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The politics of order in informal markets: Evidence from Lagos

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Abstract

Property rights are important for economic exchange, but in much of the world they are not publicly guaranteed. Private market associations can fill this gap by providing an institutional structure to enforce agreements, but with this power comes the ability to extort from group members. Under what circumstances do private associations provide a stable environment for economic activity? Using survey data collected from 1,179 randomly sampled traders across 199 markets in Lagos, I find that markets maintain institutions to support trade not in the *absence* of government, but rather in response to active government interference. I argue that associations develop pro-trade institutions when threatened by politicians they perceive to be predatory, and when the organization can respond with threats of its own; the latter is easier when traders are not competing with each other. In order to maintain this balance of power, the association will not extort because it needs trader support to maintain the credibility of its threats to mobilize against predatory politicians.

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1 Introduction

Outside of agriculture, more than half of workers in low-income countries are informally employed (Jütting, de Laiglesia and Jütting, 2009): they work in enterprises that are less regulated than similar activities in the same environment. Indeed, the informal sector accounts for an estimated 41% of developing countries' GDP (Schneider, 2005). Yet public institutions rarely serve the needs of informal workers. For instance, informal entrepreneurs do not rely on courts for protection. Courts are often seen as biased, inefficient, and ill equipped to regulate off-the-book transactions – i.e., not worth the effort. Thus informal traders have no recourse to formal institutions if they are cheated. For example, the legal system would be of little help to a trader who buys what she thought were new smartphones, only to discover that they were refurbished and must be sold at a loss. A large body of work argues that private associations can step in to fill this regulatory gap by enforcing contracts,¹ but this is not always the case. Although informal trade all over the world is organized into associations (Cross, 1998; Hummel, 2017), not all such groups promote trade. Indeed, many association leaders extort from their own traders. Markets in Lagos, Nigeria provide examples of both types of associations.

Some market association leaders in Lagos are a model of good governance and support a wide variety of policies that promote trade. For example, they impartially investigate customer complaints and organize market-wide boycotts of suppliers who cheat traders. By contrast, other market leaders extort from their traders, pocketing fees that they say will be used for services like market security. These leaders rarely intervene if a supplier wrongs a trader.

What conditions support economic growth in the informal sector? Specifically, under what conditions will private group leaders promote trade?² A dominant strand of thought suggests that private institutions arise to fill the vacuum left by weak or absent states. These institutions are thought to thrive in the absence of political interference.

I predict the opposite: that informal institutions perform *better* under the shadow of government, and

¹See, for example, Ellickson (1991), Gambetta (1996), Greif (1993), Milgrom, North, and Weingast (1990), Richman (2017), and Skarbek (2014).

²I use the terms 'association' and 'group' interchangeably. I refer to the individual who heads the group as the leader.

worse in the absence of government interference. I argue that leaders will be motivated to promote trade when politicians threaten to intrude on their domain. Such threats motivate trade-promoting policies because the leader needs to 1) minimize group disputes to reduce the likelihood of politician intervention, and 2) gain the support of group members to mobilize against politician threats. In short, leaders implement sophisticated policies to support trade not in the *absence* of government involvement, but rather in response to active government interference. The threat of politician intrusion, however, will not always result in good private governance.³ When traders are in competition with each other, market leaders will struggle to unify them. I expect threats of government meddling to be more likely to lead to better private governance when traders are selling different products.

I assess these claims by analyzing original survey data collected from 1,179 market traders across 199 market associations. Lagos markets are uniquely well suited to provide insights into these issues for two main reasons. First, Lagos State has almost 25 million residents⁴ and tens of thousands of traders. Thus the macro conditions are held constant, but there are a large number of markets and a great deal of local variation in the factors affecting market governance. In particular, some markets are on local government land where local government officials have many rights to intervene, while other markets are on privately held land, where the local government has fewer rights to intrude.

Second, in most settings it can be hard to observe groups with predatory leaders, in part because these groups fail, and ultimately disappear. This makes it difficult for researchers to assess which conditions are key to successful groups, as it is hard to observe groups if they disband. Because many Lagos markets are located on land that is designated for markets, and alternative uses of the land are not normally possible, failing markets hold on longer than they might in other contexts. This provides an opportunity to examine an elusive counterfactual.

I present evidence that markets on local government land are better governed than those on private land – at least when measured by leader representativeness and the absence of private extortion – and that this relationship holds when controlling for factors such as market leader term limits, traders’ level of education, the number of employees a trader has, and including local government fixed effects. I consider a number of

³I use private good governance and pro-trade policies interchangeably.

⁴Lagos Bureau of Statistics’ population estimate as of May 8, 2017.

alternative explanations, focusing on factors that could shape traders' ability to work together to constrain market leader behavior, such as market association size and ethnic diversity. Next, I find strong evidence that product diversification (a proxy for intra-market competition, since greater product diversification suggests traders experience less competition) matters. For markets on local government land, moving from one standard deviation below to one standard deviation above the mean in product diversification increases the predicted representativeness score by 61%. Finally, I present evidence of an additional observable implication of the argument: market associations that are more politically engaged are more likely to have leaders who implement pro-trade policies.

2 How threats of politician interference sustain private pro-trade policies

A leader of a group (whether public or private) who is strong enough to protect property rights and enforce contracts is also strong enough to confiscate the wealth of her members – what Barry Weingast calls “the fundamental political dilemma of an economic system” (1995; p. 1). A large, diverse, and inter-disciplinary literature has described the characteristics that define successful self-governing organizations in the absence of impartial public institutions that protect property rights. However, this body of work rarely grapples with when, why, or how some groups succeed in developing these institutions while others do not. I address this gap in the literature by exploring what motivates a leader to invest in pro-trade policies, when she *could* use her strength to predate on group members.

The outcome I focus on is private good governance, a concept I use to encompass the many ways in which a private leader can support trade in their group. For example, leaders can protect property rights, including by refraining from extortion. They can also invest in contracting institutions, such as obtaining and sharing information to inform group members about the past behavior of potential trading partners to help them avoid entering risky transactions with dishonest individuals (e.g. Greif, 2006; Milgrom, North and Weingast, 1990). Contracting institutions also include enforcement policies that ensure the implementation of agreements (e.g. Milgrom, North and Weingast, 1990), punish dishonest outsiders (through boycotts), and

penalize opportunistic insiders through impartial and efficient in-group policing (e.g. Fearon and Laitin, 1996; Habyarimana et al., 2009).⁵ Leader behavior can fall anywhere on a spectrum that ranges from extortion to uninvolved to actively engaging in impartial contract enforcement.

The emergence of these pro-trade policies is not a foregone conclusion, for a variety of reasons. A novel contribution of my argument is to highlight that such policies entail substantial short-term costs for a leader who must either motivate members to share information about people who have cheated them – a difficult endeavor when group members compete with each other and individually have little incentive to share such information – or occasionally make rulings in disputes that go against the short-term interests of individual group members. Most studies either claim that group members are not in fact in competition with each other (Greif, 2006) or ignore the role of competition, and focus only on what happens once collective problems have been overcome.⁶

To explain the presence or absence of these pro-trade policies, we need to first understand the incentives of three actors. My theory centers on two main actors: group leaders and politicians. The third actor, traders (group members), plays a secondary role. The argument focuses on contexts in which group leaders are members of (and elected by) the group. I assume they are self-interested, and aim to maximize their personal wealth by collecting fees from traders, which are roughly proportional to group profits. Group leaders have varying time horizons that may impact the extent to which their goals align with those of members, depending on whether their position is subject to terms and term limits, or (less commonly) on whether it is a lifetime appointment. Mancur Olson (2000) asserts that if a leader holds her position for life, her incentives are aligned with those of the group. After all, if group leaders aim to maximize their income, which is a function of fees that are collected from members proportional to the wealth generated by

⁵The distinction between property rights and contracting institutions was made by Acemoglu and Robinson (2005) and North (1981).

⁶There are two main exceptions. Frye (2000) argues that low tax rates can facilitate information sharing within a group, as the consequences of a member sharing information with the government about another member's volume of trade are less severe. Larson (2017) challenges the assumption that information will organically spread within groups, and considers the effect of hurdles to information sharing on in-group sanctioning. I build on these studies by focusing on leader sanctioning, rather than peer sanctioning, and highlight the additional hurdles to information sharing in a competitive trading context.

the group, greater group order would seem to increase leader profits over the long term.

Yet a long time horizon may not be sufficient to constrain a leader's short-term temptation to extort. They may have conflicts of interest, such as other businesses and income streams inside or outside the market, which could encourage them to act on short-term opportunities at the expense of long-term group revenue growth (Ostrom, 1990). Other factors can effectively shorten a leader's time horizon, including the prospect of disastrous events like fires.

I assume group leaders have the right to sanction group members, though they may not always choose to, and may do so without cause. There are costs associated with fair sanctioning – for example, the time and resources required to determine who is in the wrong in a dispute.

The second actor I focus on is local politicians, who in many contexts are the government actors who pose the greatest threat to trade groups. I assume local politicians have terms and term limits, and that they aim for higher positions in government. To climb the party ranks, they must increase internally generated revenue and maintain voter support. I assume that certain characteristics of the groups under their jurisdiction constrain their ability to collect revenue, including the type of land the market is on and the market association's degree of political power.

My argument rests on the assumption that group members aim to maximize their income, which partly depends on whether they are part of a group that has pro-trade policies. But they face high barriers to joining well-governed groups, and varying abilities to work together to constrain leader behavior, points I discuss further in the next section.

2.1 The argument

What prevents group leaders from simply extorting from their members? Under what conditions are group leaders incentivized to serve group interests? When a group leader could punish an opportunistic member for cheating an outsider, what prevents the leader from accepting a bribe from the member to not enforce the punishment? The literature fails to answer such important questions. Some studies have explored private constitutions and internal systems of checks and balances (e.g. Leeson, 2007). But these explanations overlook important questions such as what limits internal collusion. What constrains a predatory leader from buying

off or slandering those who oppose her rule?

My theory is that politician threats motivate leader good governance, for example by threats to increase group member taxes or other fees, which would limit a leader's ability to collect fees or even jeopardize the group's viability, perhaps by threatening its ownership status over assets. When politicians lack a track record of acting in the public interest – and in many developing countries local politicians occupy the least trusted level of government⁷ – groups and group leaders will perceive the prospect of their intrusion as threatening and contrary to group interests.

Why might these threats limit private extortion and promote other pro-trade institutions? A leader wants to keep the government out of the group, as politicians can threaten her ability to collect fees and keep her position. Faced with potential politician intrusion, group leaders can use two approaches. First, the leader can mobilize members to protest or vote as a bloc, or otherwise collectively sanction politicians (Bates and Lien, 1985). To maintain the necessary internal support, the leader will be less likely to extort. This part of the argument has parallels with the state-building literature. For Tilly (1992), a group leader's ability to resist an external threat requires support from group members, which incentivizes negotiation and exchange between the group leader and group members.⁸

In the second approach, the leader can keep their house in order by working to limit disputes, which could give public officials a pretense to intervene. For example, a local politician might become involved to resolve an altercation, especially if it got violent. If a leader permitted opportunistic behavior, such as allowing a group member to sell sub-standard products, public officials could exploit a customer complaint as an opportunity to intervene in the market and extract revenue. In some cases, politicians can use frequent fighting as an excuse to destroy the group, threatening the leader's position. By eliciting and sharing information about dishonest trading partners, the leader limits disputes, and thus minimizes opportunities for government extortion, which can threaten the leader's influence. Figure 1 summarizes this argument.

⁷Afrobarometer data from 36 countries reveals that 46% of respondents report that they trust their local government not at all or a little, which is lower than all other state institutions except the tax authorities (Bratton and Gyimah-Boadi, 2016).

⁸My argument also builds on work that suggests external threats, such as police repression, can motivate group solidarity (Thachil, 2015).

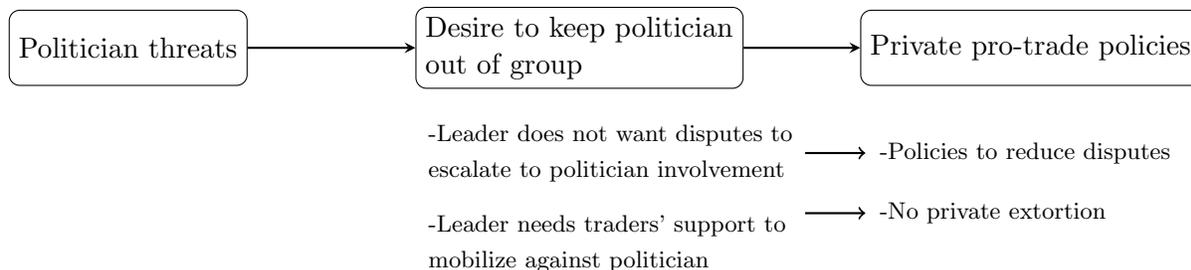


Figure 1: How politician threats lead to private pro-trade policies. The outcome of interest is private trade-promoting policies, including those that reduce disputes (including information sharing and enforcement policies) and private extortion. The presence of both can be explained by a desire to fend off politician threats. Leaders will work to reduce disputes to prevent them from escalating to the attention of a politician. Leaders will limit their extortion when they need to mobilize traders in order to collectively deter undesirable politician behavior.

Threats will not always lead to private good governance. I expect that when group members compete with each other, it will be harder for leaders to elicit information about dishonest trading partners. It will also be harder to promote group cooperation of any sort, including protest efforts. I therefore expect high levels of intra-group competition to frustrate group leader efforts to support trade.

A potential criticism of the argument is that traders should be able to constrain predatory leader behavior by either uniting or leaving the group. I will consider these as alternative explanations, but expect them to be weak. If group members are embedded in each others' lives, these ongoing social relations can facilitate cooperative behavior (Granovetter, 1985). Yet I expect that group members are rarely socially embedded in urban areas, and have few interactions with each other outside the group context. Shared ethnicity has been shown to facilitate cooperation (e.g. Habyarimana et al., 2009), which could allow members to constrain their leader, but leaders can take advantage of these social ties to more easily exert control, and not necessarily for socially desirable ends (Acemoglu, Reed and Robinson, 2014; Berman, 1997; Mattingly, 2016). Another potential criticism of the argument is that successful traders select into profitable markets, and that this explains the persistence of market order. However, I expect that traders rarely sort in this way, because 1) group membership is relatively sticky, making it difficult for individuals to frequently switch groups, and 2) outsiders have very incomplete information about group conditions before joining. These assumptions do not hold for all groups everywhere, but they do apply to many important groups in developing countries, such as trade unions and business associations.

The possibility of leader–politician collusion complicates my argument. Collusion with the goal of increasing rents from group members is theoretically most likely when structural factors empower politicians to intervene. Indeed, there are many accounts of such complicity, ranging from lineage leaders in China colluding with public officials to seize land from kin (Mattingly, 2016) to landlords cooperating with local chiefs to extort from Kenyan slum residents (Marx, Stoker and Suri, 2013). These private leaders partner with public officials to increase their power to extort. Yet many group leaders gain no additional extractive rights from such partnerships.⁹ Regardless, if collusion is occurring in the Lagos markets analyzed in this study, it should downward bias the estimates in Table 2, since it would manifest as private predation in the politician threat (i.e., local government land) scenario, pushing down the estimate on the absence of private extortion.

3 Situating the case

In this section I first introduce the context in which I test my theory – markets in Lagos. I then explain how my argument applies to the case, and describe the types of threats a market can make against a local government, and vice versa. Last I discuss how these threats motivate market leaders to implement pro-trade policies in their markets, and note the testable implications that result from this discussion.

3.1 Markets and politics in Lagos

I test the argument in Lagos, the commercial capital of Nigeria. Markets there typically have a few hundred shops that sell products ranging from mobile phones to baby clothes to kitchenware. Most markets are located on land that is either privately held or owned by the local government. Market leaders are virtually always elected, but some have term limits while others hold their position for life. Market leaders collect fees from traders that are used for trash collection and security, and serve as the liaison between traders and government officials. In many cases, politicians have delegated control over access to space in a commercial area to market leaders, who then decide who can and cannot trade there. For example, they may have the authority to lock up the shops of traders who do not abide by market rules. Market leaders may also

⁹Appendix 1 shows that collusion is rare in Lagos markets overall, but discusses one high-profile case.

negotiate with politicians over legal and illegal taxes and fees.

Once elected, a market leader will face many rent seeking opportunities. For example, market leaders often pay local government fees on traders' behalf. By collecting these fees from all traders but under-reporting the true number of traders to the government, the leader can pocket the difference. Similar opportunities arise with utility payments, such as for electricity and trash collection, along with security. Leaders can choose to hide the details of these payments, and traders may be only vaguely aware that something is amiss. Traders in one market reported that the market leader collects fees that he says will be used to pay ten security guards at a salary of \$83/month, when in fact there are only four guards who he pays just \$56/month.

Disputes are another decision point for market leaders, who can act on short-term temptations to extort, or take actions aligned with the long-term interests of the market. Many market association constitutions require that traders bring all disputes – both among traders within the market, and with outside suppliers or customers – to the market leader, and stipulate fines for failing to do so. Market leaders can choose to accept a standard dispute resolution service fee and mediate impartially, but they may be tempted to accept a bribe for ruling in one party's favor, damaging the market's reputation.

Traders struggle to constrain predatory leader behavior for similar reasons that citizens have difficulty holding politicians accountable in weak democracies. Traders say they are afraid to vote out a mediocre incumbent market leader because “the devil you know is better than the devil you don't.” If such sanctioning is difficult, the obstacles to mutiny – a risky collective action problem– are enormous. Traders must trust that many of their fellow traders will follow through on a promise to mutiny. But paradoxically, in markets where mutiny is desirable a predatory leader has probably cultivated distrust among traders. Group trust is especially challenging in urban markets where traders are unlikely to be socially embedded in each other's lives. As a result of these factors, mutiny is rare. In a survey I conducted in 2013, only three of 68 markets surveyed had had a market leader overthrown in the past 10 years.¹⁰ Markus has described a strategy where firms partner with third parties to sanction the state (2012), and one could imagine this logic helping traders

¹⁰This lack of social embeddedness applies to the traders and leaders as well, further impeding the ability of traders to hold their leader accountable through social pressure.

sanction their leaders. But these collective actions also constrain this scenario.

Nigeria has a federal system of government, with 36 states and over 800 local governments with (typically) democratically elected chairmen. One party, the All Progressives Congress Party (APC), dominates all branches and levels of government in Lagos State.¹¹ By far the most relevant level of government for markets is the local government. Local governments in Nigeria are generally weak and have few official functions; the exception is their authority over markets: they are constitutionally mandated to maintain and regulate markets, and have the authority to collect taxes from market traders (Barkan, Gboyega and Stevens, 2001). Local government power is concentrated in the hands of the chairman, who is directly elected; chairmen involve themselves personally in virtually all market affairs, as it is one of their few channels to collect rents and show senior party officials that they are capable of accomplishing tasks.

While the APC in Lagos has been dominant in recent years at the state and local levels, it is still important for local politicians to win high vote shares. This allows the party to claim a mandate for the broad reforms its leaders strive to execute. At the local government level, a high vote share signals local popularity, a reliable metric for party leaders strategizing about who to support for higher office down the line. Moreover, in recent local government elections the other main party in Nigeria, the People's Democratic Party, has come close to winning some chairmen positions. Thus winning votes may matter purely for electoral success as well.

Market leaders are critical for promoting trade, as courts in Lagos cannot be relied on to enforce contracts or uphold laws that protect property rights. Over the past 15 years Lagos State has implemented governance reforms that have increased the protection of property rights, but these reforms are incomplete and unevenly enforced.¹² In short, despite some public institutional improvements, the rule of law is weak in Lagos.

¹¹APC chairmen head all of Lagos State's 57 local governments.

¹²For example, the average number of days it takes to resolve a standard commercial dispute in a Lagos court has dropped to 447 – below even the regional average for Cape Town, South Africa – but the average cost of resolution is 62% of the claim value, compared to 34% in Cape Town (World Bank, 2014). Independent state audits of local government accounts have been introduced to increase local accountability, but these reports still regularly reveal that huge sums of money are unaccounted for (Office of State Auditor General, 2012). Likewise, despite the passage in 2011 of a law prohibiting street hawkers, a priority for many market traders who lose business to them, within four years enforcement had waned and street hawkers were visible

3.2 How market leaders can sanction local governments

If a market leader can mobilize traders to protest, she can threaten politicians. For example, shutting down the market for the day and leading a protest at state government offices would attract the attention of the state party, which has few other reliable ways of accessing information about public (dis)satisfaction with the local government. Protests by traders have caused local chairmen to lose their positions. According to Bola Tinubu, a wealthy former Lagos State governor who is the *de facto* leader of the APC and the patron of politics in southwestern Nigeria:

[T]raders act as reliable sources of information for the government and political parties...[and] serve as the crucial feedback mechanism needed by the government and policy makers to evaluate instituted and proposed policies.¹³

In Nigeria, where the party that controls the state government typically controls all local governments in the state, the most critical hurdle for aspiring local government chairmen is getting the party's nomination, not the actual election. Thus a protest would hurt a chairman's chances of being renominated. According to the Lagos APC Chairman Henry Ajomale:

Traders can prevent a chairman from getting renominated. We take cognizance of that. If we reappoint such a person we will run into trouble. In Alimosho [one Lagos local government] we picked someone, people protested, so we gave the nomination to someone else. This was before the election. We have done this so many times.¹⁴

When asked what constrained a local government from renovating a market – which would price out existing traders – one local government chairman told me he “negotiates with traders because they are voters. And some of them are party members; you don't want a public outcry.”¹⁵ While market traders may not necessarily be able to prevent an APC-nominated candidate from getting elected, protests are embarrassing for the party and weaken its credibility.

throughout the city.

¹³Interview via email, February 5, 2014.

¹⁴Interview, January 20, 2014.

¹⁵Interview, January 12, 2013.

Market leader efforts to sanction politicians will be frustrated when traders in their market are selling similar products, and are thus in competition with each other. One constantly hears the phrase “business is secret” in Lagos, and many traders say they are reluctant to cooperate with other traders in their market because “they are my competitors” or someone might “snatch my customers.”¹⁶ It will thus be easier to mobilize traders and promote intra-market collaboration when traders sell different products, and are not in direct competition.

3.3 How local governments can sanction markets

Local governments can more easily threaten markets located on local government land than those on privately held land. In this section I discuss local government chairmen’s incentives, and why markets on local government land are more vulnerable to politician threats.

Most local government chairmen have higher political ambitions, for example to work for the state government or to become a representative in the state House of Assembly or even the National Assembly.¹⁷ Their ability to obtain higher office depends almost entirely on whether they receive support from the political godfather of Lagos politics – Tinubu, the former governor of Lagos State.¹⁸ Tinubu evaluates chairmen based on three criteria, which are sometimes contradictory in practice: the extent to which they maintain public support throughout their tenure, how much revenue they are able to generate,¹⁹ and the extent to which they modernize their local government in line with “Megacity” ideals (de Gramont, 2014).²⁰ Chairmen aim to excel on all fronts. Market leaders will thus rarely view efforts to increase taxes on traders as anything but a threat, and modernizing goals often translate as market renovation, which can price out current market leaders and traders.

¹⁶These quotes are from a 2017 survey of Lagos used-clothing traders for a separate project (citation not included to anonymize this document).

¹⁷This claim is based on interviews with officials from ten local governments and the Ministry of Local Government and Chieftancy Affairs.

¹⁸This is conventional wisdom in Lagos, but was also explained to me by senior People’s Democratic Party officials in Lagos on July 1, 2013 and by a close aide to Tinubu on January 14, 2014.

¹⁹According to one former local government chairman, “There is a balance the chairman must strike between sending money up and serving people” (interview on June 26, 2013).

²⁰Local politicians think of a Megacity as an attractive and prosperous city.

Public land markets provide tempting opportunities for local government chairmen to impress the god-father. They offer greater scope than private land markets to generate revenue: while local governments are limited to a prescribed number of fees they can collect from traders in both types of markets, they collect rent from traders in public markets. Local government chairmen can also threaten to demolish (and rebuild) a market on public land, which would serve as a valuable signal of modernization. In short, local governments pose a greater threat to markets on public land compared to those on private land because they have more rights to intervene in the former.

3.4 How mutual threats sustain trade-promoting policies

How, then, do mutual threats enable contractual trade and limit private extortion? A market leader needs internal support to mobilize against government threats. The first step towards gaining trader support is to refrain from extorting from them – i.e., they must resist the temptation to collect an unreasonable amount of fees.

The presence of contractual trade-promoting policies is harder to explain by a market leader’s desire to acquire and maintain trader support, as these policies often go *against* traders’ short-term interests. I instead propose that leaders will be motivated to implement such policies in the presence of politician threats due to a desire to prevent public officials from meddling in the market. Market disorder gives politicians an excuse to pursue agendas that are in conflict with the market’s interests.

For example, in 2016 a local government destroyed Oshodi Market with the intent to renovate it. A Lagos State official justified this decision with:

[A] number of untoward activities happening there necessitated that the state should move to safeguard life and properties. It was meant to ensure that there was no breach of public order.

That was what led to the demolition exercise [...]²¹

The below implications follow from this discussion:

²¹<http://www.vanguardngr.com/2016/01/we-demolished-oshodi-market-because-arms-ammunition-were-recovered-in-the-market-lasg/>

1. Market leaders who govern markets on public land will be less likely to extort and more likely to invest in other pro-trade policies than those in charge of markets on private land.
 - (a) This relationship should be greater when traders within a market sell different types of products.
2. Market leader political engagement should be associated with less private extortion and the presence of other trade-promoting policies.

4 Research design

To test the argument, I need data on both well and badly governed markets and the leaders who govern them, for markets on both private and public land. I therefore collected survey data from markets throughout Lagos. I asked questions about market associations, which are rarely mentioned in other surveys such as the World Bank Enterprise Surveys, but which are critical to understanding trade-related outcomes.

My original survey data improves substantially on previous small business surveys in developing countries. Most of these surveys generate a sample frame by collecting a list of firms from a national or municipal statistics agency, but of course these lists exclude informal firms that, by definition, do not register with the government. One approach used by the Enterprise Surveys that focus on informal traders is to sample only from well-known informal markets, but these markets could be unrepresentative on several dimensions (Benjamin et al., 2014). Another approach is to create sampling areas from city blocks (World Bank, 2010) – for example, by starting at the corner of a given block and approaching the third shop – but poor urban areas may not have clearly defined blocks. I create a market sample frame that includes the universe of markets in the key commercial areas in Lagos, resulting in a survey that is more representative than previous surveys of informal traders. I directed enumerators to specific randomly sampled shops, greatly reducing opportunities for enumerator discretion, which has plagued prior surveys of informal traders.

4.1 Survey sampling

I conducted a survey of 1,179 consumer goods traders in plazas (small multi-story buildings with lots of small shops) from April to June 2015.²² The starting point for the sample frame was a list of plazas from

²²This survey was conducted in collaboration with [author name removed to anonymize this paper].

4.2 Measuring variables

In this section I describe how I measure variables in the survey. Appendix 3 lists the survey questions.

4.2.1 Explanatory variables

Land type. Traders were asked what type of land their market association was on, and I use the modal response to this question among traders in a given association.²⁵

Product diversification. I created a product diversification index for market associations for which I have data from at least five traders. The index is based on the number of traders selling products categorized as apparel, electronics, beauty, hardware, or home goods.²⁶ A higher score indicates higher diversification, i.e., traders are selling a wider variety of products.

4.2.2 Outcome variables

Market leader good governance. I look at four measures of market leader good governance. I use questions that can be interpreted consistently across associations.

- *Representativeness.* Traders were asked whether the market leaders represent their interests, which is the closest approximation to trade-supporting policies in the absence of data on the particular issues facing each market.
- *Honest accounting/private extortion.* Private extortion is used here to denote market leaders' extortion of traders, which I measure using a low-measurement-error question: whether traders feel market leaders *properly account for the fees they collect*. This question was developed by listening to the language traders use to talk about market leader management.

²⁵One commercial area, which encompasses several market associations in the sample, is on federal government land. The founding traders leased this land specifically because they believed the federal government would be a relatively absentee landlord (Interview with local government official on April 25, 2013). Because the circumstances surrounding this commercial area are so unique, I exclude its traders from the main analysis (which is why the N in the main tables does not equal 1,179). Table 1 in the appendix shows that the results hold if we conceptualize markets on federal land as private land – i.e., facing fewer threats from the state.

²⁶This index sums the squares of the proportion of traders selling in these product categories, and subtracts that value from one.

Leaders who, for example, collect fees for electricity but pocket these funds would not be accounting properly.

- *Free to complain.* Traders were asked whether they feel free to complain to market leaders, a measure of leader accessibility.
- *Resolve disputes.* Traders were asked if the market leaders had helped them resolve any dispute with other traders in the past year.

4.2.3 Controls and additional variables

I control for whether the market leader holds her position for life, whether the trader has any post-secondary education, the number of employees the trader has, and the value of stock in a trader's shop.²⁷ I also include local government fixed effects.

I measure market political engagement in two ways. First, traders were asked whether the market leader provides them with political information. Second, traders were asked if they had ever slept in their shop the night before an election so they could vote in the local government district where they trade. In Nigeria, vehicle movement is prohibited on election day, and many traders live and work in different districts. Politically engaged market leaders will mobilize traders to sleep in their shops on the eve of elections so that they can vote in the market's local government on election day.

I consider as alternative explanations a number of factors that have been shown to affect group cooperation. For instance, I look at how dispersed traders' homes are to assess social embeddedness. The survey asked traders what local government they live in. Local governments in Lagos are massive – each has over 435,000 residents on average – so it is not obvious that traders would have higher social capital simply because they live in the same local government district. But I lack more fine-grained data. Where I have data from five or more traders, I create a residential dispersion variable based on the variety of local governments they report residing in.²⁸ Additionally, I look at market association size. In 2016 I resurveyed the traders included in the survey discussed in this paper and asked them to estimate how many traders belong to their

²⁷Theoretically, the number of employees and stock value could be a result of market leader governance – i.e., good governance might help traders grow their businesses. Removing these as controls does not meaningfully change the results.

²⁸This variable is calculated in the same way as the product diversification index – by summing the squares of the proportion of traders residing in each local government and subtracting that value from one.

market association. I also measure ethnic diversity by creating an ethnic fractionalization index for markets for which I have data from five or more traders.²⁹

4.3 Sources of exogenous variation

In this section I address concerns that omitted variables may be shaping both exposure to threats and the outcome, and that government threats might not be exogenous to the outcome. One concern is that well-governed markets may also be more prosperous than their poorly governed counterparts, and that this attracts local government attention and threats to their market. This is a difficult possibility to address empirically, as I expect well-governed markets to be better able to negotiate with the local government, which makes it difficult to observe threats toward these markets in equilibrium. However, as shown in Appendix Table 2, there is generally no relationship between the good governance indicators and the total value of stock that traders report having in their shop;³⁰ nor is there a relationship between the total value of stock and market land type. This suggests that local government threats are not targeted only at more prosperous markets, though it is difficult to fully address this endogeneity concern.

Another concern is that markets on public land are different from those on private land not *just* because of exposure to government threats, but in other ways that could directly affect market leader policies. For example, if these markets have different degrees of ethnic homogeneity, previous studies suggest that could explain the outcome. I test for this possibility by conducting a difference-in-means test for private and public land markets by level of ethnic fractionalization; there is no statistically significant difference. Additionally, the main results are robust to controlling for ethnic fractionalization, as described in Section 6.2. Similarly, there is no difference across public and private land markets in whether the leader holds their position for life (Table 1), and the main results are virtually unchanged when controlling for whether the market leader

²⁹This variable is calculated as above – summing the squares of the proportion of traders belonging to each ethnic group, and subtracting that value from one.

³⁰This finding is itself surprising, as I would have expected good governance to support traders in growing their business. One possibility is that stock value is only distally related to market governance. Perhaps if the survey had asked about more proximate trade outcomes, such as how often customers buy on credit and fail to repay, I would have observed a relationship. There is a negative relationship between stock and dispute resolution, but as noted below I do not put much weight in the dispute resolution variable.

holds her position for life (Table 2).

An additional concern is that private good governance may be more likely on public land markets *not* due to threats of politician interference, but because public markets are selling higher-end products or have more desirable locations, and the gains from pro-trade policies are therefore greater. I have already shown that the total value of a trader's stock does not differ across public or private land, which could proxy for product value. To assess location, I can compare shop rents across public and private land markets. Rents are about 26% *higher* in private land markets, which would increase the bar for finding an effect.

My theory predicts that a shift in exposure to politician threats or the diversity of products sold in a market could lead to changes in the nature of private governance. But in the context studied here, the types of products sold in a market are slow to change, and land rarely changes from being public to private, or vice versa. Given the path dependencies of these variables, the empirical tests of the argument use cross-sectional data to assess expectations about leader governance given land type and product diversification at a given point in time.

A related endogeneity concern is that traders sort into markets based on the quality of market governance. Section 6.2.1 considers the evidence on trader sorting, and concludes that it is extremely difficult for potential group members to learn about conditions inside a market before they join.

In short, while I believe land type provides a source of exogenous variation in the extent to which markets face government threats, there are likely to be some unusual situations in which threats are a function of market attributes that are unrelated to land. My strongest claim in the findings that follow is that there is a surprising pattern – a correlation between markets located on public land (which is closely tied to threats of political interference) and private, pro-trade policies. Previous studies would predict the opposite. The empirical correlation is consistent with my argument, but I cannot definitively rule out the possibility of reverse causation.

5 Survey data analysis

The first step in analyzing the data was to determine which traders belonged to the same market association, which was sometimes difficult. For example, if one trader reports belonging to the Balogun Traders Union



Figure 3: This is a map of Lagos, with circles plotted at the location of the 199 market associations represented in the survey.

on Lagos Island and another reports belonging to the Balogun Market Union on Lagos Island, are these the same association? Research assistants were hired to visit or call traders to reconcile ambiguous cases.

I then used ordinary least squares regressions,³¹ clustering standard errors at the market association level, to examine the relationship between leader policies and the type of land the market is on. I control for variables that existing theories predict should shape private good governance. Table 1 shows trader-level descriptive statistics.³²

Table 1: Descriptive statistics.

Statistic	N	Mean	St. Dev.	Min	Max	Local govt. land	Private land	p-value
Represent	670	0.63	0.35	0	1	0.71	0.61	0.002
Honest account	519	0.76	0.42	0	1	0.88	0.73	0.000
Free complain	674	0.92	0.27	0	1	0.92	0.92	0.927
Resolve disputes	699	0.37	0.48	0	1	0.42	0.36	0.189
Post-sec. education	729	0.45	0.50	0	1	0.43	0.46	0.484
Men	729	0.74	0.44	0	1	0.67	0.76	0.047
Number employees	729	0.52	0.91	0	8	0.43	0.54	0.152
Annual rent (USD)	610	2,292.35	1,944.58	1.21	21,829.23	2004.00	2365.28	0.022
Stock value (USD)	469	15,018.86	26,770.38	251.26	301,507.50	15026.84	15017.01	0.998
Sell apparel	729	0.58	0.49	0	1	0.59	0.57	0.622
Sell electronics	729	0.16	0.36	0	1	0.08	0.18	0.000
Sell beauty	729	0.05	0.22	0	1	0.13	0.03	0.001
Sell hardware	729	0.09	0.29	0	1	0.05	0.10	0.019
Sell home goods	729	0.13	0.34	0	1	0.29	0.09	0.000
Leader for life	695	0.02	0.12	0	1	0.01	0.02	0.228
Leader provides political info	666	0.53	0.50	0	1	0.68	0.49	0.000
Sleep election eve	584	0.08	0.27	0	1	0.06	0.08	0.259

³¹The *Represent* variable had an ordered range of response options, while the other good governance indicators were yes/no questions. All models with binary outcome variables are robust to logistic models.

³²In Appendix 4 I assess whether we should be concerned that traders are nervous about speaking openly about predatory market leaders.

6 Results

6.0.1 Hypothesis 1: Markets on local government land are governed better

In this section I investigate the relationship between market leader good governance and the type of land the market is on, the proxy for exposure to politician threats.

Table 2 assesses the relationship between land type and market leader governance. Markets are more likely to be better governed when they are on local government land.³³ Using Model 2, the predicted representativeness score for markets on private land is 0.60, and 0.73 for those on local government land. Using Model 4, the predicted honest accounting score for markets on private land is 15% lower than those on local government land – 0.75 versus 0.88.

Table 2: This table shows the relationship between land type and private good governance. The sample size changes across models due to missing data. Controls include whether the market leader holds her position for life, whether the trader has any post-secondary education, the number of employees the trader has, and the value of stock in a trader’s shop. LGA fixed effects indicate the inclusion of local government fixed effects. Standard errors are clustered at the market association level.

	<i>Dependent variable:</i>							
	Represent		Honest accounting		Free to complain		Resolve dispute	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Local government land	0.10*	0.10**	0.15***	0.10**	0.002	0.02	0.06	0.10**
	(0.05)	(0.04)	(0.05)	(0.05)	(0.04)	(0.04)	(0.05)	(0.05)
Constant	0.61***	0.73**	0.73***	0.85***	0.92***	0.85***	0.36***	0.53**
	(0.03)	(0.33)	(0.03)	(0.29)	(0.02)	(0.24)	(0.02)	(0.25)
Observations	670	640	519	498	674	642	699	664
Controls	No	Yes	No	Yes	No	Yes	No	Yes
LGA fixed effects	No	Yes	No	Yes	No	Yes	No	Yes

Note:

*p<0.1; **p<0.05; ***p<0.01

These findings are especially striking, given that markets on local government land are typically on land that is exclusively designated for markets. One might expect failing markets to be most likely located on land that cannot be used for any other purpose. But markets on local government land face more threats of politician interference, and as Table 2 shows, private good governance is more likely in these markets.

³³Appendix Table 3 shows that the results in Models 1, 3, 5, and 7 of Table 2 hold when excluding observations not included in the models with controls.

I find no relationship between the type of land ownership and whether traders report feeling free to complain to their leaders. I suspect this is because there is little variation in this variable: 92% of traders say they feel free to complain to their leaders. Nor is there any connection between land type and whether the market leader works to resolve disputes in the market, except in the model with controls. Disputes are a complicated variable to interpret, as the absence of disputes could indicate reliable market leader governance, such that they never arise in the first place. Or they could indicate that traders trust the market leader and are bringing more disputes to them.

The ability to incorporate local government fixed effects is a powerful feature of the research design. A critic might charge that it is variation *across* local governments that is driving the relationship. For example, some local governments may intervene in all markets in their jurisdiction to protect traders from abusive leaders. Models 2 and 4 show that the surprising correlation holds even for the relationship between leader good governance and land type *within* local governments. Moreover, my fieldwork suggests no local government acts in this way.

Appendix 5 shows a series of robustness checks. Table 4 shows that the results hold for the subset of market associations for which I have data from at least two traders. Table 5 shows that the results largely hold for the subset of market associations for which I have data from at least five traders. Table 15 presents models that aggregate at the association level. Even with a substantially smaller sample size, the patterns are consistent and Models 2, 3, 4, 7, and 8 statistically significant.

6.0.2 Hypothesis 1a: Product diversification

Table 3 considers the interaction between land type and the diversity of products sold in the market. Models 1 and 2 provide strong support for the theory. The interaction between private land and product diversification is negative and large, suggesting that the relationship between threats (being on local government land) and private good governance is greater when markets sell a wide variety of goods, presumably because traders are in less competition with each other. This makes it easier for market leaders to implement trade-promoting policies.

The markets that perform best on the good governance measures are those on public land with a high

product diversification index – the predicted value of representativeness for markets on local government land with a product diversification score one standard deviation below and above the mean is 0.47 compared to 0.75. Greater product diversification helps private land markets too: the predicted value of representativeness increases from 0.52 to 0.66 moving between a standard deviation below and above the diversification mean. The same pattern holds for the honest accounting and free to complain variables, though the interaction effect for the latter is not statistically significant.

Table 3: This table shows the interaction of land type and a market’s product diversification index. A higher diversification index indicates that the market has traders selling a wider variety of products. The data for this table is subsetting to markets where there are five or more traders surveyed in the association. Standard errors are clustered at the market association level.

	<i>Dependent variable:</i>			
	Represent (1)	Honest accounting (2)	Free to complain (3)	Resolve dispute (4)
Local government land	-0.05 (0.05)	-0.02 (0.07)	-0.10 (0.11)	0.12** (0.05)
Product diversification	0.27*** (0.09)	0.19 (0.13)	0.05 (0.08)	0.11 (0.07)
Local govt. land*product diversification	0.27** (0.11)	0.29* (0.15)	0.22 (0.19)	-0.21* (0.11)
Constant	0.52*** (0.03)	0.66*** (0.05)	0.89*** (0.02)	0.33*** (0.03)
Observations	477	359	472	494
Controls	No	No	No	No
LGA fixed effects	No	No	No	No

Note:

*p<0.1; **p<0.05; ***p<0.01

Because land is only a proxy for politician threats – after all, private land markets may also occasionally face such threats – I also examine the simple correlation between product diversification and good governance indicators. Appendix Table 6 shows that when looking at the relationship between product diversification and good governance indicators, diversification is associated with higher representativeness and honest accounting scores.³⁴

Taken together, these results suggest that markets located on local government land are more likely to have better private governance, and that more product diversification enhances this relationship.

³⁴Table 16 aggregates at the association level. With a sample size of 31, the interaction effect is no longer significant, but the direction of coefficients is consistent.

6.1 Hypothesis 2: Is market political engagement associated with leader good governance?

One way in which politician threats promote private good governance is that leaders need traders' support to fend off these threats. If the leader extorts, she will not be able to mobilize traders for political ends, such as encouraging them to vote as a bloc. One implication of this argument is that all politically active markets – irrespective of land type – should be better governed.

Table 4 examines the relationship between two measures of market political engagement and leader good governance. There is some suggestive evidence that markets in which the leader provides traders information about politicians, and those in which the leader asks traders to sleep in their shops on election eve, are better governed. The predicted representativeness and honest accounting scores for markets where the leader does *not* ask traders to sleep in their shops before an election are 0.64 and 0.79, respectively. These increase to 0.81 and 0.95, respectively, where the leader asks traders to sleep in their shops on election eve. These patterns hold for the dispute resolution variable as well. It is possible that there is no relationship between these forms of political engagement and traders reporting being free to complain to their market leader given the small amount of variation in responses to that question.³⁵

6.2 Alternative explanations

In this section I consider several alternative explanations for private good governance. First, I consider variables that might shape traders' ability to act collectively to constrain predatory leader behavior, such as whether they live in the same local government, which I measured with the residential dispersion index. As shown in Appendix Table 7, this variable appears to mediate the relationship between land and good governance. Among markets where traders are spread out, private land markets are better governed than public land markets – 0.53 vs. 0.41 on the representativeness index. Among markets where traders live closer together, public land markets are better governed – 0.74 vs. 0.69. Similar patterns hold for the honest

³⁵Table 17 aggregates at the association level. With a quarter of the individual-level sample size, only Model 1 remains statistically significant, but the magnitude of the coefficients in the models without controls are consistent.

Table 4: This table shows the relationship between different measures of political engagement and market leader good governance. Standard errors are clustered at the market association level.

<i>Dependent variable:</i>								
	Represent		Honest accounting		Free to complain		Resolve dispute	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Election info	0.11*** (0.03)		0.06 (0.05)		-0.003 (0.03)		0.21*** (0.04)	
Sleep		0.17*** (0.04)		0.16*** (0.04)		-0.01 (0.04)		0.14* (0.08)
Constant	0.59*** (0.03)	0.64*** (0.03)	0.75*** (0.03)	0.79*** (0.03)	0.93*** (0.02)	0.94*** (0.01)	0.28*** (0.03)	0.40*** (0.02)
Observations	614	542	488	432	625	547	639	562
Controls	No							
LGA fixed effects	No							

Note:

*p<0.1; **p<0.05; ***p<0.01

accounting variable, but it is not clear what conclusions can be drawn from this, given the imprecise way in which this variable is measured. The dispersion concept merits further examination: future survey questions could investigate whether traders attend the same church or mosque to better assess whether they consider themselves part of the same community.

Three other variables might also affect traders' ability to act collectively. First, Mancur Olson, for instance, has suggested that smaller associations should be better able to cooperate (1965). Appendix Table 8 shows that the results hold when controlling for the size of the market association. The results also hold when controlling for an ethnic fractionalization index, as shown in Appendix Table 9. The coefficient on ethnic fractionalization is negative and large, suggesting that ethnic diversity is associated with worse private governance. I did not expect ethnic homogeneity to be so strongly correlated with market association good governance, despite an ample literature on this topic predicting a strong relationship. Many markets are homogenous and badly governed. So while ethnic homogeneity may not be sufficient for good governance, it *is* associated with better private governance, which is consistent with the existing literature.

Earlier I considered product diversification, but there is an additional way product type might matter. Private good governance may be more critical for certain *types* of products, which may drive the provision of private pro-trade policies. Appendix Table 10 shows that the results for honest accounting hold when controlling for the proportion of traders selling different categories of products (Model 2), but not for leader

representativeness (Model 1). The coefficients on apparel and beauty in Model 1 are negative, statistically significant, and large, but I lack theoretical priors as to why traders selling these products would benefit less from market good governance. Table 11 provides evidence that private land markets may be more likely to sell electronics, and that markets on public land may be more likely to sell beauty products. It is not obvious, however, how this would matter. If anything, electronics products might be expected to benefit more from market leader governance, as it is harder to assess their quality on the spot. And as Table 12 shows, there is no relationship between the proportion of traders selling in these two product categories and market good governance.

A third possibility is that the distance between the market and the local government secretariat matters. Table 13 shows that the results hold when controlling for this distance, which makes sense in an urban setting with small local government districts.

6.2.1 Market sorting is difficult and rare

If a leader is extorting heavily from group members, why wouldn't the members switch groups? Wouldn't this constrain extortion? This would seem to be especially true in the case at hand: traders' shops are quite small, and a trader could pack all of her wares into a taxi in an hour at most. Capital mobility should provide group members with more bargaining power *vis--vis* their leaders (Bates and Lien, 1985). In Section 2 I argued that group member sorting – i.e. members identifying orderly groups and choosing to join them – should be difficult and rare. Here I look at the evidence.

First, market membership is sticky. Shop owners require two years' rent up front from traders, which is the norm in Lagos (and many other West African cities) for residential leases as well. After these first two years, traders need only pay the following year's rent up front, which deters relocation, as a new lease would require two years' rent in advance.³⁶ As further evidence of the difficulty of moving, the average trader has been in her market or plaza for over seven years.

It may be difficult to relocate, but can traders sort into trade-supporting markets in the first place? Figure 4 shows that while many traders were attracted to their plaza because it had a reputation for being

³⁶Two years of advance rent is \$4,585 for the average trader, which is a substantial amount of money.

a place where goods sold quickly, several decided where to locate based on reasons unrelated to whether the market leader maintained pro-trade policies. For example, 10% of traders reported being attracted to their plaza *only* because of its desirable location – e.g., situated in a busy area, close to their home, or near their suppliers. Likewise, 9% of respondents reported being attracted to their plaza *only* because the product they sell was sold there.³⁷

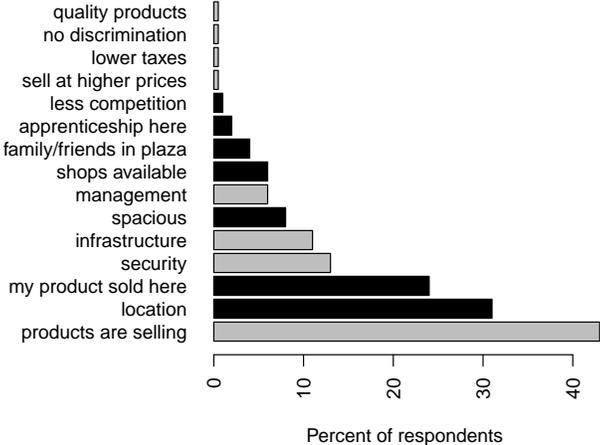


Figure 4: Traders choose to locate in markets for many reasons, several of which are unrelated to whether the market is conducive to trade. This figure shows responses to the question: “What attracted you to this plaza?” This was an open response question that was then coded. Grey bars denote reasons that could be related to market conditions, while black bars indicate unrelated reasons. Data is from a pilot for the survey (N=196).

The fact that many traders select a market based on non-trade-related characteristics is at least partly due to imperfect information about internal market affairs for non-members. Even diligent traders will struggle to obtain reliable information about conditions in a market they are considering joining. One trader tries to do her own survey of traders before renting a shop. “But most times, even if the market is bad, they won’t tell her,” her son said. “And if they know she wants to sell similar goods, they would even hoard information from her.”³⁸

Additionally, Appendix Table 14 shows that there is no relationship between association representative-

³⁷Note that Figure 4 shows all responses to this “check all that apply” question.

³⁸Interview with the son of a trader in Mile 12 market on June 13, 2016.

ness and honest accounting, and how long a trader has been in their market. Traders in the most and least representative associations report having been in their market for the same number of years: 7.6.³⁹ This suggests that, at minimum, relocation is not frictionless.

7 Conclusion

While considerable attention has been devoted to the consequences of self-enforcing internal group dynamics that protect property rights and enable contractual trade, this article has focused on the politics that sustain these policies. Survey evidence from 199 market associations in Lagos is consistent with the argument that politician threats motivate market leaders to promote trade in their markets. There is evidence that this relationship is stronger when traders sell different products, and are thus less in competition with each other. Politician threats motivate group order because 1) the leader needs to minimize group disputes to reduce the likelihood of government intervention, and 2) the leader needs the support of group members to mobilize against government threats. The survey data showed that better-governed markets are more likely to be politically engaged, which is consistent with the latter. The argument, somewhat counterintuitively, is that even when potentially predatory politicians work directly against traders' interests, they unintentionally motivate the private policies that benefit the traders.

The results of this study affirm the findings of previous studies which show that groups can enable economic exchange in contexts where the public institutional environment does not protect property rights or support contracting institutions. But I have argued that the fact that group members would benefit from private pro-trade policies – such as information sharing about opportunistic outsiders – does not explain their existence. Such policies are costly in the short term when group members compete against each other and benefit from the trader in the next store being cheated. I have proposed an argument about the conditions under which group leaders will invest in these trade-promoting policies. When the government keeps its hands off the economy, group leaders extort. When local politicians threaten to intervene, leaders organize to resist, an effort that is made easier when intra-market competition is not an obstacle.

There are reasons to be pessimistic about the externalities of private good governance. Research on

³⁹Predicted values from Model 1 of Appendix Table 14.

medieval guilds suggests that guilds not only did *not* benefit non-group members, but that they impeded general economic growth by buying privileges from political elites that tilted the playing field (Ogilvie, 2014). But in the absence of a strong rule of law, it is not clear that general economic growth is the counterfactual. Further, there are many beneficiaries of private good governance. This research has shed light on the inner workings of modern informal economies and discussed some conditions under which pro-growth policies thrive in market associations, which are responsible for a vast amount of global economic output.

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