

Formalization of informal trade in Africa: trends, experiences and socio-economic impact

Koroma, S., You, N., Ogalo, V., Owino, B., Nimarkoh, J.



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Contextⁱ

Africa's commercial landscape is characterized by a rapidly expanding informal cross border trade (ICBT) in various goods and services. ICBT is an important source of economic growth and livelihood to the continent's burgeoning population. Yet ICBT receives only little policy attention and is often shunned by various governments due to its perceived demerits such as loss of tax revenue.

ICBT refers to trade in goods/merchandise and services which may be legally imported or exported on one side of the border and illegally on the other side and vice-versa, on account of neither having been recorded in the official trade statistics nor subjected to the required statutory border formalities such as customs clearance.

ⁱThis Policy Brief provides a synopsis of the results of a much larger study on the subject matter. The study can be accessed at: <http://www.fao.org/3/a-i7101e.pdf>

ⁱⁱThese figures are merely estimates and it may well be that the value of ICBT might be higher.

ICBT is an integral aspect of Africa's economy, given its size and robust growth over the last three decades. Available statistics indicate that ICBT generates nearly US\$18 billion annually and accounts for over two-thirds of the trade flows in some African countriesⁱⁱ. In the Southern African Development Community (SADC), for example, it is believed that informal trade accounts for up to 40 percent of total intra-SADC trade.

ICBT is also a source of employment to over three-quarters of the populations in most African countries. Women informal cross border traders make an important contribution to economic growth and government revenues. Their trading activities contribute significantly to poverty reduction, employment and wealth creation in Africa. Yet they are often neglected by mainstream trade policies and institutions, thus undermining the profitability and visibility of their activities.

However, policy makers are increasingly recognizing the importance of tapping the full potential of ICBT through formalization policies. Identifying best practices in the process of transition from informal to formal markets could realize the full potential of the actors involved in ICBT in Africa.

Causes of ICBT

The high incidence of ICBT in Africa is attributed to several push factors. To begin with, weak employment opportunities in the formal sector is one of the major causes of ICBT. ICBT offers employment to millions of unskilled and semi-skilled workers who are not catered for in the formal sector.

The difficulties and costs associated with meeting all documentary requirements in the formal sector also motivate traders, especially women to engage in ICBT. This includes challenges in obtaining Tax Identification Numbers (TIN), which is necessary to formally registry a business; documents such as rules of origin certificates, as well as, cumbersome regulatory requirements which results into delays and high trading costs for small businesses. Other push factors include restrictive trade regimes – often the case where subsidy or incentive schemes are only available for foreign business; and; socio-economic challenges like gender bias that prevent beneficial engagement in formal trade.

Pull factors that promote ICBT in Africa is the high market response of ICBT to market signals, especially in times of high price volatility, exchange rate misalignment, emergencies and other types of shocks. ICBT actors have established efficient trade networks that unless they are well understood, it may make an attempt at building formal networks ineffective.

Weak capacity constraints in member states is one of the reasons for slow pace of formalization of ICBT at the Regional Economic Community (REC) level in Africa. Inadequate policy coherence and lack of political will from some member states is another key reason. There is need for data collection and management both at the regional and national level to inform policies that will promote formalization and recognition of informal cross border trade.

Challenges

Although ICBT is associated with several benefits, its high prevalence poses several challenges to enterprise development and economic transformation in Africa.

First, informal imports present unfair competition to locally produced goods due to their low prices. This results from the fact that informal imports are usually not subjected to import duty and sometimes consist of cheap counterfeits. On the other hand, ICBT leads to high tax revenue losses. This limits the amount of financial capital that governments can channel for facilitation of formal cross border trade through improvement of the business environment and infrastructure.

Secondly, the traders involved in ICBT usually face difficulties in accessing credit and other services from the formal financial institutions due to their informal nature. Banks and other formal financial institutions consider informal businesses to be high-risk customers. As a result, informal traders are either denied or forced to access credit at very high interest rates.

Thirdly, women engaged in informal trade, despite playing a substantial role, continually face stigmatization, violence, harassment and poor working conditions.

Fourthly, ICBT presents major regulatory challenges since the trade transactions and the details of the businesses or traders involved are hardly recorded or included in official statistics. Weak enforcement of regulation creates loopholes for trade in substandard or illegal products that negatively affect consumer welfare through health/safety risks and undermine efforts to ensure national security.

Lastly, ICBT creates loopholes for abuse of the rights of workers, principles of decent work and wages are hardly applicable in ICBT in Africa. Thus, workers have no access to social security, medical schemes and other benefits enjoyed by their counterparts in the formal sector. This challenge is exacerbated by informal workers' inability to unionize and ensure enforcement of national and international labour standards and human rights conditions.

Best Practices in Formalizing ICBT

The challenges highlighted in the foregoing section point to the urgent need to formalize ICBT. Efforts to formalize ICBT in Africa can be implemented under the following three themes:

Policy and legislative approaches

This approach involves using policies that directly promote sustainable small enterprises; improve business environment, infrastructure and address inequalities in a country or a REC. The approach also involves using trade, industrialization, infrastructure, and sector-specific policies that enhance productivity and formalization of informal businesses.

Examples of the policy and legislative interventions in Africa include building and expanding ongoing initiatives of developing One-Stop-Border-Posts (OSBP) across RECs and establishing trade facilitation desk at district levels within member countries. The establishment of the Non-Tariff Barriers - Reporting, Monitoring and Eliminating Mechanism under the Tripartite trade agreement (involving COMESA, EAC and SADC) is a very useful endeavor that should be replicated across other RECs in Africa.

Furthermore, in COMESA, a Simplified Trade Regime (STR) has been established to promote formalization of ICBT. The STR allows informal cross border traders to trade on a duty free basis for goods worth up to US\$ 1,000. Further, the STR exempts small traders from complying with certificate of origin when dealing in certain goods imported from member states. Facilitating free movement of persons is also an important policy-legislative intervention being used to formalize ICBT. Examples in this regard include the Common Passport initiative being used in the Economic Community of West African States (ECOWAS), as well as, the use of temporary permits and national identity (ID) cards to travel in East African Community (EAC) countries. The continental (African Union) passport launched during the AU Summit in 2016 might remedy this situation when it is finally adopted by all AU member states.

Major RECs in Africa have also developed efficient regional payment systems to eliminate informal cross border payments. This includes SADC's Integrated Regional Electronic Settlement System (SIRESS), ECOWAS's West Africa Monetary Zone (WAMZ) and EAC's East Africa Payment System (EAPS). Policy based initiatives can also advocate for greater investment cross border post infrastructure through

financing agreements between public and private agencies. The ECOWAS "Brown Card" scheme which validates motor vehicle insurance across member states is also a step in the right direction.

Perhaps one of the most successful schemes in facilitating formalization of informal trade is the "M-Pesa". The M-Pesa (M for mobile, Pesa is Swahili for money) is a mobile phone-based money transfer, financing and microfinancing service, launched in 2007 by Vodafone for Safaricom and Vodacom, the largest mobile network operators in Kenya and Tanzania. It has since expanded to many African countries and even outside of Africa.

Partnership-based approaches to formalization

This approach involves establishment of partnerships that encompass formal private sector organizations, non-governmental organizations (NGO), development partners, and governments to develop joint formalization strategies. The Charter for Cross-Border Traders in Malawi and Zambia is an example in this regard. The charter is a joint initiative by World Bank, the government of Malawi and Zambia, border agencies, traders' associations, and civil society organizations (CSOs) to address the challenges facing small cross border traders. These include challenges such as high import duty, burdensome bureaucracy, corruption, and harassment among others. In the EAC, a Grain Trade Financing Facility (GTFF) has been established as a joint initiative by ABC Bank, the East African Exchange (EAX) and the East African Farmers Federation (EAFF) to provide credit to over 20 million smallholder farmers. Additionally, the initiative provide post-harvest services to farmers, as well as, location-specific market information to grain traders, millers, and farmers through the e-granary system to enhance cross border trade in grains.

Several Market Information Systems (MIFs) have also been launched in RECs and various African countries to promote formal cross border trade in agricultural and livestock commodities. These include COMESA's Food and Agricultural Marketing Information System (FAMIS), Kenya's Agricultural Commodity Exchange, and Rwanda's e-SOKO among others.



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The MIFs focus on eliminating the information asymmetries that promote ICBT. However, in many cases, small traders are unable to use the information provided by these systems and often see them as an added cost (they are charged a small fee for information through SMS). Thus continuous capacity building activities should go along with these systems as the technologies evolve.

Incentives and compliance-based approaches to formalization

The incentives and compliance-based approach includes the measures taken by a country or a REC to facilitate formalization through incentives tailored to the needs of informal traders. The approach encourages implementation of measures that eliminate barriers to technology, credit and market access, as well as, interventions that promote compliance with formal business requirements such as registration and obtaining various permits.

Capacity building initiative that meet the demands of trade associations can also act as incentives for informal markets trade to work collectively in order to access training promoting market development and trade facilitation.

Examples of the incentive-compliance approach include Rwanda's Peace Basket Initiative (PBI) and Liberia's Sirleaf Market Women's Fund (SMWF). The PBI equips women with high production skills through training programs and links them with overseas markets. As a result, Rwandese baskets are able to access formal international retail chains such as Macys. The SMWF has rebuilt markets that were destroyed during conflicts in Liberia and provides capacity-building programs, thereby enabling women to re-engage in various businesses.

Policy Recommendations

- Improve the business/ trading environment at national and regional level to promote formalization. This calls for regulatory reforms, as well as, simplification of customs formalities, registration of businesses, and trade procedures.
- Reform institutions such as the judiciary and trade facilitation agencies such as customs departments is equally important in eliminating the inefficiencies inherent in the trading environment that often discourage formalization.
- Mainstream ICBT issues in national and regional policy frameworks to facilitate formalization.

This includes recording and archiving ICBT activities for effective planning and policy formulation.

- Prioritize data collection and analysis on ICBT to inform policy design (focus on inclusion of gender-disaggregated data).
- Create incentives to promote formalization aligned to the needs of trade associations i.e. provision of technical support through, for instance, incubation services, as well as, financial support through initiatives such as establishing national/ regional business development funds for informal traders.
- Facilitate partnerships among government, NGOs, CSOs, formal private sector, informal traders, and donors among others should be fostered to catalyze formalization.

- Focus on low cost, quick win solutions by scaling up best practices i.e. – development of information manual for traders in local languages, e.g. Swahili in EAC
- Develop trade policies that are gender responsive and encourage the promotion of women trade associations in policy formulation processes.
- Create awareness raising campaigns on trade regulations – targeting women in local languages.
- Strengthen trade flows between informal and formal markets by improving linkages across the value chain and addressing bottlenecks to up scaling i.e. capital constraints



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Suffyan Koroma
Senior Economist, FAO Regional Office for Africa
Email: suffyan.koroma@fao.org
Ny You
Agribusiness Economist, FAO Headquarters
Email: ny.you@fao.org
Victor Ogalo
Head of Policy Research and Programme, Kenya Private Sector Alliance
Email: cvo@cuts.org
Boniface Owino
Assistant Policy Analyst, CUTS ARC
Email: boo@cuts.org
Joan Nimarkoh
Policy Officer, FAO Regional Office for Africa
Email: Joan.Nimarkoh@fao.org

Contact

Food and Agriculture Organization of the United Nations
Regional Office for Africa
Gamal Abdul Nasser Road P.O Box GP 1628
Accra, Ghana
Tel: +233(0) 302 610930
Fax: +233(0) 302 668427
Email: fao-ro-africa@fao.org
Website: www.fao.org/africa/en