Towns Fund Delivery Partner

Market Failures in Town Centres

Examples and Evidence

ARUP nichols FUTUREGOV copper Grant Thornton savills

Terms & Conditions

- This document has been developed by the Towns Fund Delivery Partner, a consortium led by Ove Arup & Partners Ltd with our partners, Grant Thornton UK LLP, Nichols Group Ltd, FutureGov Ltd, Copper Consultancy Ltd and Savills UK Ltd (collectively 'we'). The content of this document is for your general information and use only.
- Neither we nor any third parties provide any warranty or guarantee as to the accuracy, timeliness, performance, completeness or suitability of the information and materials found in this document for any particular purpose. You acknowledge that such information and materials may contain inaccuracies or errors and we expressly exclude liability for any such inaccuracies or errors to the fullest extent permitted by law.
- Your use of any information or materials contained in this document is entirely at your own risk, for which we shall not be liable.
- This document contains material which is owned by or licensed to us. This material includes, but is not limited to, the design, layout, look, appearance and graphics. Reproduction is prohibited other than in accordance with the copyright notice which can be found at townsfund.org.uk
- Unauthorised use of this document may give rise to a claim for damages and/or be a criminal offence.
- This document may also include links to other materials, websites or services. These links are provided for your convenience to provide further information. They do not signify that we explicitly endorse these materials, websites or services.
- Your use of this content and any dispute arising out of such use of the content is subject to the laws of England, Northern Ireland, Scotland and Wales.
- For formal Government guidance on Towns Fund please visit gov.uk

Introduction

Audience

This session is aimed at practitioners who are developing Towns Fund business cases or managing their development.

It is pitched at those with some knowledge and experience of business cases.

Session Objectives

This Market Failure presentation and discussion will help to introduce the sometimes difficult to grasp concept and theory of Market Failure.

We will look at the different types of market failures, and examples and case studies to provide insight into how to determine if, and what type, of market failure is occurring in the town.

Agenda

Towns Fund Delivery Partner

Speakers

Rob Turner – Director in Grant Thornton's Public Services consulting team. He brings particular expertise in the analysis of large quantitative and qualitative data, with the explicit purpose of deriving intelligent insight to inform service delivery, make the case for investment and to drive performance improvement.

Danny Collins – Director of Economics at Savills with over 15 years experience of development consultancy, specialising in property market analysis and economic benefits assessment of major development projects, including new master planned communities, town centre studies, and infrastructure projects. Danny has particular expertise in developing the economic case for public sector investment projects.

1. Introduction

2. Types of Market Failure
   - Public Good
   - Externalities
   - Imperfect Information
   - Others

3. Examples of Market Failure
   - High Street Regeneration
   - Shopping Centre Regeneration
   - Brownfield Land Regeneration

1. INTRODUCTION

MARKET FAILURE IN THEORY

WHAT IS MARKET SUCCESS?

Market success is defined as perfect competition.

In a perfectly competitive market, the 'right' level of goods / services are bought and sold, and no one can be made better off without making someone else worse off. This is because the price is right.

In all other cases – all real cases – the price is wrong, market failure is present and the overall wellbeing of society is not maximised. The incorrect price causes individuals to act against the interest of the group.

Conditions for perfect competition

- Many, small buyers
- Many, small sellers
- All products are identical
- Rational decision making
- No regulation or intervention
- No barriers to market entry
- No transaction costs
- Complete information & understanding
- No effects on third parties

Towns Fund Delivery Partner

MARKET FAILURE IN THEORY

WHAT IS MARKET FAILURE?

Any situation where the conditions are different to those of perfect competition experiences market failure. It is more useful to think of market failure as market imperfection. Very imperfect markets do a bad job of allocating resources and cannot balance supply and demand at the right level.

This is typically because:

- The good or service cannot be supplied profitably (public goods)
- Buyers or sellers aren't completely aware of the availability, quality or price of the good or service (imperfect information)
- The production or consumption of the good or service has an effect on a third party (externalities)

Violations of perfect competition

- Monopolists, Collusion
- Major buyers
- Products differ
- Human decision making
- Legislation, Government departments
- Up front costs
- Search, selling or transport costs
- Private information, uncertainty
- Third parties affected

MARKET FAILURE IN THEORY

Towns Fund Delivery Partner

WHY DOES IT MATTER?

If a market is perfectly competitive and there is no market failure, government action would make society worse off. Because of this, governments tend to consider market failure when making spending decisions. This is most strongly expressed in EU State aid and UK subsidy control law, where identifying market failure is a condition for lawfulness.

Government action can increase overall wellbeing when the private benefit of an action is too low and the total benefit of the action outweighs the costs.

Not all instances of market failure can or should be remedied and identification alone does not justify government action.

"Subsidies should pursue a specific public policy objective to remedy an identified market failure"

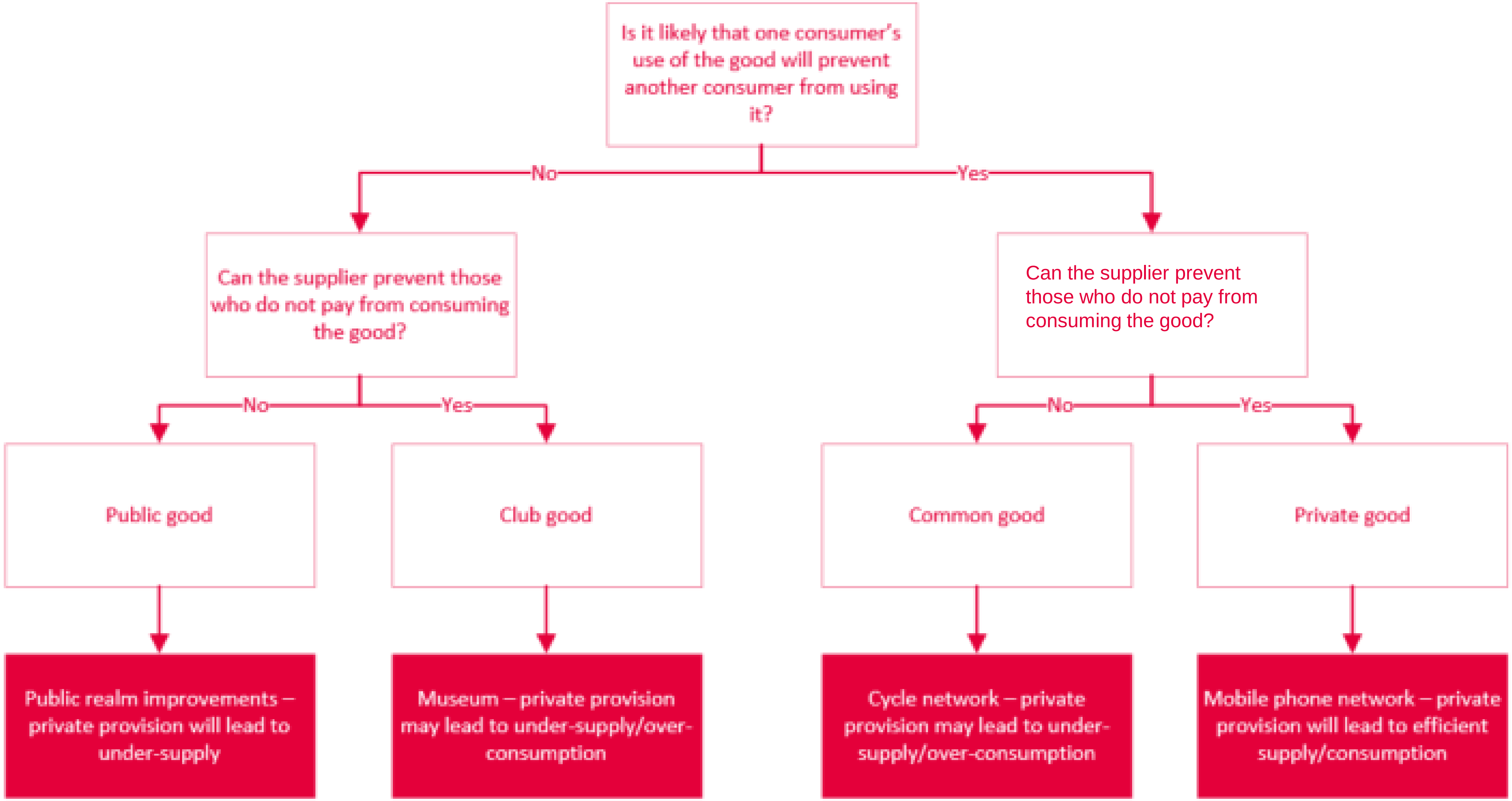
– *Technical guidance on the UK's international subsidy control commitments* (2020)

Towns Fund Delivery Partner

2. TYPES OF MARKET FAILURE

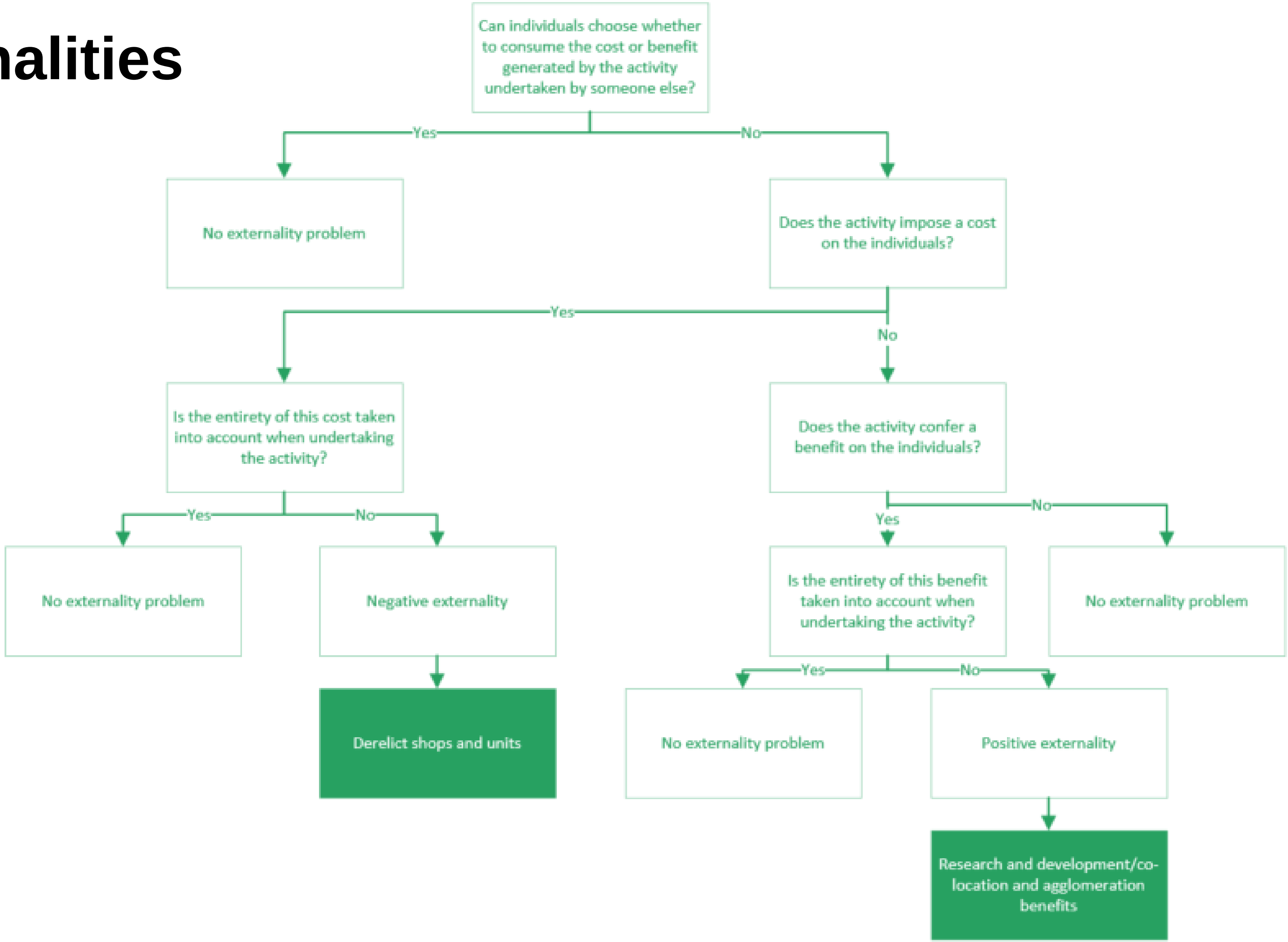
Public goods

Towns Fund Delivery Partner



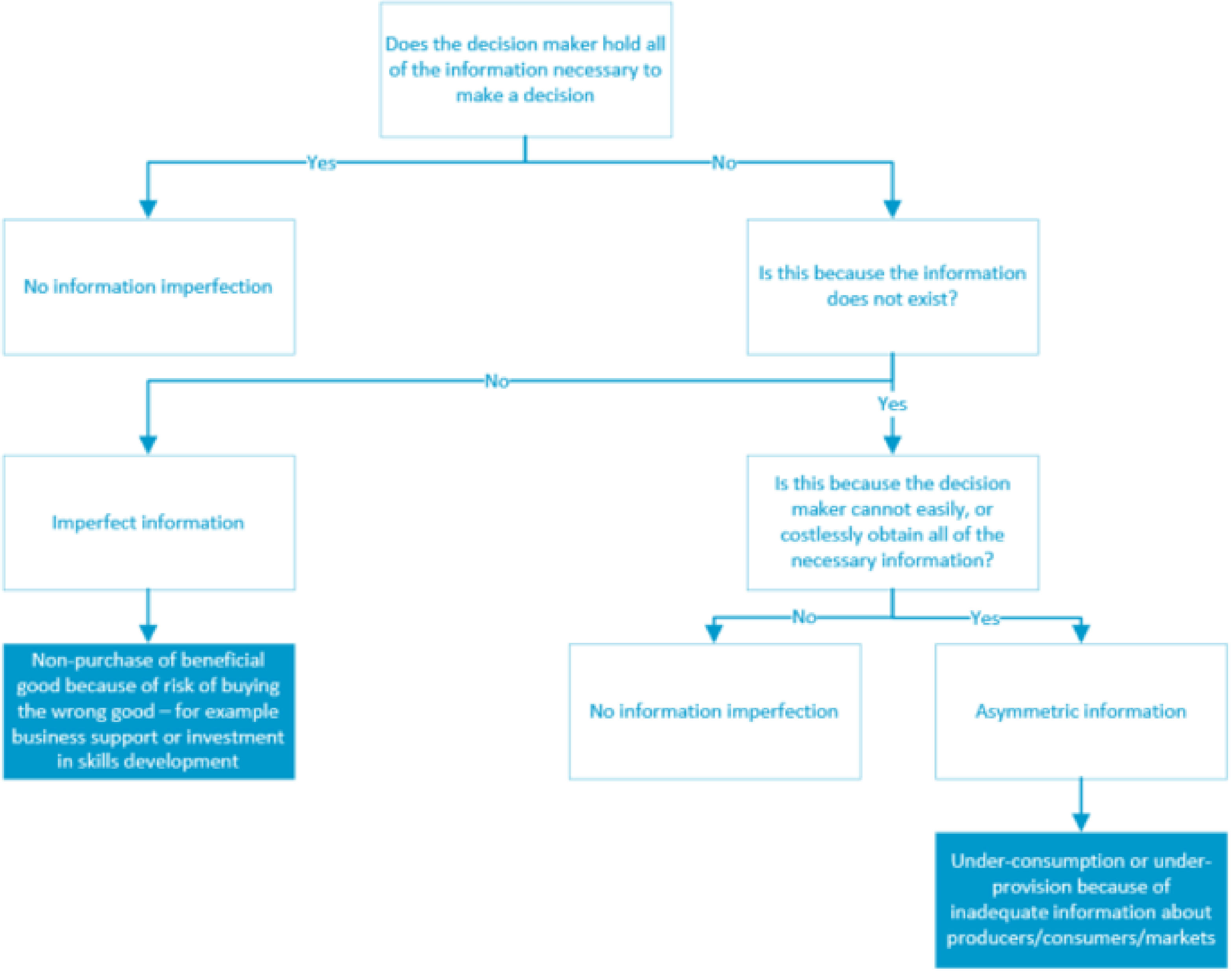
Externalities

Towns Fund Delivery Partner



Imperfect information

Towns Fund Delivery Partner



Others

Towns Fund Delivery Partner

Market power

- **Uneven competition** – higher prices and/or lower outputs than the optimum
- **Coordination failures** – cost of negotiation, failure to join up
- **Barriers to entry** – low business survival rates
- **Barriers to exit** – technological lock-in
- **Risks** – beyond scope of private sector

Equity/distributional

- **Place** – people disadvantaged by where they live
- **Equity** – people disadvantaged and excluded by who they happen to be

Coordination/institutional

- **Coordination failures** – 'silo' strategy and delivery, duplication, lack of scale and scope
- **Institutional failures** – mainstream service providers not delivering effectively

3. EXAMPLES

EXAMPLES OF MARKET FAILURE

Towns Fund Delivery Partner

EVIDENCE OF MARKET FAILURE

Within economic theory, government action is justified where market imperfections lower overall wellbeing by a significant amount.

However, this condition cannot be proven precisely or incontrovertibly. Justifications for government action thus rely on informed judgments on the degree of market failure.

HM Treasury's Green Book acknowledges that the degree of market failure is likely to be unclear. Even EU State aid law permits "multiple possible market failures, which are not clearly distinguished" (Buelens et al, 2007).

The theoretical and legal obligation to consider market failure is challenging.

"It may be difficult to determine whether there is a significant market failure… [and] it is extremely difficult to measure [its] importance"

- Buelens et al. *The Economic Analysis of State Aid: Some Open Questions.* (2007)

EXAMPLES OF MARKET FAILURE

Towns Fund Delivery Partner

LAND AND PROPERTY MARKETS

Markets in land and property are amongst the most imperfect, so much so that some economists argue that the price can never be right. This matters as real estate underlies all economic and social activity.

In general, there is a significant degree of market failure in land and property markets, so government action can be justified.

However, it is not just markets that fail to maximise wellbeing. The planning system, for example, is understood to negatively impact wellbeing by lowering supply and distorting prices.

In Urban land markets and policy failures (Cheshire, 2009) land and property markets are identified as imperfect as:

- Land and property are in a specific location.
- Neighbouring land and property influence the benefits of occupation and financial value.
- Developers underpay for public infrastructure and underprovide public parks

Conceptualising state-market relations in land and property (Adams et al, 2005) also identifies land and property as being distinctive and immovable, and affected by new housing, dereliction or undesirable uses on neighbouring sites. Further issues include:

- That land generally remains in a fixed use once developed, rather than being redeveloped for better uses as demand changes.
- Fragmented ownership, which prevents beneficial redevelopment.

EXAMPLES OF MARKET FAILURE

Towns Fund Delivery Partner

HIGH STREET REGENERATION

Example:

- Major town centre, retail site, currently vacant and derelict
- Owner has failed to bring the site back to productive use
- Scheme is having a detrimental impact on the town in terms of values, amenity, safety and security, perceptions, and wellbeing of the community

Market Failures include:

- **Externalities** – Derelict space can have negative consequences for other land owners, businesses and the community in the town, pushing down values, vibrancy, and attractiveness. This results in negative externalities which makes it hard for others to develop, invest or operate. It can also result in crime and other antisocial behavior which has negative impacts for residents and residential values. Redevelopment (supported by public funding) can deliver positive externalities – evidenced via Land Value Uplift

- **Public Goods –** Public realm which is low quality, poorly maintained, or not fit for purpose is an example of market failure. The public realm is a public good. Commercial markets cannot be established for public realm as individuals cannot be excluded from using it and one person's use does not affect another person's potential to use it. Upgrade of the public realm would cost developers money, this has a knock on impact to the viability for developers, in particular in towns with a depressed market value due to existing vacancy and low quality space.

- **Coordination Failure –** potentially if a masterplan or regeneration plans have not materialized due to one or more stakeholders not playing a role. A solution may be in site acquisition, via CPO if needed.

EXAMPLES OF MARKET FAILURE

Towns Fund Delivery Partner

SHOPPING CENTRE REGENERATION

Example:

- City Centre shopping centre with high vacancy, major occupiers leaving, and reducing footfall
- Centre no longer provides the high quality, mix of uses that are attractive to a modern market
- Complex ownership and management arrangements and large scale of site mean large scale regeneration is difficult.

Market Failures include:

- **Coordination Failure** – multiple owners and interested parties, including remaining occupiers cannot agree on the most appropriate strategy for development. Partial redevelopment is not an option due to the build form and structural issues. The lack of single ownership or control of the full asset means that regeneration initiatives continue to stall. This lack of coordination and agreement is a market failure.

- **Uneven Competition** – despite the unsuitable nature of much of the scheme for most occupiers, the site is still ideally placed to support single specialized occupiers, who enjoy a prominent location, cheap rent, and good accessibility. These occupiers are able to continue operating at this location, while others have failed. These occupiers are unwilling to move, due to the high costs, including fit out costs of a new store, and uncertain market conditions in a revised offer. This demonstrates a uneven competition market failure, where one operator has an advantage over others.

EXAMPLES OF MARKET FAILURE

Towns Fund Delivery Partner

BROWNFIELD LAND REGENERATION

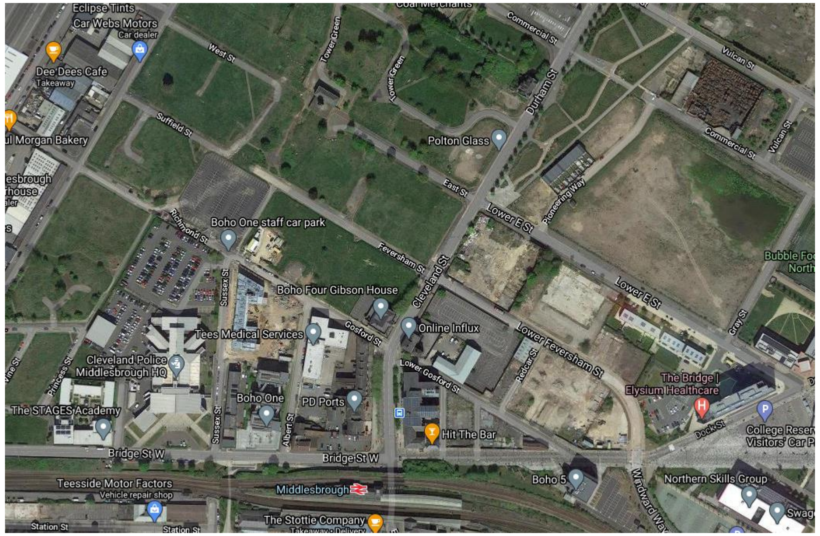
Example:

- A Town Centre industrial unit has closed and relocated to more suitable site out of town
- The site is now derelict, vacant, and on the Brownfield Land Register
- There has been no interest in redeveloping the site due to high costs of land remediation and demolition
- There are also other ground conditions, such as sewer pipes complicating the redevelopment of the site.

Market Failures include:

- **Public Goods –** Remediation of a contaminated site will provide environmental benefits which are a public good. A developer funding such works alone may find that the costs of such works make the scheme unviable, and so development will not progress and the site will remain contaminated – a development appraisal, including costs of the works will evidence this failure

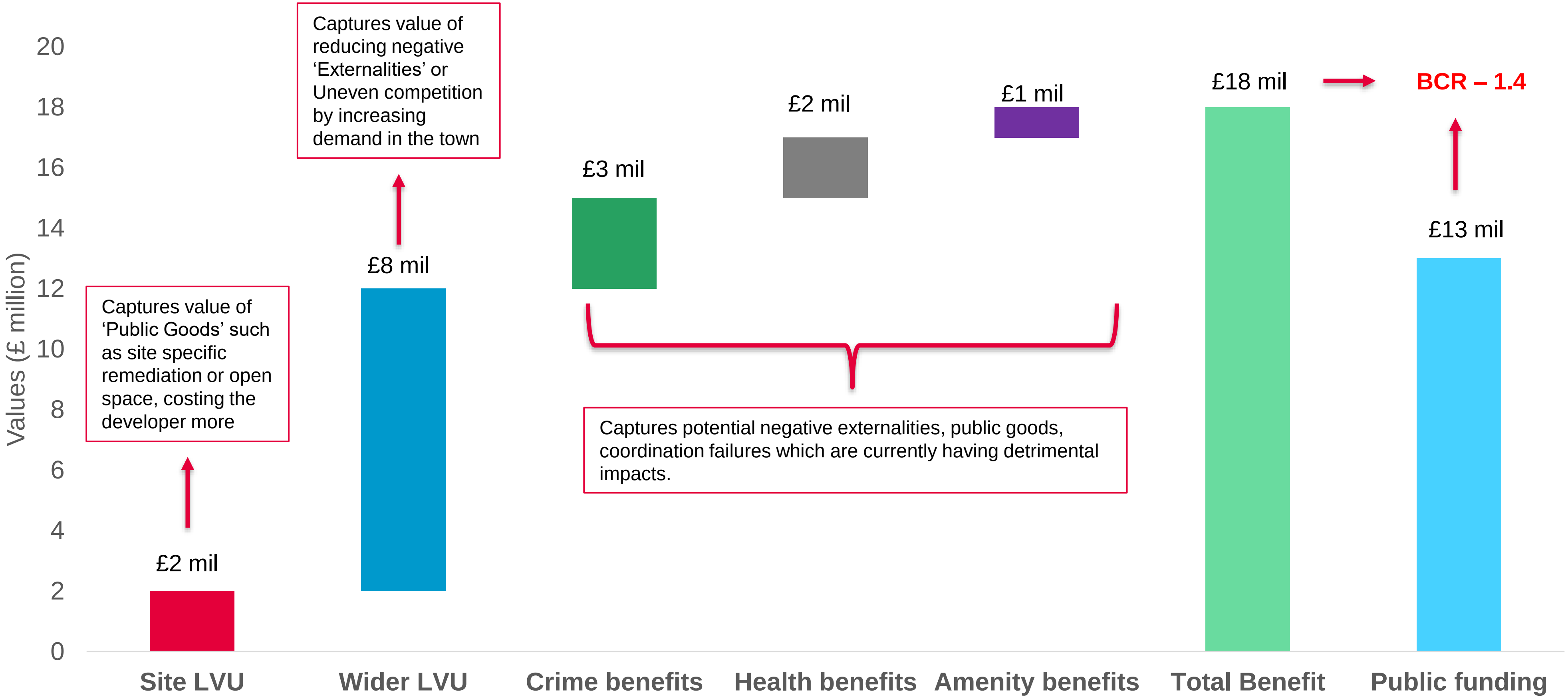
- **Imperfect Information** – There are no residential properties in this area, and the town has limited residential development (houses, apartments and flats). As such there is no evidence or market precedent on values for such units. This increases developer risk, and developers may take a more cautious approach to estimating future viability resulting in a viability shortfall. It is also likely that imperfect information will be available over the potential costs of 'Abnormal' site costs, such as infrastructure or utilities etc. This can increase the upfront costs and 'Optimism Bias', risk and contingency values, again impacting on viability



Case study – Market Failure in the Economic Case

Towns Fund Delivery Partner

BCR Analysis Reflecting Market Failures



Source: Savills, 2021

** Note that values and costs are not those used in the case study and are illustrative*

Thank you & questions

Towns Fund ©
Delivery Partner