with negotiation compared to the mining industry, exacerbating the problems discussed by Gorman (1998) in relation to small versus large mining companies. As in the case of nonpoint-source pollution versus point source pollution (Easter 1991), transaction costs are likely to increase.

One can examine the effect of transaction costs on the number of agreements reached using a modified supply and demand diagram. For simplicity the focus will be on Future Acts since this is the most common type of application and agreement. On the horizontal axis is

the number of agreements reached. On the vertical axis is a dollar value. In the case of agreements reached between native title claimants and mining companies, direct compensation is usually not provided to native title claimants. Mining companies generally agree to provide training and jobs for Indigenous people, to avoid sacred and otherwise important sites, and to rehabilitate the area. Similar to using supply and demand diagrams for pollution abatement, the assignment of property rights determines which party is represented by the supply curve and which by the demand curve (Randall 1981). In this case, the supply curve represents the cost to native title claimants of giving up some or all rights over land. It is shown as increasing with the number of agreements since certain areas may have more significance than other areas. The demand curve represents the value to the mining company of an agreement over a tenement. Certain areas are more likely to have high value mineral deposits.

Transaction costs are shown as being paid by the mining companies since generally the party desiring a change from the status quo bears the majority of these costs, although both parties bear some costs. The effect of transaction costs is to lower the number of agreements from the base case. The transaction costs are shown to decrease as the number of agreements reached increases based on the previous discussion. Demand and supply curves may also depend on the particulars of the agreement, for example, if agreements involve fewer rights being given up by the native title claimants, or more conservation requirements, the supply curve would shift to the right. If there is lower uncertainty or more security of the property right being negotiated, then the demand would shift to the right. Changes in legislation or institutions can shift the transaction cost adjusted demand curve to the left if it increases transaction costs and to the right if it decreases them.

Figure 1. Transaction Costs and Number of Agreements



Compared to court decisions that often favor one party or the other, negotiations or bargaining leads to a compromise or balance in the allocation of rights, much like the optimal amount of pollution abatement. This balance is more economically efficient than the case where bargaining is not allowed.

An aspect that hasn't been discussed is the externalities associated with agreements. Compared to the situation prior to the Native Title Act, the environment is more likely to be protected when mining companies have to negotiate with native title claimants. Given the interests in conserving country, agreements struck between Aboriginal groups and mining companies may benefit other Australians who are concerned with nature conservation. Environmental or conservation benefits and land use rights accrue to the native title claimants but could also produce positive non-use benefits to others in society who want to reduce the damage caused by mining. Agreements may include the preservation of certain sites or more strict rehabilitation requirements. On the other hand, this may reduce welfare of other groups in society such as people who previously used land that was under claim. Since transaction costs may decrease the number of agreements, this may also indirectly benefit the environment as indicated in Colby (1990). She showed that transaction costs involved with water transfers served to protect the environment, even when environmental interests were not allowed to be considered in water transfer approvals.

Future research could include measurement of transaction costs (McCann, 1999), or a logit model that examines factors that influence whether an agreement is reached or whether the case is referred to Federal Court. An empirical study of induced innovations as a function of transaction costs would treat data on the time taken to achieve settlements as a proxy for transaction costs. The time taken could then be analyzed in relation to the institutional changes experienced and other factors involved with the particular agreement.

Conclusions:

Several changes that have occurred over time with respect to native title in Australia can be interpreted as induced institutional innovation in response to transaction costs. The National Native Title Tribunal was itself an institutional innovation designed to reduce the transaction costs associated with native title determinations by the Federal Court. Incremental innovations since the establishment of the Tribunal have also generally tried to facilitate the negotiation process and reduce information costs of all parties. While one aspect of the Native Title Amendment Act of 1998 represented a realignment of property rights away from native title claimants, other components of the legislation are designed to

reduce transaction costs due to multiple and overlapping claims and to allow more comprehensive and flexible agreements. The legislation also allows states to develop their own agencies and procedures to deal with native title issues. Hopefully they will build on the innovations developed by the Tribunal and mining interests.

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