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# Institutional economics and economic development

Institutional  
economics

## The theory of property rights, economic development, good governance and the environment

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**Keywords** *Economics, Property rights, Performance, Governance, Environment, Fiji*

**Abstract** *This paper discusses the institutionalists' economic thought and how they saw the role of property rights in economic development. It points out that the role of various institutions in the economic performance of many developing countries cannot be ignored. One of the important institutional factors in many developing countries and transitional economies is the nature and definition of property rights. This paper therefore addresses the impact of property rights on overall economic performance of a country and more specifically on agricultural production and on the conservation and management of the environment. It is generally agreed that property rights are a claim to a benefit stream where the state provides protection from others who may interfere with the benefit stream. Well-defined property rights are considered vital for transitional economies which are undertaking major structural changes. The recent literature on property rights in transitional economies is largely concentrated on the former socialist and communist economies of Eastern Europe, which are embracing the market economy. However, this also has significant implications for many developing countries like Fiji which can also be considered as transitional economies. For Fiji the transition is from a highly protected, inward-looking economy towards an export-oriented economy. Getting the property rights "right" seems to be one of the major obstacles to economic reform agendas for many of the South Pacific countries including Fiji.*

### Introduction

The purpose of this paper is to briefly consider a number of issues relating to the role of property rights in economic development, but more generally to consider the theoretical frameworks in which the issue of property rights has been considered. More specifically the paper provides a theoretical discussion of some of the major issues regarding the role of property rights, including the issue of efficient resource allocation, which are relevant for economic policy making. It should be pointed out at the outset that the literature on the role of property rights in economic performance is both diverse and extensive. Therefore, the discussion in this paper is selective and draws examples from the Fiji Islands and other Pacific Island nations where the nature of property rights in land acts as an institutional impediment to economic performance.

Bromley and Cernea (1989, p. 5) define property rights as "a right to a benefit stream that is only as secure as the duty of all others to respect the conditions that protect that stream". Thus property rights involve institutional



International Journal of Social  
Economics  
Vol. 30 No. 6, 2003  
pp. 741-762  
© MCB UP Limited  
0306-8293  
DOI 10.1108/03068290310474120

issues which relate human behaviour to the exploitation of a particular resource. Property rights are also related to the broader questions of economic growth, democracy and political and economic freedom of individuals, and environmental concerns in many developing countries. As discussed later in the paper, the issue of property rights is currently a very vital issue for former socialist and communist countries which are at present making a transition to a market economy.

The role of property rights and its relationships to economic development and environment can be discussed within the broader economic literature of institutional, environmental and development economics.

The structure of the paper is as follows. The next section discusses the institutionalist's approach to economic policy making. The following section addresses the relationship between property rights and economic performance, while the next section considers the development of property rights in transitional economies. The next sections provide a discussion of the relationship of property rights to broader issues such as democracy, economic growth, rent-seeking, good governance and the differences between the Western concept of property rights and some of the indigenous concepts of property rights. The final section deals with the role of property rights in the conservation and management of the environment.

### **Institutional economic framework**

According to advocates of institutional economics, the discussion of institutions as a serious issue in economics is much more legitimate now than perhaps what it was in the late 1960s and 1970s (Maki, 1993, p. 3). Samuels (1995, p. 570) also maintains that institutionalism is much more important and has been revitalized and claims that institutional economics has a lot of prospect of providing a useful framework for economic analysis in the future. Development economists such as Hirschman (1958), Leibenstein (1957), Myint (1965), Fei and Ranis (1964), Myrdal (1957) and Nurkse (1953) considered institutional factors and indeed institutions as important dimensions in explaining economic development problems. But before the discussion on why it is much more important now, it is important to briefly trace the development of institutional economics as a serious issue in economic analysis.

The current debate within the institutional economic thought is divided between the old and new institutionalists. Rutherford (1995, p. 443) points out that on close examination the old and new institutionalists do not differ much and that both grew out of concern at the lack of consideration of institutions in conventional neoclassical economic analysis. Rutherford (1995) identifies new institutional economics with Douglas North's contribution and the old institutional economics with Veblen, Mitchell and Commons's contribution. While the purpose of this paper is not to analyse the debate between the old and the new institutionalists, it is nevertheless appropriate to highlight some of the points that are often raised. Again, Rutherford (1995) provides an explicit

account of the old institutionalist's view. He points out that according to Veblen technological changes in society brings about changes in the social and cultural attitudes and indeed the institutions that support them. Veblen refuted the idea that individuals always maximize behaviour and act rationally. He suggested that behaviour is conditioned by different social and cultural attitudes prevailing at a particular time. Mitchell, according to Rutherford, provides a similar argument as Veblen but puts less emphasis on technological change. Commons (1950) emphasizes the development of institutions as caused by changes in both the political and judicial processes. Interest groups and political parties and organizations may determine the kind of institutional structures that are created in the society.

The new institutionalism is identified with Douglas North's contribution to the theory of institutions and economic development. According to Libecap (1992, p. 227):

Douglas North has been one of the foremost economists in asserting that much more attention must be directed to the institutional structure of a society in general, and to its property rights arrangements in particular, for explaining variations in economic performance across societies and across time.

North's critics, however, point out that he may have ignored contributions from the old institutionalists (Dugger, 1995, p. 453; Stanfield, 1995, p. 459). Others such as Groenewegen *et al.* (1995, p. 473) seem to agree that North's later contribution may be "consistent with the old and neo-institutionalists, especially with the idea of John R. Commons". Despite the methodological debates between the old and the new institutionalists, the role of institutions in explaining economic performance is widely accepted. The neoclassical theory of rational choice and individual maximizing behaviour is being increasingly challenged and modified through the work of new institutionalist's such as Douglas North. It is therefore appropriate to further discuss North's contribution.

North's contribution can be traced from as early as 1955 when he first explained economic growth in terms of the institutional structures present in a developed capitalist state (North, 1955, p. 243). Subsequently he moved from this position to explain the role of institutions in the performance of economies and tried to explain both efficient and inefficient institutions and how these affected the economic variables such as GDP or economic growth in general (North and Thomas, 1973, p. 127). Within the institutional structures, issues such as property rights, role of states and the bureaucratic structures and technology have occupied prominent positions. The power structure in society was seen by North to be an important factor in determining the kind of institutional structures that emerged. For example North (1981, pp. 23, 27) points out that the bargaining process between the rulers and subjects may bring about inefficient outcomes.

North further points out that the standard neoclassical theory may be inadequate in explaining the economic variables when transaction costs are not

zero. Indeed, he postulates that transaction cost is always positive and if this is the case then institutions matter. North (1991, p. 97) defines institutions as follows:

Institutions are the humanly devised constraints that structure political, economic and social interaction. They consist of both informal constraints (sanctions, taboos, customs, traditions, and codes of conduct), and formal rules (constitutions, laws and property rights). Throughout history, institutions have been devised by human beings to create order and reduce an uncertainty in exchange. Together with the standard constraints of economics they define the choice set and therefore determine transaction and production costs and hence the profitability and feasibility of engaging in economic activity. They evolve incrementally, connecting the past with the present and the future ... Institutions provide the incentive structure of an economy; as that structure evolves, it shapes the direction of economic change towards growth, stagnation, or decline.

According to North, the existence of different kinds of institutions ultimately determines the kind of economic performance a particular country achieves. Specific institutional conditions need to be taken into consideration when policy prescriptions are put forward. Various incentive structures are determined by the different institutions and therefore the outcome of economic activities may be efficient or inefficient. On the basis of this he criticizes neoclassical theory for ignoring the existence of institutions. By understanding institutions and change, by integrating institutions in economic models and by understanding political processes the problems of economic development in many Third World countries can be better explained. North believes that the historical processes are important and he states for example that, "it is institutional analysis that connects change in economies over time, ties the past to the present and future, and relates the separate parts of an economy to each other" (North, 1993, p. 259).

Samuels (1995, p. 573) summarizes eight aspects of institutional economics as follows:

- (1) Institutional economists tend to emphasize the evolutionary processes through which an institution evolves and rejects the neoclassical theory of automatic adjustments mechanisms through changes in the price system.
- (2) Institutionalists reject the neoclassical view of a free and efficient market. They emphasize that the existence of institutions suggests collective actions on the part of individuals in the society. They also argue that the market system is itself a result of different institutions existing at a particular point in time.
- (3) An important point made by institutional economists is that the state of technology is not given. Technology is a process of continuous change and this causes important institutional changes. It determines the ultimate availability of physical resources.
- (4) Institutionalists propagate the view that resources are allocated through the various institutional structures and in particular the various power relations in the society. In fact, in many developing countries large

amounts of resources are vested in the hands of the local elite and those in political offices. Often there is a deliberate collusion between the local business elite and those who control state power in the process of allocation of national resources.

- (5) According to Samuels (1995, p. 574), "the institutionalist's theory of value does not concern the relative prices through which the values ensconced in institutions, social structures and behaviour are worked out".
- (6) Both culture and power determines the way in which an individual behaves. Individuals are bound by the society's norms and values and they behave in a collective rather than an individualist way. This view again refutes the standard neoclassical view of individual maximizing behaviour.
- (7) Samuels (1995) points out that institutional economists are more "pluralistic or democratic in their orientations". He suggests that the neoclassical view often accepts the given institutional structure and within this it also takes as given the power and social structure. It is not concerned about the inequality and other social evils that may be a result of the existing institutional structures.
- (8) Finally, the institutional economists view the economy in a holistic way and have tried to explain economic activities in a multi-disciplinary way.

One of the criticisms of the institutional economists by the mainstream orthodox economic analysis is that institutionalists merely present a dissenting view to neoclassical economics. They claim there are no credible alternatives offered by the institutionalists. To this institutionalists respond by claiming that they have moved beyond dissent and have accepted a challenge to provide credible alternative economic analysis (Kelin, 1993). In fact Kelin (1993, p. 14) points out that "while the founders of institutionalism, Veblen, Mitchell and Commons were skeptical about the adequacy of neoclassical theory, their preoccupation was not to criticize only but they also tried to put forward alternative theoretical perspectives".

Institutionalists have been increasingly critical of the ability of mainstream economics to explain the continued economic development problems not only in the developing world but also in the developed world. Tool (1993) for example, points out the inadequacy of policy making through orthodox economics and its resurgence in the 1980s by the Thatcher government in Britain and Reagan administration in the USA. Policies such as deregulation, privatization, reduction in the size of government were all designed to improve the workings of the market. He points out that, "In consequence, by design or inadvertence, a large number of fundamental economic and social problems were left insufficiently addressed and unresolved, including protracted unemployment, increasing inequality of income, increasing poverty, neglect of children and their needs, corrupted and deferred environmental management,



under-funded infrastructure, deficient support for education, destabilized financial structure and the like" (Tool, 1993, p. 2). The policy packages of Reagan and Thatcher eras have been translated into the new role of both the International Monetary Fund (IMF) and the World Bank. The policy reforms advocated by the IMF and the World Bank in many Third World countries invariably include privatization, deregulation, and reduction in the size of government and an overall commitment to free trade and a well developed market system. Many commentators on the performance of these policies have doubted the ability of these policy prescriptions to bring about meaningful development benefits to the peoples of Third World countries (Singer *et al.*, 1991). According to Tool (1993) the economic malaise of many western countries and also the Eastern European and the former Soviet bloc countries have led to increasing doubts about the ability of orthodox and Marxist/socialist type policy principles to bring about desired economic results. He feels that institutional analysis may shed some light on the rethinking of policies for economic development.

According to Adams's (1993, p. 245), "institutional differences are fundamental in explaining national development paths". He provides a useful account of the way in which the role of institutions as structure, process and incentives affect economic development. Adams' contention is that development economics must be different from the mainstream economics because it recognizes the institutional constraints. However, Adams (1993, p. 250) also highlights the differences between the development economists and institutionalists as follows:

Despite much agreement and interaction, an important division remained between institutional economists and development economists: the former stressed the importance of institutions and the dysfunctions of market capitalists system in all settings, while the latter generally held to the tenet that institutions mattered and markets are meaningful flawed only in relatively underdeveloped areas.

As structures, institutions in society determine the way in which social, cultural political and economic relations are conducted. It is therefore important from the institutionalists' perspective that various structures that form the institutions need to be carefully considered in policy making. As a process, institutions and what they do, are according to Adams (1993) meaningful in understanding the changes that take place in an economy or in the society as a whole. These processes help to shape the various rules and procedures often applied in conducting economic activities.

From the discussion of the institutionalists' literature so far it is amply clear that institutional economics as a sub-discipline provides meaningful insights into understanding the development problems not only in the developing countries but also in the developed countries. The objective of this thesis is to study the relationship of one of the institutional features, that is property rights on the economic development and environment of Fiji. Therefore the rest of this paper will consider the theoretical underpinnings of the role of property rights

in economic development and environment. More specifically it will also consider the theoretical and conceptual framework of the nature of property rights in land. Related to the development of the type of property rights structure in an economy is the issue of rent-seeking activities which will also be considered. Rent-seeking arises from the fact that individuals or groups possessing property rights often have rent-seeking objectives so the discussion of the process involved should shed some light on it.

### **Property rights and economic performance**

The literature on the definition of property rights is varied; however, two of those which perhaps include a general definition are important. Bromley (1991) defines property rights as a claim to a benefit stream that the state will agree to protect through the assignment of duty to others who may covert, or somehow interfere with the benefit stream.

Furubotom and Pejovich (1974, p. 3) define property rights as follows:

Property rights are understood as the sanctioned behavioural relations among men that arises from the existence of goods and pertain to their use. These relations specify the norms of behaviour with respect to goods that each and every person must observe in his daily interactions with other persons, or bear the cost of non observance. The term "good" is used here for any thing that yields satisfaction and utility to a person.

Following Coase (1960) it became somewhat legitimate to include the structure of property rights in the analysis of many policy questions (Bromley, 1991). Coase agreed with the view that clear definition and secure property rights are necessary for economic efficiency. He argued that in a world with full information, strict administration and enforcement of contracts and low transaction costs, distortions in the market arising from externality can be resolved by a clear definition of property rights. Coase (1960) also demonstrated that when property rights are well defined and the transaction costs zero then resources would be allocated to agents where it is most valued regardless of which of the transactors assumes liability for their effects on any other agent. As pointed out by Barzel (1989) Coase does not address the conditions under which liability problems arise. Barzel (1989) points out that liability poses a problem only in the presence of variability that is too costly to eliminate.

The standard neoclassical theory assumes a set of private property rights that already exists and which governs the use of all natural resources. Individuals engage in economic activities where exchange, enforcement and policing costs of contractual activities are zero. The conclusion often drawn is that capitalism is an efficient system because it allows the right of ownership and contractual freedom (Pejovich, 1990). This means that under this system individuals are free to pursue profit-maximizing or utility-maximizing activities and that this ensures an efficient allocation of resources. However, this may not always be the case. For instance costs may be involved in the actual maintenance of the private property rights structure. Apart from this, there is also the case of "information asymmetry" (Riker and Weimer, 1994).

Riker and Weimer (1994) point out that in the process of exchange there is unequal sharing and accumulation of information. This may lead to inefficient outcomes and may thus strain the neoclassical framework. Tietenberg (1992) accepts the neoclassical premise and suggests that an efficient structure of property rights could produce efficient allocation of resources and he identifies four characteristics of property rights which are necessary (Tietenberg, 1992, pp. 45-6):

- (1) *universality* – all resources are privately owned, and all entitlements completely specified;
- (2) *exclusivity* – all benefits and costs accrued as a result of owning and using the resources should accrue to the owner, and only to the owner, either directly or indirectly by sale to others;
- (3) *transferability* – all property rights should be transferable from one owner to another in a voluntary exchange; and
- (4) *enforceability* – a property rights should be secure from involuntary seizure or encroachment by others.

Tietenberg's framework is very similar to that proposed by Randall (1987) who also put four conditions for efficient allocation of resources as complete, exclusive, transferable and enforceable. Posner (1977) provides three conditions for efficient property rights which include universality, exclusivity and transferability. These two very similar frameworks are important from the point of view of resources. This means that if exchange (trade) under these conditions takes place then resources will be allocated to or in accordance with highest value end uses. In fact, Tietenberg believes that analysis of the property rights structure can reveal that the failure of one or more of the conditions above has caused inefficient allocation of resources.

North (1990) sums up the issue of property rights and the neglect of the issue of property rights as an aid to explaining economic performance as follows (North, 1990, p. 11):

The disparity in the performance of economies and the persistence of disparate economies through time have not been satisfactorily explained by development economists, despite forty years of immense effort. The simple fact is that the theory employed is not up to the task. The theory is based on the fundamental assumption of scarcity and hence competition, its harmonious implications come from its assumptions about friction-less exchange process in which property rights are perfectly and costlessly specified and information is likewise costless to acquire. Although competition scarcity has provided the key underpinning of neoclassical theory, the other assumptions have not survived well.

What the above definition suggests is that the world or society in reality does not conform to the assumptions made by the neoclassical theory and hence to rely on that analysis to explain the performance or failure of economies may not always give a true picture of the economy. The attempt to include the issue of property rights and indeed the various institutions that underlie these rights into economic analysis stems from cost considerations. Various advocates of



property rights analysis such as Cheung (1970), Demsetz (1967), Alchian (1974), Wallis and North (1986), Barzel (1989) and Pejovich (1990) point out that any system of property rights entails costs and this needs to be taken into consideration. While there is disagreement on the actual costs involved in the maintenance of different property rights systems, it is not a major point of contention. For example, the costs in maintaining a private property rights system may be much lower in civil society where democratic principles are highly valued and may be very high where the rule of law may be in danger, that is the cost of maintaining private property in such a country may be higher. Private property is only secure and its owner can only reap the benefits from it, if others are prevented from the use or appropriation or theft. When common property or communal property exists, institutions created to manage those resources may be costly. For example, the establishment of the Native Lands Trust Board in Fiji for the administration of the Native Land is seen to be very costly and an inefficient institution (World Bank, 1991).

The theory of property rights and the institutions that support the maintenance of particular types of property rights invariably imply that it is an important factor in explaining the differences in economic growth and development amongst countries and in particular Third World countries. While many theorists agree that a system of private property rights which meets the four characteristics of universality, exclusivity, transferability and enforceability will ensure efficient allocation of resources, they realise that in most cases these characteristics are never met. This leads them to conclude that the analysis of property rights and associated institutions can provide improved evidence of the problems or impediments to effective economic growth and development.

Pejovich (1990), for example, points out that, many reasons for differences and problems of economic development have been identified. He further points out that many developing countries attributed their problems to lack of resources, lack of capital and exploitation by former colonies but after decades of sovereignty they are still in inferior economic conditions. While it is not possible to discount the factors such as lack of resources and capital in economic growth and development, these alone do not fully explain the economic failures in many developing countries. This is one reason why the theory of property rights as proposed by its proponents is a useful tool for understanding the problems or impediments to economic development.

Pejovich (1990) has produced empirical evidence suggesting that those countries that have shown respect for the right of private ownership and freedom of contract have done better than other countries regardless of their respective availability of resources, high or low rates of savings, or growth-oriented economic policies. According to Adams (1993, p. 245) "institutional differences are fundamental in explaining national institutions as structure, process and incentives affect economic development". Adams' contention is that development economists differ from main stream economics because of

their recognition of institutional constraints. However, Adams (1993, p. 250) also highlights the differences between development economists and institutionalists as follows:

Despite much agreement and interaction, an important division remained between institutional economists and development economists: the former stressed the importance of institutions and the dysfunctions of market capitalists system in all settings, while the later generally held to the tenet that institutions mattered and markets are meaningful flaw-ridden only in relatively underdeveloped areas.

It follows then that the role of property rights is a vital component of economic growth and development. It is therefore logical to argue that the key to the explanation of why economic development has been limited both historically and currently lies in the institutional or property right structure of the country. The economics of property rights quite unambiguously points out that investment by entrepreneurs is an essential ingredient to economic growth. Both firms and individuals in the pursuit of investment have to undertake risks and if property rights are not clearly defined then the ability of investors in general to invest is limited by their own choice.

For the purpose of this paper, the definition of property rights (property rights are relations among men that arise from the existence of scarce goods and pertain to their use) provided by Furubotn and Pejovich (1974) is consistent with the arguments that will follow. According to Pejovich this definition is consistent with Roman law, common law, Karl Marx's writings and the new institutional (property rights) economics. This definition does not separate human rights from property rights, indeed one's right to vote and speak is one's property right and that it is a necessary human right (Macpherson, 1978; Barzel, 1989). And, if this is restricted by legislation, constitutions or other institutions then it will have a serious repercussion on the kind of economic activity an individual or a firm might undertake.

#### *Property rights in land*

In this section I provide only a brief introduction of the issues in relation to the property rights in land. The impact of property rights on agricultural productivity has attracted a lot of interest by economists and research in this area is continuing. The reason for this is best summarized by Jaynes (1984, p. 43) as follows:

... a growing reemergence of the belief that agriculture has a primary role to play in the development of contemporary economies; a closely related realization that land tenure institutions must be understood if past agricultural societies are to be put in historical perspective; and finally, the recognition that tenurial organization is connected to the problems that have given rise to the theory of information, uncertainty, and incentives.

The nature of property rights in land and its impact on agricultural productivity has been the focus of economists for a long time including Adam Smith, Karl Marx, Alfred Marshall, Richard Jones, and John Stuart Mills. The classical economists have generally regarded the development of the nature of

property rights in land as a “historical-evolutionary process”. Jaynes (1984, p. 44) points out four modes of tenancy arising from the classical approach which include, “rent in the form of labour, share rents, fixed rents in the form of produce and fixed rents in the form of money”. Most of the writers including Adam Smith recognize the importance of well defined property rights in land in enhancing productivity in agriculture.

### Property rights in transitional economies

Fiji's economy can be described as being in the process of transition. While it does not reflect the magnitude and scope of transition of former socialist economies, it nevertheless reflects similar principles. In the case of Fiji, the transition is from an import-substitution economy to an export-oriented one. While the property rights issue has always been a concern, it has become an important issue in the midst of the new economic policies. Even the World Bank which traditionally refrained from highlighting the property rights issue has now identified it as a major problem (World Bank, 1995).

From the institutional economics perspective, “getting the prices right” is considered less desirable for transitional economies such those in Eastern Europe and former Soviet states. Williamson (1995, p. 173), for example, points out that:

Although eliminating tariffs, quotas, and subsidies and making markets work have a lot to recommend them, that prescription too is over simple and poorly suited to the needs of reforming (as against developing) economies. “Getting the property rights right” seemed to be more responsive to the pressing needs for reform in Eastern Europe and the former Soviet Union.

Structural adjustment policies advocated by the World Bank and the IMF invariably imply “getting the prices right”. Privatization policies for example pursued by many developing countries involve eliminating the inefficient public enterprises and as Williamson (1995) points out it has become the “new prescription”. Privatization *per se* however does not mean efficiency and competition as the process itself has been controversial. Frydman and Rapaczynski (1993, p. 13) point out that:

... the meaning of privatization in Eastern Europe has turned out to be complex and ambiguous. Instead of the clarification of property rights and the introduction of incentives characteristics of a capitalist society, the privatization process has so far often led to a maze of complicated economic and legal relations that may even impede speedy transition to a system in which the rights of capital are clearly delineated and protected.

The inconsistency of the privatization process also causes problems for many countries involved in the transition. Privatization is often seen as a sectoral issue rather than one which is related to all the sectors. In Fiji, for example, privatization implies sale of public enterprises which are inefficient. It is not extended to other sectors such as land and natural resources which are communally owned and which may have a direct impact on the privatization process itself. However, it is sufficient at this stage to hypothesize that

incentive characteristics for a capitalist economy are conspicuously absent. The property rights issues are clearly in the forefront of the factors affecting the performance of the Fijian economy.

### **Property rights, economic growth and democracy**

The collapse of the Soviet Union and the transition to democracy and capitalism has once again brought the debate on democracy versus economic development to the forefront. This debate can clearly be separated in terms of the optimistic and the pessimistic view. Goldsmith (1995, p. 157) points out that "often left out of the equation is property rights as a factor distinct from democratic rule". While property rights as an issue is directly linked with the type of government, there is still debate about the ability of governments to ensure secure property rights. First it is appropriate to look at the issue of democracy and economic growth. The pessimistic view is that there is no relationship between democracy and economic growth (Huntington and Nelson, 1976; Olson, 1982). The theoretical rationale for the pessimistic view is that popular democratically elected governments are under pressure to adopt welfare-oriented policies. These policies in turn demand large levels of public spending which in turn inhibits national saving and the formation of capital. The pessimists almost contend that dictatorship or authoritative governments are better in the initial stages of economic development. This view invariably assumes that democratic governments may be unstable from the point of view of investment incentives and decisions.

The optimistic view supports the establishment of democratic governments to foster economic growth. This view is consistent with the mechanics of a free market economy. It is based on the premise that economic agents act in their self-interest by maximizing their welfare. This is consistent with the neoclassical view of how markets work. Pastor and Hilt (1993, p. 502) contend that "democratic political structures foster private investment by bolstering belief in the political system's desirability". It is believed that democratic institutions allow efficient allocation of resources as the economic decisions regarding the market mechanism are not tampered with as can be the case in undemocratic institutions. Goldsmith (1995, p. 159) sums up the optimistic view as follows:

... both democracy and capitalism foster freedom of choice and tend to unleash peoples' creative energy. What never work in the long term are authoritarian campaigns to drive society forward in a forced march to modernization.

There is no consensus on the question of which view, pessimistic or optimistic view, is acceptable. A survey of 24 empirical studies (Sirowy and Inkeles, 1990) and Przeworski and Liming (1993) provide conflicting results. Out of these, eight found a positive relationship between economic growth and democracy, six found a negative relationship, and seven showed no real relationship. Similar empirical studies by Bilson (1982), Vorhies and Glahe (1988) and Pourgerami and Assane (1992) also show positive relationship. The study by Goldsmith (1995) found no relationship.

*Property rights and democracy*

While there is no consensus about whether or not democracy supports economic growth, there is greater agreement about property rights within the framework of democracy (Goldsmith, 1995). Within the capitalist system the issue of property rights or the enforceability of property rights is vital. In the absence of this, commercial and entrepreneurial activities may be impaired. In the words of Adam Smith (1937, p. 862), “[c]ommerce and manufactures can seldom flourish long in any state which does not enjoy a regular administrative justice, in which people do not feel themselves secure in possession of their property in which faith of contracts is not supported by the law”.

Goldsmith (1995) states that in a capitalist mode of production, the making and enforcement of contracts is vital. This can only happen if the state protects the rights of individuals to own property. In a democratic framework it is believed that as the security of property becomes institutionalized, a moral obligation also arises on the part of the state to ensure its survival. Rosenberg and Birdzell (1986, p. 139) point out that “as contracts and property rights enforceability becomes institutionalized, free trade and capitalist development is promoted”. In many developing countries lack of security of property rights and the inability of governments to ensure its enforceability are real impediments to economic efficiency and growth. It has already been pointed out earlier in this paper that where property rights are undefined, insecure and not enforced by the state, people have less incentive to invest or take innovative or entrepreneurial initiatives. Various studies such as Scully (1988), Scully and Slotje (1991) and Torstensson (1994) on the issue of property rights lend support to this view.

*Property rights and economic growth*

Growth models emphasize the way in which resources are used with appropriate technology and capital. Neoclassical models invariably imply that accumulation of capital is the basis for growth. Torstensson (1994), however, points out that the neoclassical growth model takes well defined and enforceable property rights as given. This in his view is acceptable in the case of developed countries but not in the developing countries where property rights are not secure and are not always enforceable. For the purpose of this thesis, the hypothesis is that well defined and enforced property rights can lead to high levels of GDP growth. In the case of Fiji, lack of well defined property rights in land and enforceability of private property rights are in general the cause of poor economic growth performance.

**Constitutions, economic performance and property rights**

The literature on democracy, property rights and economic growth does indicate though without consensus, that economic growth is enhanced by the existence of well defined property rights in a democratic framework. In many



developing countries, democratisation has followed after a constitutional framework is put in place. It may be appropriate to state the relationship as follows. In many cases constitutions provide a basis for democracy, which in turn ensures to a large extent the existence of secure property rights and these lead to economic growth. According to Elster (1995, p. 209) "constitutions matter for economic performance to the extent that they promote stability, accountability and credibility".

Riker and Weimer (1994) point out four characteristics of property rights as necessary for efficient economic activity. These are "allocation, trespass, alienation and credibility". They point out that political stability is vital for a credible property rights system. In the former socialist countries, political stability is an important factor for an effective transition to a market economy. In many of these countries, such as Russia, Hungary, Poland and Czechoslovakia, the degree of political instability is not conducive to a credible property rights system (Riker and Weimer, 1994). While constitutions do not by themselves always lead to political stability, they do provide some structure to political processes. These structures provide the basis for credible policy decisions. Riker and Weimer (1994, p. 87) point out that "the efficient use of economic resources requires not only that rights to property be currently effective (clearly allocated to individuals, alienable at low cost, and secure from trespass), but those now exercising the rights believe that they will continue to enjoy the effectiveness in the future". Governments which are based on constitutions that lack credibility do not provide a credible commitment for the maintenance of effective property rights. The creation of future wealth depends on credible commitment of the state not only for economic but also for civil rights. The individuals in the society will be less inclined to forgo current consumption in order to accumulate savings for investment and innovation. They will be less inclined to adopt new technology for increased production and all other entrepreneurial activities if their economic and civil rights are not credibly guaranteed. Economic growth and development is retarded in the long run (Riker and Weimer, 1994). Constitutions which at least lay the foundation for the protection of civil and economic rights can provide some incentive for future investment and economic growth.

In the case of Fiji, the 1990 constitution implemented after the military coups of 1987, was a major point of national political debate for almost a decade. It provided a structure where one ethnic group was given exclusive control of government. Furthermore, it restricts the ownership of resources to Melanesian Fijians. The 1990 constitution was reviewed in 1997 and a more democratic constitution was adopted in Fiji. The impetus for the review came because of poor economic performance since 1987. It was realised by successive governments since 1987 that political instability created by the adoption of the 1990 constitution was not helping to achieve economic growth. But what does political stability mean as far its impact on economic growth is concerned. First

political stability means policy stability and for investors this is a crucial factor in their decision to invest. The economic reform process that is advocated strongly for Pacific Island nations including Fiji by the international lending agencies such as the Asian Development Bank, the World Bank and other international organizations like the IMF and the World Trade Organization (WTO) do not take into account the political and institutional impediments. In fact, policy advisors and economic policy makers in many developing countries refuse to confront the political constraints.

### **Property rights, rent-seeking and good governance**

According to Buchanan (1980) the rent-seeking analysis can be placed within the broad area of institutional economics and public choice literature. Tullock (1980) designates rent seeking as a "negative-sum game". Rent-seeking is defined as a process where individuals derive income without actually improving productivity or even lowering it. It ultimately leads to a loss in the society's welfare (Tullock, 1980). Directly unproductive profit-seeking (DUP) is another term that is used to analyse the process of income derivation with out contributing to productivity (Bhagwati and Srinivasan, 1980). While there is no consensus amongst economists on the type of analysis in the two approaches, the concept of deriving income without contributing to productivity is generally accepted in both cases. The analysis in DUP is considered more formal than the rent-seeking. Rowley (1988, p. 19), for example, points out that "[s]pecifically, if the public choice, rent seeking literature would incorporate a little more of the formal modeling of DUP, while DUP would pay more attention to the institutional perspective of public choice, the overall quality of rent-seeking contributions should rise".

Criticism of the rent-seeking and DUP analysis is based on the fact that no acceptable method is used to decide whether or not the activity undertaken is unproductive (Samuels and Mercurio, 1984). North (1986) criticizes the rent-seeking and DUP analysis for failing to take into consideration the transaction costs involved in the process of deriving income.

Rent-seeking behaviour has implications for the actual governance of resources in a country. In the case of Fiji, the concentration of the ownership of native land and its management by the Native Lands Trust Board (NLTB) is a source of rent-seeking activities (Prasad and Tisdell, 1996). The NLTB acting as both a monopolist and monopsony distorts the land market and has caused unequal distribution of land rents to the landowners.

More generally, it has been pointed out that good governance and appropriate sets of property rights are important for achieving sustainable development (Roy and Tisdell, 1997). Good governance has been emphasized by proponents of market-led economic growth (Fox, 1995). More recently, both the World Bank and the IMF have strongly advocated good governance as a precondition for restructuring the economy. The 1997 World Development Report for example describes how corruption and bad governance can reduce

the growth potential of economies. The concept of governance differs widely. Some view it in a narrow sense and apply it to the development and provision of basic infrastructure for the private sector. For others, it means the development of appropriate governing institutions through the political process. Fox (1995, p. 2) defines governance as “the institutions and processes that structure the exercise of state power framing the broad ‘who gets what and why’ of development policy”. The World Bank (1994) defines governance as “the state’s management of economic and social resources”. The nature of property rights and the nature of governance have therefore become important policy considerations in many developing countries.

In the case of Fiji, there have been concerns about the management of the economy and corruption in public enterprises. For example the National Bank of Fiji collapsed due to mismanagement and corrupt practices involving politicians and senior bank officials. Apart from this, a number of government owned enterprises have been operating at a loss for a number of years (Prasad, 1997). These include the National Trading Corporation, Rewa Rice Ltd, Yaqara Pastoral Co. Ltd, Fiji Pine Ltd, Pacific Fishing Company, Air Fiji Ltd, Pacific Forum Line, Ports Authority of Fiji, Public Rental Board and Fiji Broadcasting Commission. The NLTB has also been running at a loss and has not produced audited financial statements since 1989. These are examples of mismanagement of resources and uncertainty about the property rights and instability in the political situation has affected Fiji’s recent economic performance.

### **Western property rights concept and native land rights**

Native people in many parts of the world in recent times have demanded the restoration of their system of ownership in land (Tully, 1994). The demand for this has been prominent in Canada, New Zealand, USA and on a smaller scale in Australia. Native people in other developing countries are also considering this option.

Tully (1994) points out three views on native property and in particular land rights. The first view is that Western property systems in many countries are unjust, because it was established as a result of force. The second view is what Tully (1994, p. 157) calls “in virtue of the legal positivist principle of effective occupation and use in the last countries”. He presents a third view that does not call for the overthrow of the Western systems, as it provides the legal framework for the perceived injustice to be redressed. The origins of the Western property rights concept can be traced to Locke’s (1970) theory. The Lockean view identifies the initial settlement of native people as those without any “political society”, commercial or market-oriented activity. Their system was based purely on subsistence activity such as hunting and gathering. The property rights existed only in the labour they provided. Land in the traditional societies has been communally owned and members were free to use land that was not used. There were no rules or laws governing the use of the land in the

sense of the Western legal and property rights system. In contrast to the traditional societies, Meek (1976) points out that the Western system (European) has established legal systems, market-oriented activities and political systems.

The justification for the establishment of the Western legal and property rights system is derived from the issue of productivity. The Lockean view is that a system based on commercial activity increases productivity of the land. The system is therefore regarded as superior to the traditional system. It is further pointed out that as traditional societies move into commercial activity, the need for clear legal and secure property rights systems becomes necessary.

The Lockean view, however, has been criticized as Western prejudice about the organization and functioning of traditional societies. Roy and Tisdell (1997, p. 32), for example, point out that "Westerners appear to have shown a preference for two types of property rights, those of private property and state property". They contend that communal ownership may not necessarily be inefficient and environmentally destructive. This is particularly true for those communities where traditional rules are clearly defined and use rights for natural resources are clearly understood.

### **Property rights and the conservation and management of the environment**

The debate over particular environmental policies is usually cast in the metaphor of a "market failure". The Coase theorem is used to argue that the initial assignment of property right is irrelevant to the outcome as long as there is a definite initial assignment (Bromley and Cernea, 1989). However, it has been suggested that the initial distribution of property rights can contribute to the inefficiencies. According to Tietenberg (1992), environmental problems arise when property rights are ill-defined. They also arise when property rights are not exchanged under competitive conditions and when social and private discount rates diverge. This means that environmental problems could be avoided if the property rights systems are universal, exclusive, transferable and enforceable. These conditions will provide incentive to individuals and firms to use resources efficiently and conservation and management initiatives taken will be in their interest. However, this idealism is far from the case in many countries. While developed countries may have well developed institutional structures for proper enforcement of property rights most developing countries find it hard to satisfy this requirement. The above theoretical basis invariably implies private property rights and it is now a widely held belief that the solution to environmental degradation lies in establishment of private property regimes in place of common property or open-access regime.

Bromley (1991), however, challenges the wisdom of relying on private property rights for solutions to environmental degradation and indeed the view that private property rights will lead to increased output. Bromley's challenge to the efficacy of private property rights arises from the fact that it is not the

type of property rights that determine the economic performance but the type of economic system that leads to a creation of a particular type of property right. In fact he goes further to suggest that inept governments in many developing countries have destroyed local institutions and created new institutions which have led to the destruction of the environment. For example he points out that nationalization of forest policies and control of management and conservation of forests centrally by government have led to more destruction than if the local-level institutions defining the particular type of property rights had been maintained.

In the case of Fiji the structure of property rights is a complex one, it ranges from near private property regimes, communal property regimes, state property regimes to open access regimes. Within each regime however, there are many variations and they each present different characteristics. Major environmental issues in Fiji currently involve the following land use practices, deforestation and land denudation, soil erosion and silting problems, water pollution from industrial effluent and waste from runoff of agricultural fertilizers, natural resource depletion particularly in relation to coastal and marine resources (Treadgold, 1992). The conflicts about ownership of natural resources such as land, fisheries, forestry are not only between the two major races but also occur within the traditional Fijian society. Even where resources are communally owned and have characteristics of common property resources, there often is no clear delineation of the rights and the ways in which resources ought to be used.

### **Concluding comments**

During the late 1960s and the early 1970s, the mainstream economics was criticized for ignoring or taking the institutions as given and not taking seriously the role of institutional factors in the economic performance of countries. However, this is no longer the case, as renewed interest in institutional economics has firmly put the role of institutional factors in economic performance on the economic policy agenda of many developing countries[1]. Hence, alternative explanations are now offered by institutional economists for the disparity in economic performance of developed and developing countries.

One of the important institutional factors at present in many transitional economics is the nature of property rights. According to North (1990) the disparity in the performance of economies might be better explained through the consideration of institutional factors such as the nature of property rights and the costs of transactions. The role of institutional factors has gained attention from economists of all persuasions in recent times. The implementation of structural adjustment policies in many developing countries, for example, emphasizes the idea of "getting the prices right" and allowing the market forces to determine the incentive structures in the economy. The adoption of structural adjustment policies has not produced



clear results and in many cases developing countries have experienced greater economic difficulties. Partly the reasons for poor outcomes have been the lack of appropriate institutions and the failure of the structural adjustment policies to take into account the varied institutional factors.

In many developing countries the nature of property rights is not well defined and there is a lot of uncertainty in the distribution of property rights. The uncertainty of property rights has implications for the level of investment, production and the conservation and management of the environment. In the case of Fiji, for example, the uncertainty of property rights in land is one of the major cause of problems in the sugar industry (Prasad and Tisdell, 1996).

The institutional economics framework provides a useful analysis of the problems facing the South Pacific Island Nations (SPINs) including Fiji. Duncan *et al.* (1999) point out, for example, that in many of the SPINs the missing ingredient in the economic growth model is the absence of appropriate institutions. The new institutional economics framework discussed in this paper provides an appropriate explanation of the institutional impediments faced by many developing countries. To reap the benefits of globalization and trade liberalization developing countries would need to restructure their institutions. Foremost, amongst these institutions are appropriate property rights structure, universally accepted democratic political and legal structures. Good governance and adaptation to the forces of globalization can be achieved through the development and acceptance of these institutions.

#### Note

1. The work of North, Williamson, Olson and Schotter amongst others have helped to firmly place the role of institutions in economic analysis.

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