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Chapter 2

Defining markets: A set of transactions between actors

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Poverty reduction is usually the cornerstone on which most development policies and programmes are premised. However, true development should be defined as the production or emergence of responses that improve the ability of people to function in their environment (Earthlife Africa 1992). This is because, as Nussbaum (2006) and Sen (2000) argue, poverty should be viewed as capability deprivation (a lack of capability to live a decent life) and that development should be a process where people's capabilities are created and strengthened to enable them to attain an acceptable quality of life. The goal of development is not just about achieving a certain standard of living, but rather about the ongoing enhancement of the capability to achieve this state. One of the key ways in which this can be done is to enable people to, ‘invest in ways that build their capital assets such as land, education, social networks and so on’ (Moser cited in Kihato & Royston 2013:2).
The central argument is that socio-economic mobility is brought about by increasing the poor’s capability to grow and realise assets. There are several factors of production, including land, capital, labour and the more recently recognised entrepreneurship. These are the key ingredients required for the production of goods and services and ultimately capital assets. While all these factors are critical, land is unique. It is important because, firstly, the demand for land is a result of the activities that occur or could occur on its surface. Unlike other factors of production such as labour, which is a direct input in the production process, land acts as the ‘host’ to the other factors and resultant economic activity. In economic terms, land has derived demand. Secondly, the location in which the factors of production are put to work determines the extent to which they are able to generate assets. By definition, there are limited locations where the factors of production will be optimised to generate assets. As a result an opportunity cost occurs, as the use of a well-located piece of land for a particular activity and by one particular actor prevents another actor from putting the factors of production to work on that site.

The fact that land is such a critical element in the means of production and that it is scarce and fixed in nature, means that any attempt to improve the capability of the poor must begin from a ‘rights-based approach’ that ensures everyone has a fair and equitable chance of accessing this critical element.

Competition for scarce, well-located land rarely occurs on a level playing field: where some groups for historical reasons have been given unfair bidding power, the result is exclusion and poverty. For this reason, it may be necessary for governance institutions (state or community-based) to intervene to address these skewed power relations. However, there are additional reasons why land needs to be ‘governed’. Land is fixed in space and therefore it is difficult for people to avoid the negative effects (externalities) of certain activities occurring on a particular land parcel or area. As the true costs of the externalities are often not borne by the person undertaking the activity, there is no incentive for them to be reduced, and such activities may thus need to be controlled by state or community governance structures.
In addition, the value of land and its use as a means of production are not only determined by the internal characteristics of land (e.g. size and shape), but also by its relationship to other amenities in the area (infrastructure, schools, transport, policing, etc.). Due to the fact that it is often difficult to exclude non-paying people from using these amenities and services, and given that the amenities generally require substantial capital outlays that can only be recouped over generations, there is often no incentive for private actors to provide such amenities and services. Consequently, state and broader community investment is required.

LAND IS A UNIQUE ECONOMIC RESOURCE

There are a number of reasons why land is a unique resource.

It is **immovable**, and therefore fixed in space, unlike labour, capital and entrepreneurs which are mobile factors of production.

Land is a **finite** resource with limited availability at any location. This fosters competition over land use, especially in cities where there is often high demand for land.

Each parcel of land is **unique** and unlike another, which affects its perceived and market value.

Land also has **cultural value**, which means that its worth is determined not only by ‘objective’ market forces of demand and supply, but also by the value people place on it. For example, ancestral lands and burial grounds have a non-monetary value to a community.

Unlike other resources, land has far-reaching social, political and environmental consequences in African (and other) societies.

Ensuring adequate rights to and governance of land is thus critical if the means of production are to be adequately used to increase the capabilities of people to create a decent life for themselves. However, whilst necessary, such rights and governance will not in and of themselves result in development. Maximising the factors of production – land, capital and labour – depends on different entrepreneurs combining them innovatively in a myriad of different ways, in different locations, over different periods of time. For this
to happen, land, capital and labour need to be invested in, leveraged and traded. Rights and governance thus establish the platform on which the factors of production can be used to create assets and promote socio-economic mobility.

What roles do markets play in facilitating these activities and enabling the poor to realise the benefits that accrue from such investment? Although structurally they can be highly exclusionary, local evidence shows that the poor are active agents in markets and, in many cases, structure and use them to increase their capabilities to bring about better developmental outcomes (Kihato & Royston 2013). The position is thus not whether markets are right or wrong, but rather that they exist.

As markets play such an important role in the development process, it is important to understand how they operate. What are the overarching structural issues that undermine the functioning of markets in general, and specifically how do they undermine the ability of the poor to enhance their capabilities? This requires an understanding of how the use of markets is inhibited among the poor, and how people creatively engage and structure markets to overcome these constraints. It enables one to identify the structural barriers requiring intervention, and the local practices that could possibly be co-opted and adapted at scale to bring about a more equitable and efficient system. As Sen (2000:28) states, policy-making has to be ‘parasitic on the understanding generated by epistemic investigations’.

However, important as it is to understand how markets function, it is equally important to understand the context in which they are increasingly functioning in urban areas. This chapter therefore examines urban areas as the location for market activity; it defines and explores the nature of land markets in urban areas, and looks at the role of the state in land markets.

Urban areas as the location for market activity

Urban living is characterised by the need to transact. While by no means unique to urban contexts, transacting is central to surviving
2. DEFINING MARKETS: A SET OF TRANSACTIONS BETWEEN ACTORS

and prospering in urban areas as people cannot provide for all their needs themselves and because many of the opportunities created in urban contexts can be accessed and maximised by transacting. The dense nature of urban areas also means that activities are conducted in limited space for which there is intense competition (see box below).

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URBANISATION AND ECONOMIC GROWTH

Urbanisation creates the conditions for greater production and rapid productivity as cities grow. Cities offer considerable economic efficiency benefits through economies of scale arising from the close proximity of factories and production facilities in higher density areas. As a result, firms have lower production costs due to reduced transport costs, proximity to markets, and better forward and backward linkages. The costs of providing services thus become cheaper as people live in increasingly dense conditions.

For example, the concentration of populations in cities allows city governments to provide bulk services like water, electricity, and at times housing, at cheaper prices than any individual firm and household would be able to provide. There is greater sharing of education and knowledge, which leads to greater innovation in industries. Dense populations also allow for increased specialisation and lower transaction costs as, among others, skills are better matched with production.

In other words, because of the economies of scale, cities become engines of growth, providing economic opportunities, allowing for higher levels of production with the benefits of lower costs, and shared public investments (see Quigley 2009).

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Urban areas allow for economies of scale and agglomeration, which in turn allow specialisation to occur, and for resource generation and distribution to be maximised. The growing level of urbanisation we see today is evidence of this benefit.

Even as households take advantage of the employment opportunities and wages that arise from higher productivity, the transition
to urban areas is not as straightforward as individuals simply moving to cities in search of higher wages. Indeed, migration to cities is a complex and dynamic process, and people use a network of relationships and resources between rural and urban areas, and between cities, to meet their needs and support their social and economic lives. Notwithstanding these complexities, there is a general trend towards growing wealth through urban living, with people generally doing better in urban areas.

The following graph, taken from UN-Habitat’s *The State of African Cities 2010* report, shows this by and large to be true. The Human Development Index (HDI), a composite measure of social and economic variables, improves as nations urbanise. Although there are outliers where geographical factors, oil or war have had consequences on HDI/urbanisation readings, most countries follow the general trend.

**FIGURE 1** The relationship between HDI and urbanisation

Urban living has afforded many people significant socio-economic benefits and opportunities, and has enabled public services to be administered efficiently to a vast number of people. Nevertheless, the scale and rate of urbanisation, the political context in which it happens (such as colonialism or apartheid), and the presence of
inequalities and instabilities have meant that many urban areas exhibit high levels of deprivation in absolute and relative terms. Even though people continue to move from rural areas to cities in search of better wages and an improved quality of life (Borjas 1989, Todaro 1982), increasing unemployment, poor wages and the lack of adequate infrastructure to support human life impact negatively on human development.

Thus, the neo-classical premise that households will generally do better in cities because of the higher wages they can command, does not hold for all (Todaro 1982). But why do people keep moving to cities even when there are limited jobs and opportunities for wealth creation? Economists explain that the continued migration to cities, particularly in developing countries, is a result of households’ expected rather than real incomes. In other words, people make the decision to move to cities because they assume higher wages and a better quality of life, even when the reality presents a significantly different picture.

This is indeed the case in African cities. Unlike cities in the west, African cities have grown without the concomitant economic levels seen in other parts of the world. So, while cities continue to experience net growth in population due to migration and births, the majority of those who live in African cities live in slums with no security of tenure, adequate water and sanitation, nor infrastructure and employment opportunities.

**TABLE 1**  Population of slum dwellers as a proportion of the urban population in selected African cities

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<tr>
<td>Urban population (000s)</td>
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<tr>
<td>Nigeria</td>
<td>33 325</td>
<td>42 372</td>
<td>53 048</td>
<td>65 270</td>
<td>70 539</td>
<td>78 845</td>
<td>77.3</td>
<td>73.5</td>
<td>69.6</td>
<td>65.3</td>
<td>64.2</td>
<td>61.9</td>
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<tr>
<td>South Africa</td>
<td>19 034</td>
<td>22 614</td>
<td>25 827</td>
<td>28 419</td>
<td>29 266</td>
<td>30 405</td>
<td>46.2</td>
<td>39.7</td>
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<tr>
<td>Egypt</td>
<td>23 972</td>
<td>25 966</td>
<td>28 364</td>
<td>31 062</td>
<td>32 193</td>
<td>34 041</td>
<td>50.2</td>
<td>39.2</td>
<td>28.1</td>
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<tr>
<td>Morocco</td>
<td>12 005</td>
<td>13 931</td>
<td>15 375</td>
<td>16 763</td>
<td>17 377</td>
<td>18 374</td>
<td>37.4</td>
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Source: UN-Habitat, 2010
With Africa’s urban population projected at one billion in 2030, land resources in cities are becoming critical points of competition and conflict. Growing populations imply that there is increasing pressure on cities to provide economic opportunities, housing, infrastructure and social services to existing and incoming urban dwellers. All these activities need space, and the pressure of population growth, finite land resources, limited state capacity, and limited or skewed economic growth, imply that not all urban dwellers have access to land for housing or livelihoods. As such, the availability of land resources – the ways growing cities utilise land and the means by which populations acquire, regulate and trade land – has important consequences for a city’s socio-political, spatial and economic character.

Given land’s unique features, the dynamics of its economy are critical in shaping the nature of development outcomes in African cities. The urban land market determines how urban land is used, the location of activities, the nature of the built environment and urban spatial form. Whether it is used for manufacturing, retail and residential spaces, parks, slums, central business districts, or peri-urban settlements, all these activities are outcomes of the urban land market.

Just as neo-classical economics has failed to explain how markets have led to increasing deprivation in many African cities, development discourse has equally failed to address how markets have been used by many, including the poor, to gain greater access to the city and to reduce poverty. For this reason, it is important to define what markets are and to understand how they function.

The nature of land markets in urban areas

Urban land markets in Africa are complex. The number and complexity of the transactions involved result in the emergence of sub-markets through which these transactions occur. Markets are made up of interactions between a variety of endogenous and exogenous factors, local and global actors, and multiple regimes of authority and relationships of exchange. The supply of urban land in African
cities, for example, is determined by a variety of factors: customary practices, common law, religious laws and practices, everyday social practices, conversion of agricultural land in urban peripheries, and state policies and practices. In many African cities, the state recognises common, customary, and religious law – in particular Sharia law – which allows for the individual ownership of land. These legal means of land acquisition are based on different tenets of ownership. Customary law recognises group ownership, while common law recognises individual ownership and the alienation of land. Managing these different types of land regimes is in itself difficult, given limited state capacity, skills and resources. Yet, in addition to the legal means of owning land, a significant proportion of urban land transactions in cities occur outside state legislation and are not legally recognised, although they may be unofficially tolerated.

In order to facilitate and mediate this complexity, various societal agents set up the ‘rules of the game’ that may or may not be formally regulated and managed by the state. Yet there is an underlying market logic that underpins urban land markets, whether in the formal or informal realm. Forces of demand and supply shape all urban land markets, and these factors have a significant bearing on urban land dynamics on the continent. In this sense, land markets are no more or less than basic arrangements that allow people to interact to achieve mutually beneficial (but not necessarily equal) outcomes.

Land is not a ‘neutral’ commodity. Its demand and supply are influenced by social and political processes in any given society. For example, lack of access to land for the urban poor often means their exclusion from socio-economic processes and increasing poverty. Poverty manifests itself in the development of slums in which people live in squalor, with consequences for health, safety and livelihoods. The distribution and ownership of land in society also has political implications, particularly where the elite controls the ownership and use of the land. These inequalities could have political consequences such as social unrest, land clashes and war. As such, the extent to which land is accessible in urban areas has far-reaching socio-economic and environmental consequences.

Sen (2000) further highlights that markets can be highly problematic when they exclude certain participants, or include them
on highly unequal terms. At the base of exclusion is the fact that competitive bidding is central to many markets; those who have or can generate the most resources from a site can out-compete the other participants in the market. In those societies with high levels of inequality, the exclusionary impact is particularly severe.

THE COMPETITION FOR SPACE IN TWO SOUTH AFRICAN CITIES

The inner city of Cape Town is a sought-after location for middle to high-income residential, office and retail space users. The demand produces relatively high land prices which, when added to the cost of construction, pushes building costs to approximately ZAR 18 000/m\(^2\). In order to repay the finance necessary to undertake such construction, any residential space needs to be rented out for approximately ZAR 150/m\(^2\) per month. Given that the vast majority of the city’s population can only afford to pay between ZAR 1 000 and ZAR 2 000 per month towards their housing needs, this means that most of the city’s people are able to rent only about 10m\(^2\) in these areas. Since more profitable uses can be generated on this space and the state does not permit accommodation of this size, residential opportunities in the inner city effectively exclude a large percentage of the city’s population.

Interestingly, when left to its own devices the market can respond to the need for such space. In Hillbrow, Johannesburg, for example, people pay around ZAR 800 per month to share a bedroom space in an apartment. Since most rooms vary between 12 and 20m\(^2\) in size, this translates into a cost of approximately ZAR 100/m\(^2\). Considering the older state of the buildings in Hillbrow, this provides a sufficient return to enable the market to provide such space and, importantly, to out-compete other uses (e.g. commercial uses) and higher income users for that space.

This suggests that, while the bidding process can make markets highly exclusionary, this effect can often be exacerbated by the norms and standards imposed by society and the state.

Where markets follow a capitalist logic, one must be aware of their instability and contradictions. Central to a capitalist system is the
accumulation of capital that is in constant search for a home and commensurate return relative to the risk involved. This leads to flows of capital in and out of land sub-markets and between land markets and non-land markets. The complexity of this system, its bureaucratic inefficiencies, regulations, poor information and market predictive ability, along with a psychological herd mentality and a healthy dose of greed, often leads to a set of inherently unstable systems prone to cycles and crises (Harvey 2011). Therefore, while it is argued that markets can play an important role in improving the capabilities of people and households, it is prudent not to ignore the inherently volatile and unpredictable nature of a capitalist-based market system.

However, while markets are key to capitalist pursuits, they are not limited to the world of private ownership and profit maximisation. Work done by Kihato & Royston (2013) and Shisaka Development Management Services (2004) have shown that many property transactions in lower income housing areas in South Africa and other African cities are driven by social imperatives and facilitated through markets based on community norms and practices. In reality very few markets will be driven by pure profit motives. Syagga et al. (2002) point out that, in the African context, locally constructed markets set up to overcome the problems associated with regulated markets usually reflect a hybrid of socially-driven, customary markets and legally constructed, price-driven markets. In fact, as markets are socially constructed institutions created to facilitate transactions, by definition they will all be socially driven to varying degrees. Even the very profit-orientated commercial property markets are driven by people who conduct business through social relationships and institutions.

Another criticism of markets is that they enable more powerful interests to exploit the poor through, for example, ‘land grabs’. However, as discussed above, the poor often use locally, socially driven markets to withstand such external forces or to negotiate better terms of engagement – although they often cannot fully fend off corrupt practices and threats of eviction. Furthermore, the act of a poorer person transacting an asset to an external party is not a problem per se, as this act can realise the value of an asset and
facilitate socio-economic mobility. However, if market inefficiencies exist and information is poor, asymmetries in the negotiation can occur and weaker parties can lose out.

An often-quoted example of this in South Africa is of someone selling a state-subsidised house below the cost of constructing the house. The difference between the price paid and the initial cost of the house is a function of two factors: firstly, the low demand for the house by the market, often due to its poor location and the low level of income among prospective buyers; secondly, the high cost of delivering the house. This high cost is often partially a result of poor supply-chain management, onerous standards, inefficient provision of development rights and infrastructure, and maladministration in the delivery of state-funded housing. As a result, it would be incorrect to argue that the market transaction is totally to blame for the ‘exploitative’ price difference between the cost of the house and the price paid in the transaction.

As urban life is dominated by transaction-based activities, markets permeate and characterise people’s existence in all urban areas. The fact is, markets are not exogenous, stand-alone entities that people engage with on a temporary basis and then extract themselves from. In this sense, the poor cannot be shielded from the impact and operation of markets by somehow ‘removing’ them from these systems. Similarly, the problem is not simply that the poor are ‘excluded’ from markets; nor is the solution merely a matter of ‘opening’ these markets up to the poor. There is evidence (see box alongside) that when the poor are excluded from ‘formal’ land markets, they generate their own markets, their own regulatory frameworks, their own rules of the game and their own means of securing their assets. In many cases, upward mobility of the poor has occurred where city living has facilitated the creation of niche markets allowing for the creation of a merchant class (such as the Ethiopian and Somali trading communities in South African cities like Johannesburg and Cape Town).

The Somali traders operating in South Africa are, however, not tied to the local trading ‘rules of the game’ and hence can compete on price, giving them a significant competitive edge over the local traders. In addition, the Somali traders regularly engage in bulk
buying, which reduces their input costs and makes them more competitive. Drawing on the thinking of Gladwell (2008), one can further hypothesise that many of the Somali immigrants in the Cape Town suburb of Delft originate from urban areas such as Mogadishu where competitive trading is part and parcel of everyday life, providing them with a trading skills base. These traders are now looking to purchase formal upstream wholesale businesses that supply the local retailers, again highlighting how markets interact and how the different actors use them to advance their position.

DEVELOPING AND ACCESSING MARKETS IN JOHANNESBURG AND CAPE TOWN, SOUTH AFRICA

Research undertaken by Urban LandMark and others (Zack & Arnot 2011) highlights many ways in which the poor constitute important markets and engage with them to maximise their position. In Jeppe Street in the centre of downtown Johannesburg, traders, predominantly of Ethiopian origin, dominate street retail in the area by outcompeting both high-end recognised retailers and other street traders: they pay rentals approximately four times the highest rentals paid in exclusive suburban shopping centres. The key to being able to pay such rentals is to rent small spaces and use this space to sell high volumes of goods that are stored in cheaper basements nearby.

In effect, the traders are tapping into two different property markets to facilitate their business activities – expensive, visible retail property and cheap C-grade office basement space. The traders are able to sell the necessary high volume of goods because they service the large cross-border consumer goods market, where significant quantities of goods are bought in Johannesburg to be consumed or re-sold in neighbouring countries. The traditional high-end retailers do not service this market, and by filling this gap, these traders have created a thriving retail and property market in the area.

Another example comes from predominantly Somali traders who have come to dominate and change the retail market in Delft, a poor area on the outskirts of Cape Town. Historically, the South African traders in the area have tended to conduct their business on a ‘survivalist’ basis.
where retailing was not seen as a permanent occupation, but rather an interim activity to see them through until more permanent formal employment could be secured. Furthermore, many of these traders originate from the rural Eastern Cape Province and are likely to have limited experience in trading in competitive urban areas. Due to the vulnerable position of these traders, a series of social norms dictate the terms on which they can compete with each other. For example, competing in terms of price is seen as unethical and unfair; consequently traders compete through non-price mechanisms such as location, product presentation and customer engagement (Charmers et al. 2011).

Shortcomings of state regulated markets

A common response by the poor to being excluded from ‘formal’ markets is to transact through ‘informal’ processes. These processes are often viewed by authorities and ‘formal’ businesses as unacceptable and/or temporary – either to be eradicated or assisted to reach a ‘formal’ state. Closer inspection usually reveals that the indicators used to make these distinctions are arbitrary. They do not promote understanding of how these markets increase people’s capabilities, nor do they assist in finding ways to improve such markets. For example, many enterprises are categorised as ‘formal’ or ‘informal’, depending on whether they are registered for value-added tax or have a business trading licence. Yet these indicators say nothing about the nature of the market institution itself or how it does or does not facilitate transactions. These are state imposed categories which, if altered, could change a market from being ‘informal’ to ‘formal’ overnight without there being any change in the nature or functioning of the market itself.

Furthermore, Kihato & Royston (2013) have shown that, contrary to popular belief, ‘informal’ markets are far from disorganised and unregulated. Rather, they are governed by a set of norms and practices put in place by community structures rather than the state. In this way, urban spaces are co-constructed through a number of markets that are managed and articulated through various governance regimes that include the state, but go beyond it (Kihato &
Royston 2013). By definition therefore, this categorisation is conceptually flawed and not helpful. Not only is this categorisation incorrect; it can also systematically undermine the capability of a market and prevent it from operating successfully in its environment. Many examples exist (Burzynski 2011) where the authorities shut down ‘informal’ activities, and often the authorities are legally prevented from providing much-needed basic services to areas that have an ‘informal’ status.

Some argue that the distinction between ‘informal’ and ‘formal’ is best understood as a continuum rather than as two distinct categories. However, this too is conceptually limited because, as discussed above, the categorisation is often externally imposed from the perspective of the state and the law. In terms of these definitions, these markets are definitely one or the other – a business either has a business trading licence or it does not. More importantly, though, most markets do not operate in a bubble and unregulated markets frequently engage and transact with regulated markets. For example, privately provided affordable rental housing in the Cape Town township of Du Noon is built on sites formally registered in the deeds office. These houses are, however, usually constructed without formal building permits and often are built over registered cadastral lines. Nevertheless the buildings are made out of bricks and mortar using construction techniques and standards similar to those used for residential dwellings found in low to middle-income suburbs in Cape Town. The question is, is this a formal or informal dwelling? More importantly, is it a useful question to ask and is the distinction valid?

The issue is therefore not whether ‘formal’ or ‘informal’ markets exist and whether one is better than the other. Instead, it is necessary to identify whether the governance of these markets weakens or strengthens their role in enhancing capabilities. The question that needs to be asked is: What outcomes are desired and how can the governance of these markets be changed to achieve these outcomes?

For example, with respect to finance, registered title is not an end in itself, but is a means to an end: it facilitates secured lending practices by enabling a claim to, and transaction of, a property held as security against a loan. The task, therefore, is to determine whether...
other more cost effective and accessible mechanisms can be used to achieve a similar outcome.

The prevailing belief that ‘formal’ markets produce more favourable outcomes is also flawed for a number of reasons. Firstly, the formalisation of a market system can impose a number of cost- and skill-related barriers. Usually, due to the legal complexities involved, professional skills (e.g. lawyers) are required and fees and taxes have to be paid that are often disproportionate to the size of the transaction. For example, Downie (2011) has shown that the cost of a formal lower income housing transaction can be as much as 25 to 30 per cent of the value of the house.

These costs and complexities created by a state regulated system create barriers for all participants in the market. However, some of the more established and better resourced players are in a stronger position to overcome these constraints by employing professionals, for example, and can effectively outcompete the weaker participants in the market. Yet, this scenario is not as clear cut as it appears: markets are social constructs and the participants often use their social positions to manoeuvre themselves into better bargaining positions.

Research undertaken by DEMACON Market Studies (McGaffin & Gavera 2011) on the impact of formal retail centres in emerging economies provides an illustration in this regard. Due to market saturation in most of the suburban areas in South African cities, many retailers and developers have expanded elsewhere to take advantage of the underserviced retail markets in the urban townships and rural towns that are often situated in former apartheid ‘homeland’ areas. These areas usually lack formal cadastre and legal title; land management systems are often unclear, with many areas still governed to varying degrees by customary processes. As a result, formal developers find it difficult to acquire and hold land, and to raise finance on the back of land security. This usually forces them to negotiate with local communities to secure a site, and in this process a share of the equity in the retail development is passed to the community through various mechanisms (community trusts, provision of facilities, etc.). This demonstrates how communities manipulate the transaction to overcome their weak economic and financial bargaining position.
However, while this may result in a better developmental outcome for a community, it is often not without its shortcomings. Many examples exist where only local elites and community leaders benefit from these transactions, and the lack of clarity around the required market process can lead to corrupt practices and significant delays in a development. These outcomes frequently result in many investors opting to invest elsewhere, depriving the area of much needed external investment.

The second reason why the formal regulation of markets can be problematic is that in most cases the state apparatus is not geared to handle the scale of market activity, resulting in significant bureaucratic delays and additional costs to the market participants. This is illustrated in South Africa where, under apartheid, the title deed registration system was designed and resourced to serve the minority of the population. Following democratisation in 1994, the country has not been able to cope with applying a sophisticated land registration system to the broader population.

Notwithstanding the shortcomings of state regulated markets outlined above, it is important to recognise that markets that lack this regulation can also undermine the capabilities of the participants in these markets. For example, research done by Gordon et al. (2011) and Downie (2011) has shown that the lack of registered title can significantly undermine the security of a household and its beneficiaries over the long term. Furthermore, the ability to lend into and raise finance in non-regulated markets is particularly difficult. For secured lending to occur, a lender has to be able to lay a claim to a property and be able to transact that property. Theoretically, assuming that an active market exists, an unregistered property could be transacted informally, although this would be difficult for reasons of corporate governance, among others. Without legal title, however, it is unclear how the lender would be able to lay a claim to the property in the event of non-payment of the loan. In many markets, secured lending is inappropriate, but in some housing sub-markets, households could benefit from the lower lending rates associated with secured lending, and therefore the lack of registered title definitely undermines their capabilities.
Realising value through land and property

Of particular importance to markets, especially land markets, is the fact that transactions occur in space, and that location can have a huge impact on whether markets can improve people’s capabilities – their ability to achieve a better quality of life. Hence, it is not only critical that people can exercise their rights, but that they can do so in particular locations. With respect to land and property, value is usually a function of a set of features that are internal to a site (such as size and quality), as well as features external to the site (such as access to amenities, transport logistics, degree of visibility, and safety of the broader environment).

As many people have been excluded for political and economic reasons from well-located sites, the challenge is to either open up existing, well-performing market locations to poorer and marginalised communities and/or to create new locations with positive attributes closer to such communities. For example, transport infrastructure can significantly change the location attributes of a site and increase the surrounding values as a result. However, the use of public infrastructure in this regard is most effective when the wider developmental conditions around the infrastructure are improved and the economics of the broader area are changed.

If poor development conditions exist, it is unlikely that the value creation potential resulting from the infrastructure provision will be realised and maximised. Poor development conditions exist when there is poor urban management, limited land is available, complex land ownership patterns and poor levels of infrastructure prevail, and development rights are lacking or difficult to obtain. This is therefore an area where public authorities can intervene meaningfully to maximise value creation.

However, although proactive public intervention is necessary to create favourable development conditions, it is not sufficient to maximise the value creation potential of public infrastructure provision. Risk capital and business expertise and experience are required as well, to create and realise the value. Furthermore, as value is generally a function of income, the provision of infrastructure needs to change the level of spend in the particular location.
In other words, if the provision of infrastructure does not change the level of income that an area can attract and capture, then by definition, additional value is unlikely to be generated. If, for example, upgrading a railway station does not alter the number of commuters who pass through the station, improve the level of commuter spend in the adjacent area or increase the number of commuters wanting to live near the station, then the level of value added by the station upgrade is likely to be low.

When markets fail

Besides being exclusionary, markets, especially land markets, are prone to failure. Markets fail in two broad ways. The first is when there is insufficient income to create an effective demand for a product or good. However, it could be argued that this is not the failure of the market itself, but rather a function of the context in which it operates, and it is questionable whether the market should be seen to fail when it does not provide a good or service in the context of insufficient effective demand. If there is no effective demand for a service or product, a market should not provide it as in time the market will fail. The sub-prime housing crisis in the US is an example where a market provided housing ownership to households who did not have the effective income to pay for it. Not only did this undermine the financial system, it also led to significant loss of household assets and savings in the process.

It is more useful rather to see markets failing when, despite the effective demand for a service or good, markets do not provide it. This failure generally occurs for the following reasons.

Firstly, markets need certain conditions in order to function properly. These include low barriers to entry and exit, significant knowledge about the market being equally available to all participants, being able to compare relatively homogenous products, the presence of many players, and inputs that can be shifted easily in response to price and other signals. Owing to land and property’s fixed nature, heterogeneity and associated high capital costs, these conditions do not exist in land and property markets and, conse-
quently, they are prone to failure. Unfortunately, many of these conditions are exacerbated by state policies and interventions.

Secondly, markets do not respond well to externalities where the actions (both positive and negative) of one party are felt by another party, despite no action of their own. Again, due to its fixed nature, land and property are particularly susceptible to the impact of externalities. This is because the party or parties causing the impact do not receive the necessary signal or incentive, and they thus do not respond to the impact.

Lastly, markets do not operate well where public goods exist. Public goods can be divided into three categories: community goods, collective goods and merit goods (Harvey & Jowsey 2004). Community goods such as police services cannot be divided and are non-exclusionary (free-riders can’t be excluded), and therefore individuals cannot be charged a price based on how much is used. Collective goods such as electricity supply usually require such high capital outlays that they can only be provided if huge economies of scale are achieved and long repayment periods can be accommodated. As a result, monopolies tend to be the providers of such goods. Lastly, merit goods such as education or healthcare are those goods on which society places greater value than do individuals or communities. Merit goods have an interesting application in the context of South Africa’s subsidised housing.

Many South African commentators are critical of the eight-year resale restriction imposed on houses provided by the state, saying that it undermines the economic and financial value of the house and prevents socio-economic mobility. This raises an important dilemma. On the one hand, such a restriction precludes the right of households to make trade-offs between competing needs. As a recipient of a subsidy house stated, ‘I can delay my housing needs, but I can’t delay my child’s high school education when they are 12 or 13 years old.’

On the other hand, selling the subsidy house may result in the household having to move back into an informal settlement, which may exacerbate the health issues (such as tuberculosis) in the settlement and place a greater cost burden on the state health system. Therefore, due to the negative health externality created, the state
may place a greater value on the subsidy house than the individual household does.

The role of the state in land markets

A common response by the state to market failure in land markets is to provide property directly to its citizens in the form of land and housing. This response can be effective where the causes of the market failure are correctly identified and a capable and efficient state apparatus exists. However, state responses are often flawed, inefficient and can result in further market distortions.

This is because, in an effort to be equitable, many state policies provide a standardised product to everyone, despite different people having different land and space requirements. The inability of public policy to cope with these diverse requirements and the limited availability of certain types of spaces means that people’s capabilities are undermined and the intended developmental outcomes of most programmes are not realised. The failure arises from the fact that land and space can contribute to increasing capabilities, but this is determined heavily by where it is located. While land may be abundant in many cases, well-located land is not, which usually produces intense competition for it. This has two consequences. Firstly, many uses and groups are out-competed and excluded and, secondly, the space is usually intensely used – as is evident from the over-crowding of inner city buildings or relatively better located informal settlements.

As a result, rather than looking to provide the land and housing directly, in many cases the state would be better off reducing the barriers to entry to existing well-located sites and creating more well located sites by combining the factors that create such sites e.g. infrastructure, good schools etc. No privately owned land exists in a vacuum and many of its attributes, such as location relative to urban amenities, are determined by surrounding state-owned land and facilities such as roads, schools and infrastructure. By increasing the supply of better located and well-serviced sites, the level of competition will drop, making them more affordable and thus creating access for more people and uses.
Furthermore, the state’s systems are often central to defining the land in question and in determining what the land can be used for. Market transactions are not once off events but represent a process or series of steps, many of which have direct or indirect state involvement. Government policies on urban land ownership play a significant role in the supply of land in African cities, and have consequences for infrastructure investment and urban development more generally.

Different countries have had, and continue to have, different policies on urban land, which affect patterns of land ownership and the nature of urban development. Under apartheid, for example, black South Africans were not permitted to own land in most South African cities. Much of the investment in infrastructure for retail, residential and manufacturing occurred in wealthier parts of the cities close to residential areas previously reserved for white South Africans, with little investment made in economic infrastructure for black outlying townships. In Tanzania, the nationalisation of land in 1967 meant that the fees payable for land were far less than its market price and the cost of installing infrastructure. This dampened the appetite for investing in urban development. In Ethiopia, after the revolution in 1974, individuals could not own more than half a hectare of land in the city and family members were restricted to one house. The rest of the land was nationalised. While it provided an opportunity for poor Ethiopians to live in the city, the low rents collected in nationalised dwellings could not keep up with the maintenance and development needs of existing infrastructure, resulting in its decay (Rakodi 1997). In Mozambique, the Constitution of 2004, based on the Land Law of 1997, stipulates that land belongs to the state and prohibits its sale, mortgage or alienation. However, a vibrant land market continues to operate, based on improvements to land rather than the land itself as a transferable commodity.

These examples illustrate how government policy has consequences for investment patterns in urban areas. Whether the exclusionary policies of apartheid South Africa or the nationalisation policies of the revolutionary government in Ethiopia, these ideolo-
gies determine the extent to which investors are willing to risk developing property in urban areas. In addition, public policy determines how much money is available in state coffers for investment in new infrastructure and the operation and maintenance of existing infrastructure and property.

The state is also often directly involved in various markets as a landowner and tenant. For example, the state leases significant office space from private landlords in most of South Africa’s major cities. Ironically, this demand for office space in these well-located areas increases the value of these buildings. This in turn prevents many of the buildings being converted into affordable residential accommodation, which is a policy objective of the state. In some cases the state is indirectly the landlord in these markets. South Africa’s Public Investment Corporation, which is responsible for managing the pension funds of all state employees, is recognised as being the largest owner of commercial property, controlling and managing a significant portfolio of the country’s retail, industrial and office space. Similarly, many South African parastatals and government departments possess large land holdings and their choosing to retain or release this land into the market can have large impacts on the availability and price of land.

The role of the state as a regulator also has major impacts on markets and the degree to which people are able to participate in these markets. As a regulator, the state imposes numerous standards on the goods and services produced in the market. These include the standards imposed on building construction. While many of these standards have beneficial health, safety and environmental outcomes, they can have a significant impact on the costs involved, which in turn may have unintended consequences. If the standards are excessive and the consequent costs are too high, the development of affordable accommodation will not be feasible and development will not occur within the law. This leaves residents with no choice but to rent from illegal landlords in buildings that do not comply with the most basic health and safety standards. Alternatively, the costs of providing high standards have to be passed on to the tenants and end users in the form of higher
rents and prices. The imposition of such standards is thus in many cases a tax on the poor without their knowledge or consent. Clearly a balance has to be achieved.

Lastly, the state is reliant on the market for the revenue generation necessary for it to fulfil its mandate. This usually occurs in the form of property taxes and user-charges, but increasingly the state is entering into public-private partnerships where both parties share in the risks and benefits of engaging in market activity. In South Africa examples of these include the provision and management of public infrastructure such as roads and rail systems through tolling arrangements and the rapid rise in the number of city improvement districts throughout the country. This use of markets, especially local land markets, to raise funding is likely to increase in the future in South Africa as there is growing concern that, ‘municipalities are becoming increasingly dependent on national infrastructure grants to fund their capital budgets. This is not a sustainable trend, because it means the tariffs for the main municipal services are not covering the infrastructure costs of providing those services. There is also a concern that the use of conditional grants by national government reduces municipalities’ scope to set their own expenditure priorities, and thus weakens their accountability to local communities’ (South African Treasury 2011). As a result, national and local governments are looking to use value-capture techniques to engage with markets to increase local revenue generation (McGaffin & Gavera 2012).

The state’s involvement in the provision of goods and services can however be very problematic. This is not to say that there is not a case for state provision of goods and services, especially those of a public nature; rather, this shouldn’t necessarily be the fall-back position in the face of market failure. Firstly, the state’s resources are generally limited and its supply-chain requirements are often bureaucratic and not geared towards achieving the greatest value for money. Secondly, while in many cases effective demand may be low, most households are in a position to pay for a particular level of good or service, and hence a far greater resource base can be mobilised to meet a range of living standard requirements. Thirdly, by definition, the state is generally required to provide goods on
an equitable basis, which generally produces the negative consequence of a ‘one size fits all’ product or service being delivered when in fact a variety and choice are required. Following on from this, markets are far more likely to be able to innovate and provide nuanced responses to local needs.

The role of markets in facilitating investment

Ultimately the eradication of poverty depends on strengthening the capability of people and communities to improve their standards of living. Due to the absolute backlog of many basic needs and the high degree of inequality in this regard, the total resource base needs to grow and the way in which it is divided needs to change.

Increasing the resource base depends on growth, which in turn requires investment. Incentivising investment depends on creating a reasonable expectation of future value and instilling confidence that this value can be realised. Value could be defined in economic, financial or social terms.

However, increasing the resource base alone won’t necessarily reduce poverty; how the resource base is divided also needs to be addressed. For this reason, investment needs to be focused at an individual/household, enterprise, community and state level. If an entity such as a household is responsible for investing and creating value (by incrementally expanding their house, for example), they have a legitimate claim on the value created when it is realised – by selling the house, passing it on to their children, etc. In other words, they become shareholders in the urban space and an entry point is developed to access the resource base. Another example would be municipalities investing in infrastructure and capturing some of the value generated through a value creation mechanism. In this way they increase the resource base, but also reduce their reliance on equitable transfers and conditional grants, which gives them greater flexibility to address poverty at a local level.

In addition to creating a legitimate claim on the value generated, locally-focused investment increases the investment pool and therefore maximises society’s value creation potential. In light of
the enormity of the task of reducing poverty, the entire resource base of society needs to be drawn upon. Locally-based investment (by households for example) enables local innovations and knowledge to be drawn upon, and for trade-offs to be made by those best placed to make them. Lastly, because inequality and poverty have a spatial dimension, by definition geographical investment is needed to break this pattern.

The key objective, then, should be to create environments that are conducive to investment. These are created when there is a reasonable expectation that value will be created by the investment and that the value can be realised by the investor. It is here that markets play a key role as they facilitate the transactions that are needed to realise the investment value. Households, for example, will be less inclined to invest in their properties if they can’t transact (e.g. sell it or pass it on to relatives) the property to realise its value, or if someone else can take the property and future value away, through an action such as an eviction. Investment is situated in space, and having access to space of a particular type is a key aspect of creating a conducive investment environment. Therefore, it is critical to understand how the poor access, acquire, hold and transact land.

The goal of development is not just about achieving a certain standard of living, but rather is about the ongoing enhancement of the capability to achieve this end. Markets impact on how transactions influence capabilities and asset creation. It is therefore important to define what markets are, how they operate, and how they can improve capabilities and structure the investment process in a more equitable and efficient manner.

Endnotes

1. Acknowledgement to Liza Cirolia for this point.

2. See Harvey (2011) for a detailed discussion of the inherent contradiction and inevitable crises created by capitalism and capital accumulation.

3. Another example would be municipalities investing in infrastructure and capturing some of the value created through a value capture mechanism. In this way they increase the resource base but also reduce their reliance of equitable transfers and conditional grants, which gives them greater flexibility to address poverty at a local level.