The effect of market association political power and local government effectiveness on trade: Evidence from Nigeria

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This project examines how the political power of market associations and local government effectiveness affect contractual trade and extortion in Lagos. Contrary to earlier research findings, the project concludes that without a check on their power, strong markets associations extort traders, and traders in such markets are less likely to obtain products on credit from their suppliers. These effects are mitigated when there is a balance of power between the market and local government, challenging the assertions that either impartial public institutions or strong private associations are necessary for market order.

In contexts where individuals cannot rely on the state to impartially enforce contracts, what explains how order is created in markets? Why are some private associations able to create markets that support contractual trade whilst others cannot? This project explores these questions in the context of open-air markets and the market associations that govern them in Lagos State, the commercial centre of Nigeria, which has 400 markets and 57 local governments.

The project will help to resolve some uncertainty amongst social scientists about the institutional basis of long-distance trade in countries where the rule of law is weak. Some argue that public, legal institutions are unnecessary and rarely used to enforce contracts, and that private mechanisms (e.g., private judges, codes of practices, and coalitions) are sufficient to counter exploitation and extortion and to enable trade. Others claim that public institutions are the basis of long-distance trade and private mechanisms are either not critical or actually not private.

Fig.1 – Ladipo market: negotiations for spare parts

There have been few empirical tests of these opposing arguments in a developing country context. This research tests the argument that order is more likely when the market association is politically powerful *and* the local government is effective, which allows the market leaders and local government to mutually hold each other accountable. With the market's political power comes the ability to remove public officials from office and constrain state taxation and extortion. On the other side, an effective local government can shut down the market and prevent market associations from extreme abuses of power. The market association's political power depends on its ability to mobilize traders. To accomplish this, the association must earn trader support, resulting in market-level policies that promote contractual trade. Specifically, the market association will provide neutral dispute resolution services to individuals inside and outside of the market, a critical service that backstops risky but profitable contractual trade.

Collecting the data

A representative survey of more than 800 market traders, market association officials, and local government revenue collectors from Lagos' 57 local governments was conducted by local enumerators in English, Yoruba, and Pidgin between August and October 2013.

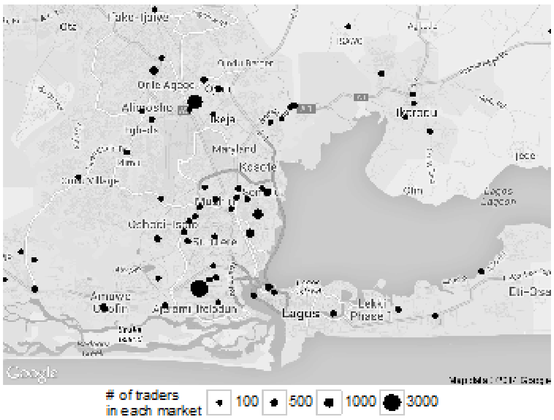

Fig.2 – Map of sampled markets

A sample market frame was developed by asking each local government revenue collector for a list of markets under their control, which was then cross-checked with a list of markets from the Lagos Waste Management Authority.

Lagosians who wish to vote in any election must register and vote in the local government where they live, as no vehicle movement is allowed on Election Day. Therefore, markets with traders who live in the local government where they trade are more politically powerful. Local government effectiveness was measured with an SMS audit of local government chairmen to assess responsiveness.

Main results

Initial analysis of the survey data has resulted in several findings:

- Market association strength is consistently and significantly correlated with *fewer* contractual transactions, measured by responses to questions about how frequently traders engage in non-spot transactions with their suppliers. This is a finding in contrast with the existing literature on private ordering. Measures of market strength are based on the ability of the association to compel or encourage traders to attend weekly market meetings.
- Politically powerful markets in effective local governments experience the least extortion, as measured by the predictability of local government taxation (Fig. 3). This is consistent with the idea that politically powerful markets can constrain local government behaviour.
- The interaction between politically powerful markets and effective local governments is associated with more credit. When a trader is in a politically powerful market and an effective local government, she is 36% more likely to get products on credit from her supplier than if she is in neither.

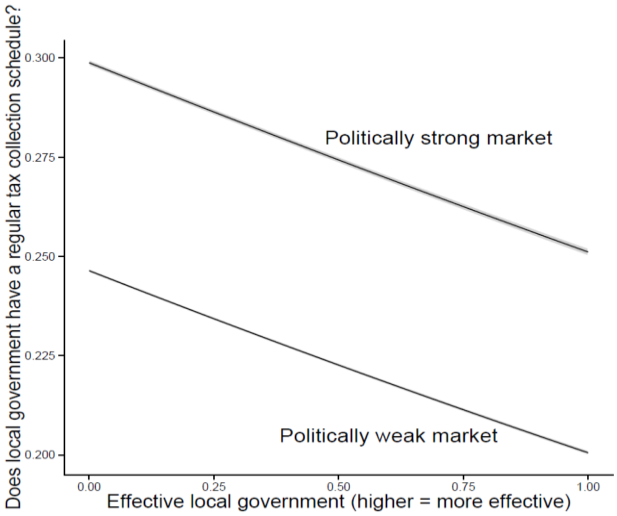

Fig.3 – Taxation schedules in politically strong vs. politically weak markets

In summary, some of the initial research findings appear to oppose the existing literature on the determinants of trade expansion in countries where the rule of law is weak. In contrast to existing research that emphasizes either the irrelevance of public institutions for private order or the idea that private order is not actually private, this research suggests the emergence of private order is a function of the interaction between public and private institutions. Market associations that are strong in the sense that they can mobilize traders are no more likely to create market institutions that enable contractual trade. The intuition for this finding is straightforward: without a check on their power, strong market associations are just as likely to extort their traders and not provide trade-promoting services. These trade-promoting institutions are more likely to emerge when a market association and a state can sanction each other.

Private Enterprise Development in Low-Income Countries

Implications for policy

- Understanding the effect of market political power and local government effectiveness on trade is important for policy. State or federal government projects related to markets can often be managed by the local government or by the market directly. When making decisions like this, more attention should be paid to the balance of power between the market and local government.
- Given that market strength is associated with many outcomes not conducive to trade expansion, policy makers should think carefully before crafting initiatives to strengthen market leaders, particular with regard to market traders. In theory, a strong market should be capable of providing trade-promoting services, such as neutral dispute resolution and information sharing about opportunistic suppliers and customers. Yet it is clear that in practice most strong markets do *not* engage in these activities.

Moving Forward…

Future analysis will consider a number of issues such as whether and how information is shared about opportunistic suppliers and customers; the extent of local government predictability and market association independence; individual trader-level analysis; and the determinants of market responsiveness and local government effectiveness. In addition, two other projects have emerged from this research. The first examines why Lagos traders engage in frequent and costly travel to China, Pakistan, and elsewhere to meet with their suppliers. Building off of the findings of this project, we hypothesize in part that this travel reduces the probability of being cheated by overseas suppliers. The second project looks at municipal government enforcement strategies with hawkers in Lagos, examining the political calculus that results in the removal of hawkers who often take business away from more formalized traders with stalls in markets.