

Abstract

This paper examines how land tenure reforms based on long-term occupation affect informal settlements and the informal economy, with a particular focus on expectation formation under ex post legalization. While land titling policies have been widely studied as tools for promoting formalization, far less is known about retrospective institutions such as adverse possession that legalize occupation after prolonged informal use.

Theoretically, adverse possession reforms generate ambiguous incentives. They may encourage households to invest and transition into formal economic activities by stabilizing tenure and reducing eviction risk, (the stabilization effect). On the other hand, when legal enforcement is uncertain, such reforms may shape expectations of future legalization in a way that encourages households to remain informal while waiting for rights to be granted (the incentive effect). Whether informal activity expands or contracts depends on which expectation dominates.

Treating adverse possession reforms as external institutional shocks, this study employs a country-pair difference-in-differences approach using panel data from 2000 to 2020. The analysis focuses on two pairs: South Africa–Kenya and Georgia–Armenia. Informal economic activity is measured using an index capturing the scale of the informal economy, while informal settlement prevalence is proxied by the urban slum population share.

The results reveal heterogeneity across institutional contexts. In South Africa, the reform is associated with a relative contraction of the informal economy, consistent with a dominant stabilization effect, while no statistically significant impact is observed for the slum rate. In contrast, Georgia experiences a relative expansion of informal economic activity following reform, suggesting that expectations of future legalization outweighed stabilization incentives, again without a clear effect on slum prevalence.

Overall, the findings highlight expectation formation as a key mechanism linking land institutions to informal economic behavior and demonstrate that housing formalization and economic formalization may respond differently to the same institutional change.