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SPRING - 2016
DECLARATION

I, the undersigned, declare that this is my original work and has not been submitted to any other college, institution or university other than the United States International University in Nairobi for academic credit.

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This thesis has been presented for examination with my approval as the appointed supervisor.

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DEDICATION

I dedicate this thesis to my beloved parents Mr. & Mrs. Munjuri who have always been there for me, and other strong supporters are my brothers and lecturers whose contribution was immense towards successful completion of this work.
ACKNOWLEDGMENT

Firstly, I would like to express my sincere gratitude to my advisors George Kabongah and Moses Onyango for their continuous support of my study and related research, for their patience, motivation, and immense knowledge. Their guidance helped me during the period of research and writing of this thesis. I could not have imagined having better advisors and mentors for my study.

Additionally, if it were not for all the lecturers of the masters of international relations, my interest in international relations would have never developed into its current capacity. During my postgraduate studies, they were always the people whom I looked up to and respected dearly. I will always owe a great deal of gratitude towards the lecturers who guided me throughout my study.

I thank my fellow classmates for the stimulating discussions, for the weekends and evenings we worked together before deadlines, and for all the fun we have had in the University.

Last but not least, I would like to thank my brother Dennis Mutwiri for supporting me financially, spiritually and morally throughout writing this thesis and my life in general.
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ABSTRACT
The study investigates the causes of informal cross border trade in East Africa border points even with the establishment of the East African Community Customs Union. The study has established that majority of the traders are not familiar with the EAC Customs Union Protocols and so they may not benefit from it.

The few traders aware of it are less motivated to know how the Protocol can benefit them and they perceive the opening up of trade under the evolving EAC Customs Union Protocol and promotion of formality as an interference and threat to their livelihoods.

The study has established lack of formal employment fueled by inappropriate economic reforms such as structural adjustment programmes, (SAPs), rising rural-urban migration in search of often non-existent employment, and, low wages from the formal employment as the main push factors towards Informal Cross Border Trade (ICBT).
LIST OF ACRONYMS

CBT – Cross Border Trade

COMESA - Common Market for Eastern and Southern Africa

CU – Customs Union

EAC - East African Community

GDP - Gross Domestic Product

ICBT - Informal Cross Border Trade

MSMEs - Micro, Small and Medium Enterprises

OECD - Organization for Economic Cooperation and Development

SME’s - Small Micro-enterprises

SAPs - structural adjustment programmes

SPS - Sanitary and Phytosanitary

SSA - Sub-Saharan Africa

STR – Simplified Trade Regimes

TTC’s – Trade Transaction Costs

UBOS – Uganda Bureau of Statistics

UNDP – United Nations Development Programme

UNCTDA – United Nations Conference on Trade and Development

VAT - Value Added Tax
CHAPTER ONE

1.0 Introduction

1.1 Background of the Study

Hart (1970, 1973) was the first person to bring the term informal sector in a Third World context into the academic literature. He introduced the concept of the informal sector to describe a part of the urban labor force, which works outside the formal labor market.

He considered the informal sector as almost synonymous for all categories of small self-employed individuals. This was thereafter typically used to refer to ways of making a living outside the formal wage economy, either as an alternative to it, or as a means of supplementing income earned within it (Bromley et al, 1979:pg.41).

Even though Hart’s original notion of the informal sector is limited to the self-employed, the introduction of the concept made it possible to incorporate activities that were previously ignored in theoretical models of development and in national economic accounts (Swaminathan, 1991). This was an important characteristic of the subsequent use of the term. In spite of the early work by Hart, the pioneering research on the informal sector is widely considered to be a report of the International Labor Office (ILO, 1972) on employment in Kenya.

Informality is mainly characterized by the avoidance of government regulations and taxes. Initially, the ILO considered the main aim of the informal sector to be the provision of subsistence to families. It related the growth of the informal sector to its positive effects on employment opportunities and the distribution of income. As a consequence, it argued that solving the problems of the informal sector is only possible if issues like employment relationships and inequality are solved.
According to De Soto (1989: pg. 185), the conceptualization of the informal sector took yet another meaning by focusing on the regulatory framework. In his approach, the legal status is the main element distinguishing informal from formal activities. It relates the emergence of the informal sector to the policies applied and to transaction costs. It suggests, therefore, that to let the informal sector develop, deregulation of the market, greater private property rights, and almost complete abolition of state intervention are needed.

During the Asian economic crisis of the 1990s, millions of people who lost formal jobs in the former East Asian Tiger countries tried to find jobs or create work in the informal economy (Lee 1998: pg. 132). Meanwhile, structural adjustment in Africa and economic transition in the former Soviet Union and in Central and Eastern Europe were also associated with an expansion of employment in the informal economy.

According to Standing (1999: pg. 94) in the 1990s, globalization of the economy contributed to the informalization of the workforce in many industries and countries. Whereas globalization can generate new jobs and open new markets, many of the jobs are not efficient jobs and many of the new markets are inaccessible to small-scale or disadvantaged producers. This is because, in response to global competition, formal firms tend to hire all but a few core workers under informal arrangements or to outsource the production of goods and services to other firms and countries (Rodrik, 1997:pg.144). Further, informal firms and small producers often lack the market knowledge and skills to compete with formal firms for export markets and often face competition from imported goods in domestic markets.

Today the informal sector still constitutes an important part of developing country economies. According to a report by USAID( 2014 ) in Africa, Informal Cross Border Trade (ICBT) is
estimated to represent 43 percent of official gross domestic product (GDP), thus being almost equivalent to the formal sector.

In EAC, many cross-border markets pre-date colonial and post-colonial state boundaries when there were no cross-border procedures to be followed. Hence, what continues today as ICBT could simply reflect the longstanding indigenous patterns of trade that make more sense than formal trade channels (Meagher, 1997: pg. 56).

Though this phenomenon may provide short-term solutions to poor households, in the longer term, it can seriously challenge the economic development of African countries. This study explores one particular aspect of the informal economy, namely Informal Cross Border Trade (ICBT) in East Africa member states countries, and identifies trade facilitation measures like the implementation of the East Africa Customs Union protocol as having the potential to encourage traders to switch from informal to formal trade. E.g. Article 2 of the union provides for the elimination of tariff and non-tariff barriers to trade as well as customs duties and any other charges on imports. The elimination of these barriers to trade results to a free trade environment. Many of the traders engage in ICBT to evade paying tariffs as well as avoid the hassle of non-tariff barriers. The removal of these barriers would mean increase in competition. Increase in competition would mean increase in production. Increased productivity would result in higher income for the traders which would lead to raised standards of living ultimately in economic growth.

A Protocol for the Establishment of the East African Community Customs Union was signed by the then three East African Heads of State of Kenya, Uganda and Tanzania on 2 March 2004 in Arusha, Tanzania.
The objectives of the EAC Customs Union are: a) To further liberalize intra-regional trade in goods on the basis of mutually beneficial trade arrangements among Partner States; b) To promote efficiency in production within the Community; c) To enhance domestic, cross-border and foreign investment in the Community; and d) To promote economic development and diversification in industrialization in the Community.

This Co-operation is to apply to any activity undertaken by the Partner States in the field of Customs Management, and includes the following: a) Customs administration; b) Matters concerning trade liberalization; c) Trade related aspects including the simplification and harmonization of trade documentation, customs regulations and procedures; d) Trade remedies; e) National and joint institutional arrangements; f) Training facilities and programmes on customs and trade; g) Production and exchange of customs and trade statistics and information; and h) The promotion of exports.

Since the commencement of the EAC Customs Union in 2005, several official efforts are being put in place to increase formal trade links among Partner States.

1.2 Statement of the Problem.

The main objective of the Customs Union Protocol is the formation of a single customs territory in East Africa. In so doing, it seeks to liberalize intra-regional trade, enhance the promotion of economic development and diversification in industrialization and facilitate domestic, formal cross border and foreign investment in the community. However this has not been realized as informal cross border trade has been a big hindrance.
It offers a competitive advantage over the formal sector hence leading to loss of revenue through evasion of taxes and puts the populations in the region on a health risk as informal cross border traders avoid safety checks on their commodities at the border.

Despite the fact that the customs union protocol was established as way of enriching formal intra-regional trade in EAC, there exists a gap in literature on why ICBT is still a problem in EAC.

It is therefore the aim of this study to investigate the causes of ICBT in EAC, ten years after the establishment of the customs union protocol.

1.3 Research Objectives

1. To examine the forms of informal cross border trade in East Africa.
2. To identify the causes of Informal Cross Border Trade in East Africa.
3. To examine the impact of informal cross border trade on the economy of the member states.
4. To find out the right measures that can improve the effectiveness of formal cross border trade.

1.4 Research Questions

1. What are the major forms of informal cross border trade in Eastern Africa?
2. What are the causes of Informal Cross Border Trade in Eastern Africa?
3. What is the impact of Informal Cross Border trade on the economy of the major states?
4. What measures can improve the formal cross border trade?
1.5 Significance of the Study

The study will act as a reference point for government, non-governmental organizations that may want to intervene in tackling informal cross border trade as well as the public, the study will therefore act as a reference point for such.

This study will also provide policy recommendation for more realistic policies of Informal Cross Border Trade to ensure that cross border trade benefits the traders as well as the governments of the member states.

1.6 Scope of the study

The scope of this study is limited to the border points of the East Africa community member states.

1.7 Limitations and Delimitations

1.7.1 Limitations

Time Limitation

The research was done within a specified amount of time. Collecting a large amount of data and analyzing it within this time was not be possible.

Funding

To acquire primary data, data collection tools such as interview guides were to be used. However, questionnaires were to be printed and researchers were required to go to the field to distribute them and collect firsthand information. This whole process would have required funding which I did not have. Therefore, I did not use this method.
1.7.2 Delimitations

Due to the time constraints the researcher was bound to collect only secondary data. Since collecting primary data was expensive, most of the research was based on secondary data. Getting secondary data was cheaper and also saved time. The researcher did not spend any money going to the field, although the researcher left the field study option open.

1.8 Theoretical Framework for Analysis

1.8.1 Rational Choice Theory

The basic principles of rational theory are derived from neo-classical economics. Based on a variety of different models according to Ritzer (1996), Freidman et al (1988) put together what they describe as a ‘Skeletal’ model of rational choice theory. The focus of rational choice theory is on actors. Actors are seen as being purposive, or as having intentionality. That is, actors have ends or goals toward which their actions are aimed. Actors also have preferences (values and utilities). The main assumption of this theory is that any action by an individual is a purposive behavior, which will hold benefits for the actor in some ways.

Rational Choice Theory sees individuals’ behavior as motivated by their wants, needs and goals. It is also said that individuals act with specific given constraints that are based on the information they have about the conditions under which they are acting. The relationship between individuals’ wants and the constraints in achieving them can be seen in the pure technical terms of relationship of a means to an end and since it is not possible to achieve all their desires and goals they have to make choices in their goals and the means of achieving them. Rational Choice Theory holds that individuals usually anticipate the outcomes of alternative courses of action and calculate that which
will be best for them. Rational individuals are believed to choose the alternative that is likely to grant them their goals at the minimal cost.

There are two types of decision-making identified by Rational Choice theorists, namely, involvement decisions and event decisions. Involvement decisions are those in which choices are made to become involved in an act or behavior, and the continuity or retreat from such behavior depends on the weight of costs and benefit of it, while event decisions are those in which the strategies of carrying out an action are determined. If these strategies are difficult, such course of action or behavior will not be taken.

The argument of this research is anchored on the notion that economic activity of informal cross-border trading is rooted in rational choice theory as any individual, before opting for informal cross-border trading, will have to weigh the pros and cons of such decision. And since informal cross-border trading does not require much capital, it is an easy option for women as a means of easing economic repression. Along the line, as informal cross-border traders realize that the rewards/profits accrued from cross-border trade far outweigh its costs, they develop tactics to cope and minimize whatever costs and difficulties associated with the trade.
CHAPTER 2 - LITERATURE REVIEW

2.1 Introduction

This chapter reviews some past studies conducted on informal cross border trade, what causes it and its implications on the member states, traders and the citizens at large. It also looks at East Africa Customs in detail as a viable measure against the informal cross border trade. Literature covered include books and journal articles.

2.2 The Concept of Informal Cross Border Trade

Lesser et al (2009:pg. 148) describe ICBT as involving legitimately produced goods and services, which escape the government regulatory framework, thereby avoiding certain tax and regulatory burdens; hence fully or partly evading payment of duties and charges. Such trade includes those which pass through unofficial routes and avoid customs controls, as well as those that pass through official routes with border crossing points and customs offices yet involve illegal practices. Such practices can comprise under-invoicing that is reporting a lower quantity, weight or value of goods to pay lower import tariffs, misclassification which is falsifying the description of products so that they are misclassified as products subject to lower tariffs, misdeclaration of the country of origin, with or without clandestine operations such as secret deals involving formal importers, exporters, customs and other public officials (Macamo et al, 1998:pg.234).

ICBT is also referred to as parallel trade or smuggling (Kallungia 2001:pg.178). Little (2007:pg.90) defines it as "a normal market response to cumbersome, time consuming export regulations and regional price distortions, and should be encouraged as a means to increase intraregional trade (and ‘regionalization’), meet local demand that is not being met by national production and markets, and ensure regional food security".
The impact of ICBT is difficult to estimate because of the unregistered characteristics of the trade. Apart from its negative impact on the formal economy of any nation through potential losses of tax revenues, possible promotion of illegal trade and corruption, violation of health and sanitary requirements and, to some extent, a negative environmental impact, it has an even greater positive impact on the individuals participating in the trade, their families and relatives through contribution to food security, creation of employment, provision of income and poverty alleviation, complementing the formal commercial network and contribution to the opening of new markets for domestic products.

Estimates show that, on the average, 60% of the trade are informal (Macamo, 1999; Demon et al, 2009; Ackello-Ogutu et al, 1998; Minde et al, 1998). ICBT enables traders to obtain decent shelters for themselves and their relatives using the income generated from the trade and it has a multiplier effect on education and health care, not only for themselves but for their dependents. It is also a source of employment for the traders and their relatives (Mijere, 2006:pg.89), though it has not been recognized by governments as a part of the national or regional economy.

According to Westbrook et al, (1994:pg.122) the first studies of informal sector have sometimes been criticized for being vague because they have not clearly defined what the informal sector was. Conceptually, the informal economy focuses on activities that are under the form and structure, operating outside the bureaucratic controls, which are likely to be more insecure and less stable.

Chauvin et al (2002:pg. 96) asserts that the area of informal trade, has been neglected. Although informal trade takes different forms and is known under different names (for example, unrecorded trade, illegal trade, unofficial trade underground trade, part of parallel market activity, the activities of black market, trade subject of over-and under-invoicing, smuggling or
hoarding), it is best characterized by its non-inclusion in the national accounts of a country or region in terms of its domestic and International trade (Hummels, 2006:pg.98). Little (2007:pg.67) argues that the relationship between economic growth and the informal sector has always led to considerable interest at different points in time. The informal sector has been considered as a temporary situation that would disappear with economic growth take off.

Martinez-Zarzoso et al (2007:pg.237) add that cross border trade is highly sensitive to the treatment meted out to traders by conditions imposed by national governments. Its success depends critically on the ability of individuals to routinely cross the border without paying a large unofficial payment or prohibitive tariff duties and border charges, and to cross the border with their own passenger vehicles or with light vehicles from bordering regions.

According to a review paper by Organization for Economic Cooperation and Development (OECD) (2006) cross-border trade among continents dates back to the pre-industrial era. Spices, textiles and precious stones were the main commodities in the international commerce during the pre-industrial era. Europeans worked their way into this commercial nexus in the early sixteenth century. Auboin, et al (2003:pg.73) argues that the Portuguese were the first to arrive, having discovered a sea route from Europe to the East that allowed them to avoid the heavy taxes on goods sent overland through the Middle East. This indicates that tariffs and transport difficulties were the main barrier for cross-border trade. The Dutch and the British took domination of international trade and controlled the exports and imports in Southeast Asia. In the period from 1600 to 1800, cross-border trade considerably increased between European and South Asian traders, but
collapsed after the independence due to various reasons including political affairs of the countries.

According to Dradri (2007: pg. 90), in Africa, it is estimated that informal cross border trade (ICBT) represents 43 percent of official gross domestic product (GDP), thus being almost equivalent to the formal sector. Giovannucci (2008: pg. 165) notes that in some African countries, informal regional trade flows represent up to 90 per cent of official flow. Intra-Africa trade is quite diversified compared with Africa's trade with the rest of the world, a large part of which is ICBT, generally following a long trading tradition among African nations. It is significant in boosting Intra-African trade, as well as in tackling unemployment levels, improving the supply side of goods and services and food security among others.

Hertel et al (2006: pg. 67) argue that in many instances, informal trade represents the only type of exchange that is possible under conditions prevailing in some regional economic communities. Poor regional infrastructure and communications often render near-impossible official trade between neighboring countries.

Brown (2007: pg. 34) argues that for many parts of Africa the overall effect of structural adjustment has resulted in a significant expansion of trans-border trade, especially by large numbers of unemployed youth, women, and others, including ex-formal sector employees downsized through budget reforms.

Nkoroi (2015: pg. 63) says that ICBT is illegal in many countries of the region because it avoids official procedures and channels, but it does not mean that the traded products themselves are illegal. Most cross-border commerce is in clean commodities, although perceptions are that (Cross Border Trader (CBT) especially in the Horn of Africa encourages trade in illicit drugs,
weapons, and other illegal and harmful goods. Despite common perceptions CBT has strong ties to the formal sector. In fact, the distinctions between what is formal and informal in CBT are difficult to make. Take the case of maize, for example, that may be informally sourced from trans-border markets but eventually sold through licensed retail shops in the import country; or the case of livestock that are trekked across borders to be sold but are officially taxed at different market centers and eventually sold through formal market channels. CBT also generates significant amounts of local taxes and permit revenues for the formal sector, as well as a wide range of unofficial payments or taxes to government personnel and offices.

A report by USAID (2010) indicate that policies directed at formal food market channels can strongly affect the performance and profitability of unofficial commerce and vice-versa is further evidence of the interconnectedness of the formal and informal sectors.

Forman et al (2005:pg.233) indicate that (CBT) is also an increasingly important phenomenon in Eastern Africa, but one that remains surrounded by considerable controversy and ignorance.

A report by Icafrica (2011) indicate that to some observers CBT represents a normal market response to cumbersome, time-consuming export regulations and regional price distortions, and should be encouraged as a means to increase intra-regional trade and regionalization, meet local demand that is not being met by national production and markets, and insure regional food security. These same supporters often argue that many trans-border markets pre-date colonial and post-colonial state boundaries and, thus, reflect longstanding indigenous patterns that make more sense than formal trade channels.

According to Njinkeu et al (2008:pg.243) CBT reflects a potential loss of foreign exchange, an illegal activity, and a source of unfair competition for official traders and food producers. As
Njinkeuet et al., work shows, it was assumed by some policy makers that market liberalization, structural adjustment policies of the 1980s and 1990s would have channeled most informal trade into formal market channels, which has not been the case in large parts of Africa.

Wilson et al (2005:pg.32) argue that the informal cross border trade provides people with a source of income and employment. Cross border trade enables traders to meet the education, housing and other basic needs of a significant number of their dependents.

Kaplan et al (2004:pg.168) indicate that cross border traders supported an average of 3.2 children as well as 3.1 dependents who were not children or spouses. Heracleous (2000:pg.75) states that research suggests that cross border trade involves a greater number of female than male entrepreneurs, thus promoting the empowerment of women in the Southern Africa Development Community.

2.3 Nature and Magnitude of Informal Economy in EAC

There is no universally accepted definition of the informal sector. Many definitions have been offered that refer to this sector as unofficial, underground, hidden, invisible, shadow, parallel, second, unregulated, unrecorded, black, moonlighting, unmeasured and unobserved economy. Yet, there is no economy in the world without the informal sector (Ogada et al, 2015:pg.11).

In many developing countries, the informal economy represents the largest share of GDP compared to developed countries. In Africa and Latin America, for instance, it represents about 43 percent of official GDP, almost equivalent to the formal sector, compared to just about 16 percent in OECD countries; and, in Central and Eastern European countries, it constitutes approximately 40 percent (Table 1). Although we don’t have the exact recent measure of the
informal economy anywhere in the world, due to complexities that defy measurability, but, as was observed by Schneider, this sector has been growing by an annual average of one percentage over the last decade in Africa.

<table>
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Source: Schneider, 2002

Note: The data pertains to 37 African countries, 28 Asian countries, 21 Central and South American countries, 25 Central and Eastern European Countries and former Soviet Union countries, and 21 OECD countries

According to Ogalla (2012:pg.96), the informal economy in EAC, as with the rest of African countries, largely correspond to the micro, small and medium-scale enterprises (MSMEs) that are seen as semi-organised and un-regulated.

In Kenya, these enterprises are responsible for employment of 7.5 million people or 80 percent of the country’s total employment outside small-scale agriculture. But players in the informal
economy are not necessarily small businesses. Actually, the informal economy is composed of small and big players both from formal firms and informal firms.

They range from professional consultants (such as lawyers, doctors, accountants and engineers), to fruit and vegetable vendors, public transport operators, food kiosks, hair-dressers/barbers, jua-kali manufacturers of all sorts of goods including artisans like tinsmiths, ironmongers and blacksmiths; shoe shineers, miraa dealers, open air photographers, hawkers of all sorts of wares, painters, engravers, graphics and designers, carpenters, massage parlours, saloons and sand harvesters. Thus, informal sector participation has not only been linked with junior public and private sector employees – seeking for additional income to their salaries, but also with corporate executives; hence, it has developed as a means of extension of formal businesses.

Nkoroi (2015:pg.67) argues that there are big formal firms which prefer to remain small but keep several branches of the same business (registered under different names and ownership) so that they can hide in the informal economy. They know that it is economically worthless for the taxman to track and arrest small businesses given the human resource and financial constraints of tax authorities; when, in fact, their intention is simply to evade certain taxation measures and regulations meant for big formal businesses – their basic aim is to maximise supernormal profits.

The informal economy may also be characterized by simple labor intensive technology; may or may not have licenses from authorities and are not registered with the registrar of companies; ease of entry; small-scale nature of the activities; self-employment with a high proportion of family workers and apprentices; little capital and equipment; labor intensive technology; low skills; low level of organisation with little access to organised markets; unregulated and competitive markets; less formal credit; low education and training; cheap provision of goods and services; low productivity and low incomes; and lastly, most of the transactions are
conducted mainly on cash basis, with very little or none through banks. In addition, entrepreneurs in the informal sector, especially the small survivalist enterprises, depict a quick shift from one business to the next.

Most of them have little tied capital and move from one economic activity to another quite rapidly depending on the changing profit margins of the businesses. For example, if selling tomatoes today is more profitable than green maize yesterday, they would rather sell tomatoes. It is therefore impractical for any authorities to require that such enterprises undergo formal registration.

2.4 Causes of Informal Cross Border Trade

The informal sector still constitutes an important part of developing country economies. In Africa, it is estimated to represent 43 percent of official gross domestic product (GDP), thus being almost equivalent to the formal sector. While this phenomenon may provide short-term solutions to poor households, in the longer term, it can seriously challenge the economic development of African countries (Morrisey, 2015: pg. 43).

Morrisey adds that ICBT in Africa reflects historical, geographical and institutional commonalities across the continent. At the same time, national and regional particularities also influence the specific forms of ICBT. He argues that a number of factors contribute to the prominence of ICBT which are; long traditions of regional trade preceding the colonial era; artificial borders imposed by the colonial powers, largely maintained as African nations became independent around the early 1960s; strong ethnic and religious ties uniting people across borders; uncoordinated and often highly interventionist policies in the newly independent states, particularly with regard to trade policies; weak state institutions, which undermine the
effectiveness of the enforcement of these policies, and widespread corruption; and inability of governments to control movements of people and goods across artificial borders.

2.4.1 Trading traditions.

Long traditions of regional short- and long-distance trade throughout Africa preceded the colonial era, based on resource endowments, agro climatic conditions, population density and weather fluctuations, i.e., comparative advantage. These same factors continue to drive contemporary ICBT, along with institutional and policy developments in the colonial and post-colonial periods.

2.4.2 Artificial National borders.

Prior to the colonial era, hard geographical borders did not characterize states in Africa, with rulers having only lose control over territory and movements of people (Herbst, 2000:pg.61). At the Berlin conference of 1884 the colonial powers divided up Africa among themselves, creating territorial borders based on their de facto zones of control. These boundaries arbitrarily separated regions with long-standing ethnic ties and often without clear geographical separators (Young, 1994:pg.48).

These colonial borders remained the basis for national boundaries following the end of colonialism in the early 1960s. Moreover, governments are unable to effectively prevent unofficial crossings along long borders with few human or natural barriers, making evasion relatively easy.
2.4.3 Uncoordinated and ineffective economic policies.

The newly-independent post-colonial nation states developed their own economic policies, but more often than not these policies were wielded irresponsibly in the first few decades of independence and not coordinated among neighboring countries.

Governments intervened massively but ineffectively in industry. Trade policies were of particular importance as they served both to protect local industries and generate government revenues (Berg, 1985:pg.81).

Taxes on international trade have historically provided an unusually large portion of government revenues in Africa, dating back to the colonial period and continuing to the present day.

Direct taxes on income and wealth are difficult to enforce in Africa due to lack of state control over much of the population (Herbst, 2000:pg.66). In a context of weak states and porous borders, these large differences in import protection, subsidies, price controls, exchange-rate misalignments and other policies between countries have provided an impetus to smuggling (Boone 1989, Berg et al 1985, Egg and Herrera 1998).

Many countries, particularly those pursuing import-substitution strategies most vigorously, adopted very high import barriers, including tariffs and import prohibitions. The high levels of protection have impeded legal trade within Africa and provided very large incentives for smuggling, while almost completely failing in their intended effects of promoting viable domestic industries. Although statutory trade barriers have declined in many countries, actual implementation is highly variable and non-tariff barriers remain pervasive. Lengthy and costly procedures and demands for unofficial payments induce traders to avoid official border crossings (Afrika et al, 2012:pg.73).
In cases where traders do pass through official border posts, payments are negotiated between traders and officials. Cameroon has resorted to stipulating minimum duties per vehicle (World Bank, 2013). Traders now generally pay more in formal and informal payments than the minimum but well less than the statutory duties, subject to bargaining and competition between border posts in revenue generation.

In the Great Lakes region, particularly in the Congo, traders are often subject to a variety of taxes by different agencies and their multiple representatives (Titeca et al 2012:pg.23). Some of these agencies are not officially authorized to be present at the borders, but nonetheless collect payments from traders.

2.4.4 Weak states and strong informal sectors.

ICBT is part of the informal sector in Africa more generally, as discussed above. Recent literature views informality as a choice conditioned by the costs and benefits of formal versus informal status, (Benjamin et al (2012), Perry et al (2007), Kanbur (2009), Djankov et al. (2002), Loayza et al. (2005), Johnson et al (2000),).

The institutional environment in turn affects the balance between these costs and benefits. Formalization permits greater access to public services but also requires compliance with regulations and payment of taxes. The higher the quality of public services and the lower the costs of compliance with tax obligations and regulations, the more firms will opt for formal status. The extent to which the government enforces rules and sanctions non-compliance is also critical.

In many African countries, public services are poor while tax rates are high and procedures very complex. Governments' limited monitoring and enforcement capabilities and widespread corruption enable informal enterprises to conceal their activities and evade taxes. Another major
problem is lack of cooperation among different government agencies, particularly between customs and tax authorities. For ICBT, weakness of the state is most manifest in terms of inefficacy and corruption of customs and inefficient and costly trade facilitation.

Smart (2013: pg. 45) observes that the inability to eradicate smuggling reflects social attitudes regarding the legitimacy of government rules as much as the economic distortions created by those rules usually stressed by economists.

Perry et al (2007: pg. 212) argues that there is general perception that governments are corrupt which undermines tax morale and reduces the sense of obligation to comply with civic and legal obligations. This leads to a vicious circle of state weakness and informal practices that develop overtime. In contemporary Africa, marginalized ethnic groups or refugees often undertake ICBT. Informal trade obtains legitimacy as part of the struggle against oppression and for survival. This is the case in North-West Uganda from which former President Idi Amin originated, but which became marginalized when President Museveni took power in 1986 (Titeca et al 2010: pg. 91).

2.4.5. Political instability and civil conflict.

In more extreme situations of failed states and civil wars, as in Sierra Leone (diamonds), Somalia and the Congo, there is little possibility of formal trade (Little 2005, Titeca et al 2010).

In such situations, military power and illicit trade go together (Roitman, 2004: pg. 53). Alternatively, ICBT can take on a political dimension as the embodiment of opposition to the regime in power.

In some cases, informal trading networks developed in opposition to the colonial powers. For example, the Mourides in Senegal arose in part in opposition to the French in the late 19th century (Golub et al, 2012: pg. 211).
2.4.6. Poverty and Unemployment.

Even in countries without civil wars, the collapse of state-supported formal private sectors and state-owned enterprises in much of Africa in the aftermath of economic mismanagement in the 1960s and 1970s and structural adjustment policies in the 1980s and 1990s has entailed widespread unemployment and poverty (Meagher, 1995: pg. 97).

The informal sector and ICBT have filled the gap through a combination of low-income demand-pull from consumers seeking inexpensive goods and cheap-labor supply push of entry of unemployed workers into ICBT (Macamo, 1999: pg. 171).

2.4.7. Kinship networks.


In Africa, allegiance to traditional sources of authority is often far more binding than to the modern state. Kinship groups often originated many centuries prior to European colonization, and have adapted to the colonial and postcolonial economic environments.

On the positive side, the social and religious bonds linking the members of the group enable complex and flexible trading strategies with property rights and contract enforcement provided by group solidarity rather than formal rules.

Religious affiliation and belief plays a major role in many groups' solidarity. The bonds of trust, norms and enforcement mechanisms provided by kinship networks enable contract fulfillment, access to financing, and information exchange without documentation or official involvement (Putnam 1995, Fafchamps 2004).
Kinship groups play a particularly important part in international trade, helping to overcome transaction costs created by lack of information and differences in business practices across countries (Rauch, 2001:pg.123).

On the negative side, however, informal networks can be exclusionary, accepting or even promoting anti-social behavior and violation of the rules and norms in the formal economy (Adhikari et al 2009, Field 2003, Portes 1998).

Often several ethnic groups operate within the same country but in different regions. Examples where ethnic groups living in adjacent countries play a major role in ICBT include the Mourides in Senegal and the Gambia (Golub et al, 2012), the Yoruba in Eastern Nigeria and Benin (Igué et al, 1992), the Igbo in Cameroon and Southern Nigeria (World Bank, 2013), the Hausa in Northern Nigeria and Niger (Hashim et al, 1999), the Burji in Northern Kenya and Ethiopia (Mahmood, 2008), the Nande in Eastern Congo (Kabamba, 2013), and the Lugbara in north-western Uganda and the north-eastern Congo (Titeca, 2009).

Aker et al (2013:pg.102) provide a recent interesting illustration of the role of kinship groups in integrating markets across countries. They find that there is no border price discontinuity for trade in millet and cowpeas across the Niger-Nigeria political border, as long as that trade takes place between markets of the same (Hausa) ethnicity. There is a border effect, however, when cross-border trade is between Hausa and non-Hausa markets as well as a statistically significant price discontinuity across the virtual border between Hausa and Zarma regions within Niger.

2.4.8. Important price disparities and high trade transaction costs

According to Lesser et al (2009:pg.127) price disparities can in part be accounted for by the existence of significant levels of import duties in destination countries and export duties in exporting countries on selected commodities. In Côte d’Ivoire and Ghana, for example,
agricultural exports have been taxed by a marketing board. This contributed to raising their consumer price in formal markets (Azam, 2006:pg.81).

More generally, Keen (2003) notes that while collected tariff rates have more than halved in OECD countries between 1980 and 1998 (decreasing from 4.2 to 1.2), this was not the case in Africa, where the average effective rate remained more or less unchanged.

In 2004, the average collected tariff rate in Sub-Saharan Africa was still close to 15, with trade taxes representing almost 5% of GDP (Mansour, 2007:pg.53).

In this regard, Levin et al (2007) found that the extent of informal trade is directly correlated with the average applied tax rate which are tariffs and value-added tax in the importing country.

In Tanzania, for example, a one percentage point increase in the overall imposed tax rate on imported goods from Kenya led to a 3.8% increase in tax evasion on those same goods in 2004.

2.4.9 Inability to obtain the necessary documentation.

According to Lesser et al (2009:pg.147) some traders are incited to trade informally as they are unaware or unable to apply formal preferential tariff rates or tax exemptions for which they are eligible in the importing or exporting country. A recent report highlights that some qualifying COMESA traders have been unable to benefit from the duty- and quota-free access in the COMESA market due to their inability to obtain the necessary documentation like the certificate of origin to enable them to qualify for duty-free status. This is because key documents are issued in capital cities and large commercial centres, away from where actual cross-border trade is conducted. Obtaining the required documents is not only expensive, but also inaccessible to small traders. As a consequence, some of these traders have been inclined to trade informally (COMESA, 2007).

Lesser et al (2009:pg.84) argues that formally traded goods might be subject to non-transparent, complex or non harmonized regulatory measures in the importing and exporting country, which contribute to augmenting —trade transaction costs associated with formal trade and thus further increase price disparities between formally and informally traded goods.

This in turn is likely to incite traders to avoid formal trade-related regulations and duties. Several studies examining the informal economy in general indeed emphasize the strong correlation between the intensity and complexity of regulations (i.e., number of enforceable regulations) and the size of the informal economy (Schneider, 2006:pg.117).

Trade transaction costs (TTC’s) arising from official import- and export-related procedures, including Customs compliance costs, have been estimated to range between 1% and 15% of the trade transaction value. They include direct as well as indirect costs. Some costs are directly related to the level of regulation, others arise due to differences in regulations across countries.
Table 2. Activities contributing to costs arising from official import- and export-related regulations. (Source: OECD, 2002)

<table>
<thead>
<tr>
<th>Direct Costs</th>
<th>Indirect Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Complete and supply documents to the relevant authorities (e.g., customs declaration, certificate of origin, phytosanitary certificate, bill of lading etc.)</td>
<td>• Long delays at the border causing depreciation costs (e.g., due to spoilage of perishable food products)</td>
</tr>
<tr>
<td>• Payment of border agency fees and charges (e.g., administrative and inspection fees, license fees, consular fees, terminal handling charges, etc.)</td>
<td>• Unreliable customs clearance and arbitrary application of regulations, leading to lack of predictability in the trading environment</td>
</tr>
<tr>
<td>• Compliance with other formalities which bear additional expenses (e.g., conformity assessments with technical regulations, insurance, pre-shipment inspections, customs brokers, etc.)</td>
<td>• Loss of business and foreign investment opportunities (e.g., for goods that need to be delivered just-in-time), leading to loss of international competitiveness</td>
</tr>
<tr>
<td>• Transportation and storage costs</td>
<td></td>
</tr>
</tbody>
</table>
2.4.11. Variations on transaction costs

Lesser et al (2009:pg.218) says that the extent and impact of transaction costs vary depending on the quality of border processes and services in the importing and exporting country, the geographical situation of the country, the type of good that is traded and the type of company that is trading.

Limao et al (2001:pg.119), for example, empirically demonstrate that TTCs in intra-Sub Saharan Africa trade are substantially higher than those for other African countries due to the relatively low efficiency of customs procedures and institutions in that region. Similarly, perishable agriculture and food products are often subject to additional trade-related procedures to ensure compliance with sanitary and phytosanitary requirements. This can lead to a considerable increase in border process fees and clearance times per consignment, hence leading to higher TTCs.

In addition, perishable agriculture and food products are more vulnerable to delays at the border, hence trade in such products might be more affected by TTCs than other goods. Likewise, Micro, Small and Medium Enterprises (MSMEs) often do not have a rich track record with Customs authorities and are thus classified in a higher risk category. As a consequence, they are more frequently subject to costly documentary and physical cargo checks, which, in turn, contribute to increasing TTCs which are relatively high in proportion to their sales and turnover. Furthermore, MSMEs often have lower capacities and resources to internalize such costs (OECD, 2003). This might in part explain why it is often these firms that are involved in informal cross-border trade.
24.12. Lack of knowledge on regulatory requirements by traders.

Lesser et al (2009:pg.127) point out that regulatory requirements are sometimes also unknown or unclear to traders. In surveys and workshops conducted in the East African Community (EAC) and COMESA, for example, traders have consistently cited lack of information on regulatory requirements like quality standards, customs documents and procedures and certificates of origin and conformity as a key constraint towards formal cross-border trade in the region. A 2005 EAC report for example notes that —the lack of information on regulation compels many traders to engage in unrecorded trade across the border. In some cases, traders are aware of the mandatory trade-related requirements yet have difficulties complying with the latter. In Uganda, for example, the only offices that can provide phytosanitary certificates required for export are located at or near the Entebbe airport, and may thus be difficult to access for traders located in remote areas. Generally, informal trade surveys pinpoint that the existence of non-transparent, complicated or costly import, export and customs formalities and charges in the importing and exporting countries constitute important obstacles to formal trade in Sub-Saharan Africa, particularly for SMEs which often do not trade large quantities (Peberdy (2002), Dzaka-Kikouta, (2004), Uganda Bureau of Statistics (2007), COMESA (2007).

24.13. Customs procedures, formalities and charges.

Lesser et al (2009:pg.73) adds that among the wide range of regulatory requirements facing traders, customs procedures, formalities and charges have often acted as important barriers to formal trade, contributing to raising Trade Transaction Costs (TTC’s).

According to UNCTAD, the average customs transaction in Africa involves 20–30 different parties, 200 data elements (30 of which are repeated at least 30 times) and the re-keying of 60% - 70% of all data at least once (UNCTAD, 2004). On average, Africa has the longest customs
delays in the world. Consignments commonly experience substantial and unpredictable delays of 30 to 40 days - before release from customs control. Not only are the delays long, they are also costly.

The barriers to formal South-South trade, including intra-regional trade in Sub-Saharan Africa, are often more important than barriers to North-South or North-North formal trade (Kowalski et al, 2006:pg.361)

24.14. Technical barriers to trade (TBT) and sanitary and Phytosanitary measures.

Lesser et al (2009:pg.66) notes that technical barriers to trade (TBT) and sanitary and Phytosanitary measures (SPS), such as quality control, packaging and sanitary requirements, might also raise the price of formally traded commodities in the importing country and as such incite entrepreneurs to trade informally (Uganda Bureau of Statistics, 2007).

Traders in Sub-Saharan Africa not only face costs for complying with such regulations or lack information on the latter, they often do not have the capacity to implement them. Many MSMEs and farmer groups lack the financial and human resources needed to upgrade their products to meet standards and technical regulations applied in the importing country.

25. Characteristics of Informal Cross Border Trade in East Africa.

According to Lesser et al (2009:pg.71) entrepreneurs and MSMEs engage in informal cross-border trade due to a combination of factors. First of all, individual traders and businesses that are not registered at all and escape domestic taxes and regulations are most likely to conduct trade informally since most of their operations whether domestic or international are informal.

In addition, formal firms and entrepreneurs are incited to engage in unofficial trade and resort to illegal practices such as under-invoicing, misclassification or misdeclaration of origin due to cost advantages inherent to such transactions.
Informal trade is likely to occur when important price disparities exist between formally and informally traded goods in the importing country and when transaction costs arising from compliance with regulatory requirements are significant; when the formal entry or exit of certain goods is obstructed; and/or when, due to low law enforcement, a high degree of corruption and the requirement of —facilitation payment prevail along official border posts.

Finally, cross-border trade whether formal or informal is likely to be influenced by the degree of availability of certain goods, the quality of road and transport infrastructure and the existence of trust-based networks among traders.

2.6. Nature of informal cross border trade in East Africa.

According to Ajumbo et al (2012:pg.6) traders engage in ICBT as a source of income and economic activity. Most traders have no education and raise capital from their own resources or through loans from friends and relatives. Traders are generally not bankable nor do they have assets that Banks would accept as collateral. They can also be formally registered firms evading regulations and taxes or aiming to avoid border crossing posts. They categorize the ICBT traders into three categories as follows;

Table 3. Categories of ICBT

<table>
<thead>
<tr>
<th>Category A</th>
<th>Category B</th>
<th>Category C</th>
</tr>
</thead>
<tbody>
<tr>
<td>Informal traders operating entirely outside the formal economy</td>
<td>Formal firms fully evading trading regulations and duties e.g formal cross border, border posts.</td>
<td>Formal firms partially evading Trading regulations and duties resorting to illegal practices e.g under invoicing.</td>
</tr>
</tbody>
</table>
2.6.1. Education and Gender in Informal Cross Border Trade.

According to Ogalo (2010:pg.82) most of the traders involved in ICBT have low level of education, most with primary education and below and most players were women. He adds that cross-border trade is becoming complex and most participants have above secondary education.

- Majority fall in 20-40 years age bracket
- 44.2 percent have secondary
- 25.8 percent with professional/semi-professional diploma and certificate
- 10 percent with degree constitute

UBOS (2009) reported that most women create relationships with officials, and change routes or avoid official routes. Others employ other people to carry and transport their goods; sometimes they change their time/schedule for crossing the border, changing/alternating informal routes, paying bribes, changing clothes to confuse authorities, using brokers, crying and pleading to win sympathy and carrying weapons like knives for self defense.

This finding goes in sequence with Njikam (2011:pg.97) who reports that, male and female informal cross-border traders overcome the challenges using different strategies.

2.6.2. Goods traded in Informal Cross Border Trade in East Africa

Ogalo (2010:pg.87) argues that staple food commodities such as maize, beans, rice, fish, groundnuts, bananas, and even food aid that have a direct impact on regional food security low
quality consumer goods such as shoes, clothes, textile and vehicle and bicycle parts and even fake drugs.

Figure 1. Informally Traded Goods in East and South Africa 2014

- Maize Grain
- Maize Flour
- Onion
- Rice Grain
- Tomatoes
- Wheat Flour
- Beans & Dry Legumes
- Fish & Crustaceae
- Cassava

Data source: ACTESA, UBOS, FEWSNET and EAGC

Maize grain, beans & dry legumes were the most traded commodities in 2014. There was also significant informal cross-border trade of rice.
Informal trade in the ESA region consistently grew during the period of reference.

2.6.3. Transport and Storage in Informal Cross Border Trade.

Long distance wholesalers are the key players. Once at border, towns, they divide goods into small quantities and involve different modes of transport across the border. Main modes of transport used are vehicles, bicycles, head/hand, motorcycles, wheel chairs, animals (donkeys), push carts, boats/canoe etc. People with disabilities on wheel chairs help in moving small/light but valuable products e.g. Sugar/salt/soap/cooking oil/plastics. (Ogalo, 2010:pg.90).

2.7. Implications of Informal Cross Border Trade.

Informal trade can in the short- to medium-term encourage entrepreneurial activity and regional trade which is currently marginal in the formal economy of the African continent, contribute to greater food security in food-importing countries suffering from drought, e.g., Somalia and Malawi and enhance income earnings and employment opportunities for poor households.

Data source: UBOS, EAGC, FEWSNET, ACTESA

Peberdy (2002:pg.116) notes that informal traders in Southern Africa employ 1 to 8 people in their home country or in the country of destination. Informal cross-border trade can, in that sense, contribute to poverty alleviation and women’s economic empowerment across Sub-Saharan Africa. Yet, informal cross border trade is also likely to have negative effects on both importers and exporters in the longer term, which might contribute to further marginalizing African economies.

2.7.1. Loss of competitiveness and weaker formal private sector development.

First of all, a high incidence of informal cross-border trade is likely to lower investments in the local economy and reduce possibilities to integrate the world economy effectively, as such weakening formal private sector development and ensuing growth prospects. Informal trade creates unfair competition vis-à-vis formal traders.

According to a 2006 World Bank enterprise survey, approximately 39% of manufacturing firms ranked competition from informal firms as one of the top three obstacles to doing business. Experts have, for example, noted that informal cross-border inflows of agricultural commodities in Niger, Cameroon and Benin undermined the longer-term viability of local formal agriculture, by under-cutting commodity prices. Similarly, in Nigeria, informal cross border outflows have disrupted agricultural development initiatives by transferring key subsidized inputs to neighboring countries (Meagher, 2003:pg.61).

Meagher (2003) also notes that the flood of informal Asian manufactured imports has crippled some manufacturing industries throughout West Africa. More generally, when local businesses face higher basic production costs and the inability to evade official taxes, they are unable to

When the incidence of informality and tax evasion is high, formal traders carry the totality of the tax burden, which reduces their incentives to invest in the formal economy. This in turn is likely to reduce the longer-term prospects for economic development of Sub-Saharan Africa. Bringing informal traders back to the formal economy would not only help broaden the tax base and, as a consequence, potentially permit to lower tax rates, but would also help create a level playing field for all firms within the importing country.

Furthermore, cross-border business opportunities for firms trading informally are limited. Important numbers of informal cross-border traders imply that a lower proportion of firms in Sub-Saharan Africa are likely to integrate (formal) regional and global production networks and supply chains which characterize today's international manufacturing and trade patterns in which firm level linkages are contract-based.

As a consequence, Sub-Saharan countries may have more difficulties to integrate effectively the world economy and achieve export-led economic growth (Subramanian et al, 2007, Perry et al., 2007).

2.7.2 Lower efficiency of health, safety and environmental protection measures.

A high incidence of informal trade can lower the efficiency of policy measures to ensure health, safety and environmental protection. Agricultural commodities which are traded informally escape sanitary and Phytosanitary controls which are conducted at the border, and can thus reduce the effectiveness of control efforts governments have put in place to ensure adequate food safety at home and avoid the proliferation of human, animal and plant diseases across borders.
Similarly, informally traded manufactured goods escape inspections that aim to ensure that goods comply with regulations set to promote national security, public safety and environmental protection. Increased risks of the spread of diseases and product defects may in turn undermine industries' reputation across countries.

Thus, while SPS and TBT requirements are important to promote public policy objectives, they should be designed and implemented in such a way as to avoid acting as important barriers to formal trade, as such reducing incentives for firms to move into informality and ensuring the efficiency of the existing measures in place (Lesser et al., 2009: pg. 59).

27.3. Erosion of state revenues

Informal cross-border trade also erodes state control of resources. Millions of dollars are lost annually in unpaid duties and custom taxes, not to mention the losses in foreign exchange receipts. In Uganda, for example, the tax revenue loss arising from the estimated informal imports from its five neighboring countries during the 10 monitored months in 2004/5 is estimated at USD 10.1 million, representing approximately 3% of Uganda's total customs revenues excluding oil in 2004 (Republic of Uganda, 2007).

It is important to note that informal cross-border trade triggers losses from unpaid custom duties and from unpaid VAT as import duties and VAT are often collected simultaneously on imported goods. Losses arising from informal cross-border trade are particularly significant for Sub-Saharan African countries where trade taxes mainly on imports still represent a significant source of fiscal revenue for many countries. Such taxes in fact still accounted for about 25% of total tax revenue in the region in 2004 (Walsh, 2006, and Mansour, 2007), or about 4 percent of GDP in 2008 (Gupt, et al., 2008: pg. 72).
In the Southern Africa Development Community (SADC), the share of customs revenues as part of total government revenue stands at almost 50% for Lesotho and Swaziland. Similarly, VAT collected on imports at the border, often represent more than half of total VAT revenues in developing countries. In Benin and Zambia, this share even reaches 70% and 67% respectively (Walsh, 2006 and Keen, 2003).

While generally, taxes collected at the border might not be the most efficient way to collect government revenue, the difficulty developing countries still face to collect VAT and other taxes domestically through self-reporting implies that they are still very reliant on such taxes (Keen, 2003).

Government revenue losses arising from informal trade are, in turn, likely to reduce the quality and quantity of publicly provided goods and services and limit the possibilities to make further public investments in productive industries and essential (technological, communications and transport) infrastructure, which are crucial to facilitate trade, attract foreign investors and boost economic development (Meagher, 2003 and Ishengoma et al, 2006).

2.7.4. Difficulty to formulate appropriate trade and macroeconomic policies.

Informal cross-border trade, which is not captured by official records, leads to unreliable external trade statistics which might, in turn, hinder the effective formulation, implementation and monitoring of domestic, regional and international trade policies and negatively affect the negotiation of trade agreements. Missing trade data (which impacts balance-of-payment and national income data) can also complicate the formulation of effective macroeconomic and development policies (Uganda Bureau of Statistics, 2006 and Ndlela, 2006).

Experts have highlighted the importance of having adequate and reliable country statistics to conduct evidence-based policy making in Sub-Saharan Africa and to guide donor actions,
particularlly in the current period, since there is an urgent need to track progress towards international commitments such as the UN Millennium Development Goals and the Doha Development Agenda (Scott, 2005:pg.67).

2. The East Africa Customs Union

According to Bagamuhunda (2015:pg.16), The EAC development strategy for 1997-2000 laid the foundation for the Treaty on the establishment of EAC. It considered the effects of globalization which brought about heightened competition as a result of trade liberalization.

He adds that as a consequence, among the objectives of the Community was to develop policies and programs aimed at widening and deepening co-operation among member states in political, social, economic and cultural fields, research and technology, defence, security and legal and judicial affairs for their mutual benefit.

Mwapachu (2012:pg.79) argues that in pursuance of that, the Community was to establish a Customs Union, a Common Market, a Monetary Union and finally a Political Federation. Thus far, the EAC established a customs union in 2005, a common market in 2010 and the establishment of a monetary union is underway. To achieve this, the Community was to be guided by the fundamental principles of peaceful co-existence, peaceful settlement of disputes, equitable distribution of benefits and co-operation for mutual benefit to achieve a people-centered and market driven co-operation.

Muthee (2015:pg.53) argues that, while ordinarily the Customs Union is usually the second stage in economic integration after a Free Trade Area, the EAC Treaty provided that the formation of a Customs Union would be the first step in the progressive course of a transition period of 5 years from the coming into force of the Customs Union Protocol.
A brief of East Africa Customs Union (2006) shows that previously, the EAC founding member states being Uganda, Kenya and Tanzania traded under the COMESA trade regime. However, within that regime, Kenya had reduced its tariff rates by 90 per cent while Uganda and Tanzania had only managed 80 per cent tariff reduction. This meant that Kenya was giving Uganda and Tanzania preferential market access at 90 per cent. Tanzania then dropped out of COMESA and the 3 countries agreed to continue trading preferentially in relation to the EAC Treaty which the Heads of States had signed on 30 November 1999 and came into force on 7 July 2000.

The quest for regional integration had the ultimate goal of enhancing economic development through increasing trade among countries and uplifting the peoples’ standards of living. This was certainly the driving force behind the formation of the East African Customs Union (Muthee, 2015:pg.48).

In accordance with the EAC Treaty, the Protocol for the establishment of the East African Customs Union was signed on 2 March 2004 in Arusha, Tanzania. At that time, only Uganda, Kenya and Tanzania were members. Rwanda and Burundi thereafter joined the Customs Union in July 2007.

In accordance to the Customs Union Protocol, the main objectives of the Customs Union are to liberalize intra-regional trade in goods through beneficial trade arrangements among Member States, promote efficiency in production; enhance domestic, cross border and foreign investment in the Community and promote economic development and diversification in industrialization in the Community.

In essence, trade goes to the heart of the EAC Customs Union. In so doing, the Member States agree to co-operate on a number of trade related aspects towards realization of its objectives for
instance on matters of trade liberalization, simplification and harmonization of trade
documentation, customs regulations and procedures, trade remedies, production and exchange of
customs and trade statistics and information as well as promotion of exports.

2.9. The impact of the Customs Union on East Africa

According to Chimilila et al (2014:pg.24), the coming into being of the Customs Union has had a
great impact on economic development within the East Africa Community. The elimination of
tariffs and non-tariff barriers, adoption of a common external tariff and the reform initiatives
provided for in the Customs Union Protocol has contributed to immense growth of intra EAC
trade.

A report by Trade Mark East Africa (2015) shows that Trade in EAC increased from 2 billion
USD in 2005 to 5.5 USD in 2013 hence contributing to a growth of 36.36 per cent. The said
tablulation however is in exclusion of ICBT which has been estimated to be about 40 per cent of
formal trade (Sezibera, 2015:pg.62).

The common external tariff has also contributed to economic growth through as it has attracted
more exporters and other foreign investors who wish to conduct trade in a predictable and
transparent environment Chimilila et al (2014) as a common external tariff tends to be stable.

According to Bagamuhunda (2015:pg.18), The Customs Union has also contributed to revenue
generation for the Community. So far there has been an average revenue growth of 30 per cent
per annum which has been as a result of increase in volumes of trade, increased investment flows
and production and improved efficiency in revenue administration in the Community.

In accordance to the East Africa Customs union (2015), the Customs Union, being an integral
part of the Community seeks to promote cross border trade and investment. In so doing, it has
provided opportunities for private sector investors to explore more and better opportunities where they use comparative advantage to pursue and expand their investment without having to factor in the differences in tariff protection and transaction costs at the borders.

The Customs Union has brought about the creation of uniform custom laws in terms of competition policies, customs procedures and external tariffs on imports from foreign countries which create a transparent and predictable trading environment. This has subsequently resulted to increased investment in the region which has led to advancing in its economic development and poverty reduction agenda (Bagamuhunda, 2015:pg.21).
CHAPTER 3

RESEARCH DESIGN

3.1. Introduction.

This chapter aims to highlight the research design as well as the data collection methods.

3.2. Research Design.

In analyzing informal cross-border trade in East Africa after the establishment of the East Africa Customs Union Protocol, this research study pre-dominantly relies on the descriptive research design. Descriptive research design explains what exists, providing an accurate portrayal or account of characteristics. This study is aimed at describing what actually exists and explains the prevailing circumstances. Case study is be used because we are mainly focusing one scope (East Africa). The study will also get information from other secondary sources such as newspapers, academic journals, books, publications and reports.

3.3. Target Population.

This study looks at the informal cross border trade in East Africa. The target population under study is informal cross border traders.

3.4. Data Sources and Instruments.

The data qualifying this study is collected through secondary data which data shall be collected from library sources and texts with the relevant material, internet sources and other e-resource database, scholarly magazines and newspapers.
3.5 Data Types and Analysis

Table 4: Intra-EAC Trade

It is important to point out that the research was carried out to shed light on the involvement and characteristics of ICBT. It also looked at the awareness of the EAC Custom Union Protocols by the traders.

Secondary data were collected from sources such as academic books, online journals, internet and articles. Results were also presented in text form supported by graphs and simple frequency tables for each data category.

3.6 Data Presentation and Analysis

3.6.1. State of Informal Cross Border Trade in EAC

In order to assess the extent of ICBT in EAC, let us first take a look at table 4 and consider the inter-EAC trade developments since the coming into force of the Customs Union in 2005. With this picture, we can then compare with data on ICBT in order to appreciate the likely implications on regional trade.
<table>
<thead>
<tr>
<th></th>
<th>Kenya</th>
<th>Tanzania</th>
<th>Uganda</th>
<th>Burundi</th>
<th>Rwanda</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Trading partner</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>97.2</td>
<td>188.6</td>
<td>169.1</td>
<td>2006</td>
<td></td>
</tr>
<tr>
<td></td>
<td>169.1</td>
<td>198.0</td>
<td>201.0</td>
<td>511.3</td>
<td></td>
</tr>
<tr>
<td></td>
<td>253.6</td>
<td>422.4</td>
<td>13.7</td>
<td>30.5</td>
<td>0.0</td>
</tr>
<tr>
<td></td>
<td>62.6</td>
<td>105.0</td>
<td>28.7</td>
<td>55.5</td>
<td></td>
</tr>
<tr>
<td></td>
<td>385.7</td>
<td>611.2</td>
<td>20.5</td>
<td>36.5</td>
<td></td>
</tr>
<tr>
<td></td>
<td>13.9</td>
<td>75.5</td>
<td>152.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>371.8</td>
<td>535.8</td>
<td>15.2</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>30.3</td>
<td>50.3</td>
<td>31.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>4.7</td>
<td>0.1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>25.6</td>
<td>49.2</td>
<td>30.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>66.1</td>
<td>129.4</td>
<td>9.1</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>2.9</td>
<td>0.1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>63.2</td>
<td>129.1</td>
<td>9.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>735.8</td>
<td>1213.4</td>
<td>157.8</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>84.1</td>
<td>182.0</td>
<td>175.5</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>651.6</td>
<td>1031.4</td>
<td>-17.7</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: EAC Secretariat, 2009

Table 4 shows us several things. If we consider the initial three EAC Partners States, we see that each of them has had an overall growing positive trade balance with the region between 2006, one year after coming into force of the Customs Union, and 2008. But, specifically, Uganda has been a net importer both from Kenya and Tanzania.
However, Uganda’s positive trade balance with the region is as a result of its positive trade with both Rwanda and Burundi. We also see that a year after joining the EAC Customs Union, the three initial EAC Partner States have increased their exports into the two countries, with most exports into the two countries coming from Kenya and Uganda. Except for Uganda, imports of Kenya and Tanzania from Burundi and Rwanda have fallen in 2008 compared to their levels before joining the EAC Customs Union.

The trade balance between Rwanda and Burundi has slipped into a deficit and while trade balance between Burundi and Rwanda remains positive, it can be seen that it can be seen that the change is a negative one in 2008 compared to the level in 2006.

As compared to other member countries, Tanzania exports much of its produce to Kenya (US$188.6mn by 2008); imports much as well from Kenya (US$198.0mn). In both years, over 96 percent of Tanzania’s inter-EAC imports and exports came from and went to Kenya. With respect to Rwanda’s inter-EAC exports in 2008, about 70 percent went to Kenya compared to 44 percent and 43 percent of its inter-EAC imports coming from Kenya and Uganda respectively.

Table 5 below shows that Kenya exports most of its products to Uganda followed by Tanzania and most of its imports are from Tanzania. The rates of trade between Kenya and Burundi and Rwanda are still low, but we see a dramatic increase of more than a 100 percent in 2008 of its exports to Rwanda from the levels in 2006. Overall, both Burundi and Rwanda have experienced increased inter-EAC trade in 2008.

According to Table 5, Uganda maintains an increasing trade deficit with Kenya. However, according to ICBT statistics provided by Uganda Bureau of Statistics (2010), Uganda has been keeping a positive trade balance with Kenya. Similarly, while official flows from Uganda to
Kenya, Tanzania and Rwanda indicate an amount of US$132.2mn in 2006, the data on ICBT trade that is not recorded in the official national statistics shows that Uganda informally exported to the three countries goods worth US$143.4mn, which is more than the official flows by eight percent. If the two sets of data were added together, Uganda would record exports to the three countries amounting to US$275.6mn compared to just US$152.8mn indicated as its total inter-EAC exports. One therefore sees that the official flows fall short by more than 80 percent of what should be Uganda's inter-EAC exports.

Table 5 also shows that the informal exports flowing from Uganda to its five neighboring countries – Kenya, Rwanda and Tanzania (EAC), Democratic Republic of Congo, and Sudan – amounted to an estimated US$231.7mn in 2006, corresponding to around 86 percent of official export flows to these countries over the same period, or 46 percent of total (i.e., formal and informal) export flows to these countries.

On the other hand, informal imports were estimated at US$80.6mn, corresponding to approximately 19 percent of official flows from these countries or 16 percent of total imports (formal and informal) from these countries. But, what is more important to note is the finding that these ICBT values represented an increase compared to 2005 informal trade flows.
Informal exports flows from Uganda to Rwanda and Tanzania, in particular, have experienced the most important steady annual growth over the past three years between 2005 and 2007 as indicated in Table 5.

Table 5: Extent of ICBT between Uganda and its Neighbors (in thousand US$)

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Kenya</td>
<td>107,042</td>
<td>96,882</td>
<td>86,013</td>
<td>44,214</td>
<td>63,880</td>
<td>7,037</td>
<td>62,828</td>
<td>33,002</td>
<td>78,976</td>
</tr>
<tr>
<td>Rwanda</td>
<td>7,340</td>
<td>25,046</td>
<td>39,104</td>
<td>681</td>
<td>694</td>
<td>405</td>
<td>6,659</td>
<td>24,352</td>
<td>38,699</td>
</tr>
<tr>
<td>Tanzania</td>
<td>2,842</td>
<td>21,518</td>
<td>38,486</td>
<td>607</td>
<td>4,255</td>
<td>2,886</td>
<td>2,235</td>
<td>17,263</td>
<td>35,600</td>
</tr>
<tr>
<td>Subtotal -EAC</td>
<td>117,224</td>
<td>143,446</td>
<td>163,603</td>
<td>45,502</td>
<td>68,829</td>
<td>10,328</td>
<td>71,722</td>
<td>57,354</td>
<td>153,275</td>
</tr>
<tr>
<td>DRC</td>
<td>73,964</td>
<td>80,453</td>
<td>156,534</td>
<td>19,550</td>
<td>11,288</td>
<td>18,242</td>
<td>54,414</td>
<td>69,165</td>
<td>138,292</td>
</tr>
<tr>
<td>Sudan</td>
<td>9,119</td>
<td>7,842</td>
<td>456,373</td>
<td>820</td>
<td>517</td>
<td>8,669</td>
<td>8,299</td>
<td>7,325</td>
<td>447,704</td>
</tr>
<tr>
<td>Subtotal</td>
<td>83,083</td>
<td>88,295</td>
<td>612,907</td>
<td>20,370</td>
<td>11,805</td>
<td>26,911</td>
<td>62,713</td>
<td>76,490</td>
<td>585,996</td>
</tr>
<tr>
<td>Total ICBT</td>
<td>200,307</td>
<td>231,741</td>
<td>776,510</td>
<td>65,872</td>
<td>80,634</td>
<td>37,239</td>
<td>134,435</td>
<td>133,844</td>
<td>739,271</td>
</tr>
<tr>
<td>Total formal CBT</td>
<td>268,842</td>
<td>430,366</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>-</td>
<td>161,524</td>
<td></td>
</tr>
</tbody>
</table>
3.6.2. Comparing ICBT between Uganda and EAC Counterparts

According to Ackello (1996), The Uganda Bureau of Statistics UBS surveys done in 2005, 2006 and 2007 are the most comprehensive surveys that have attempted to unravel the quantum of ICBT in the EAC for most number of goods than any other recent study. The surveys found that 25 percent of petroleum fuel (petrol, diesel and paraffin) consumed in Uganda is smuggled from Kenya, costing the Ugandan government about US$1.2mn annually in lost tax revenue.

3.6.2.1. ICBT between Uganda and Kenya

Agricultural commodities are the leading informal exports to Kenya estimated at 65.4 percent of total ICBT and worth estimated at US$56.2mn, followed by industrial/manufactured products valued at US$29.6mn and other products valued at US$0.2mn.
The main agricultural commodities according to rank during 2007 are maize, fish, beans, groundnuts, and bananas, while, the main manufactured are Shoes (both second hand and new), clothes and petroleum jelly.

During 2007, the amount of maize grains informally exported to Kenya fell from 123,173 tonnes in 2006 (worth US$19.6mn) to 58,212 tonnes in 2007 (valued at US$10.3mn). This significant reduction in the quantity of maize grains exported to Kenya could be attributed to the high domestic and regional demand after the floods which devastated the northern part of Uganda and the food scarcity in South Sudan where maize flour was among the food items exported to these regions.

The fact that agricultural commodities informally exported to Kenya were mainly food stuffs highlights the interstate dependence of regional states during food scarcity.

Meanwhile, the leading agricultural ICBT imports during 2007 were coffee (unprocessed), rice, potatoes (Irish), and peas with values estimated at US$2.5mn in 2007. There was a general reduction on informal imports bill on these products compared to 2006. For instance, the amount of rice was estimated at US$3.4mn in 2006, but drastically fell to US$0.80mn in 2007 due to reduction in its exports to avert food crisis in Kenya.

With regard to manufactured/industrial ICBT imports, polythene bags remained as the main product although its value reduced remarkably from US$25.6mn in 2006 to US$5.6mn in 2007, which could be attributed to the Ugandan government policy that limited the importation of polythene bags of less than 30 microns. Other commodities that featured highly among the main industrial ICBT imports to Uganda were clothes (new and second hand), cooking oil and sugar.
3.2. ICBT between Uganda and Tanzania

The main ICBT exports to Tanzania have been rising from US$2.8mn in 2005 to US$21.5mn in 2006 and then to US$38.5mn in 2007. Agricultural products take the lead and they include beans, maize and bananas whose total value was estimated at US$3mn.

The major industrial ICBT exports to Tanzania comprised of clothes (second hand and new), human medicine, polythene bags and shoes estimated at US$5.6mn, US$5.3mn, US$5.0mn, US$4.5mn, and US$4.0mn respectively thus totalling US$24.4mn. The other industrial products exported were Match boxes, alcohol/spirits, maize flour and boutiques.

Similarly, informal imports have increased from US$0.6mn in 2005 to US$4.3mn in 2006 and then dropped to US$2.9mn in 2007. In 2007, major imported agricultural products from Tanzania were beans, unprocessed coffee, fish, and rice with a total value stood of US$1.4mn. Major industrial products informally imported were medicine, cooking oil, ghee and sugar estimated at US$0.2mn, US$0.1mn, US$0.1mn and US$0.08mn respectively.

3.6.2.3. ICBT between Uganda and Rwanda

ICBT between Uganda and Rwanda has continued to increase from US$7.3mn in 2005, US$25.0mn in 2006 and then to US$39.1mn in 2007. The trend suggests that ICBT between Uganda and Rwanda is likely to increase following the entry of Rwanda into the EAC regional bloc. Major informal agricultural exports from Uganda were maize grain, beans, bananas and sorghum estimated at a total of US$9.7mn. On the other hand, the major industrial products exported to Rwanda were maize flour, shoes and clothes which accounted for US$7.8mn, US$6.6mn and US$5.0mn in 2007 respectively. Uganda’s informal agricultural imports from
Rwanda were peas, passion fruits, avocados estimated at a total of US$0.07mn, US$0.07mn and US$0.18mn, while the overall informal import bill on industrial products from Rwanda was valued at US$0.09mn in 2007 compared to an estimated value of 0.70 million in 2006.

3.6.3. Impacts of Informal Cross Border Trade.

According to Boko et al (2013) depending on border specificities, regional and local circumstances, ICBT impacts consumers, producers and the government differently. In terms of revenue collection, governments are generally on the losing end.

Ackello (2012) observes that countries with low revenue bases but higher incidence of ICBT along their borders such as Ethiopia, Benin, Togo, Niger, Mali, Congo, South Sudan, Somalia may experience macroeconomic imbalances due to revenue losses. Coastal countries such as Benin and Togo spend foreign exchange importing merchandise that are later informally sold across its borders on local currencies hence exerting a drain on their economies. However, this doesn’t mean that governments should criminalize the practice. Uganda showed that although its government lost potential revenues from ICBT, the economy as whole was better with foreign exchange earnings on ICBT amounting to positive informal trade balances of US$ 717 million and US$ 461 million respectively for 2009 and 2010.

Peberdy (2010) observes that consumers usually come out as winners, but not all the time. ICBT generally benefits consumers by increasing the availability of goods at affordable prices. However, consumption of tradable goods not subjected to customs clearance and other border formalities may in some cases lead to loss of consumer welfare.

Lesser et al (2009) add that most foodstuff and other commodities traded informally are not subject to Sanitary and Phytosanitary (SPS) measures thus making consumption riskier. Failure
subject goods to standards inspection exposes consumers to health, safety and environmental risks creating a glut, decreasing prices in the local market and leaving local farmers with no market for their products.

Generally, the positive impacts of ICBT outweigh the negative ones. The knock-on effects of ICBT on employment creation, income generation and the improvement of welfare for the participants is an important contribution to the economy from informal trade. (Little, 2010).

In East Africa, ICBT has proven to lessen the impact of food crises and help reduce price volatility. ICBT can lead to wider market access and a greater availability of goods at affordable prices and can also contribute to macroeconomic stabilization. The example of Uganda where ICBT accounted for 33.8% and 24.6% of total exports trade in 2009 and 2010 respectively provides empirical evidence and demonstrates how beneficial ICBT can be to some African economies. (Tumuhimbise et al, 2010).

3.6.4. Implication of ICBT on East Africa member states.

ICBT is an integral position in the survival and basic economic arrangement of humankind is well documented. Chung (2010) notes that the sector can however no longer be considered as a temporary phenomenon. The informal sector as in this study has been described as the unregulated and mostly unregistered sector of the economy. According to him, the trade is operated by artisans, peasants and other micro entrepreneurs, within the economy.

Borai (2013) argues that regardless of the level of state involvement in the economy, the informal cross border trade provides employment for a significant number of the unemployed and underemployed.
According to the International Labor Organization (ILO) (2009) 1.8 billion, compared to 1.2 billion (formal sector) people are employed in the informal sector. UNCTAD (2009) report give this interface between the informal sector and the formal sector, some complexity is obvious. A continuum exists between the informal and the formal economy in which backward linkages and forward linkages are involved. With respect to the sustainable management of local resources hence greening the economy, the informal actors are better informed to deal with the environment given their closeness to environmental products. Besides, sustainability embraces the notion of social justice.

Kinana (2012) observes that the informal actors are commonly powerless and voiceless, particularly women hence the empowerment embedded in informal opportunities can be capitalized upon towards poverty eradication and promotion of gender equality.

Harris (2007) argues that ICBT does not only promote a developing community (through regional integration), ensure employment creation and income generation- especially for people who are unable to find formal employment due to various socio-economic reasons; but it also plays an important role in ensuring food security by moving agricultural produce and other foodstuffs across borders where they are needed the most. With the eastern African countries beginning to feel the realities of climate change, through high food prices, severe droughts and flooding informal trade offers people an alternative to still live in dignity. Furthermore, and often overlooked is that ICBT is a key source of empowerment for women who constitute the majority of traders. It has been found that over 70 percent of informal cross border traders are women who are either widowed, divorced or simply undertake this business to supplement their husbands' incomes.
Akech (2012) argues that one of the key factors contributing to ICBT is the interaction and mutual reinforcement between the so-called labor-supply push and low-income-demand. Within the context of the present situation in the Eastern Africa border, what is referred to as the labor-supply push is characterized by: high unemployment, resulting in an increasingly cheap labor supply; and the search for alternative or complementary income earning opportunities as a result of eroded income levels, decreases in the labor force in productive enterprises and lack of skills to enter into the shrinking formal sector.

The low-income-demand pull on the other hand has the following features: the existence of a large number of poor consumers with low effective demand for basic consumer goods offered in the formal sector; and the existence of suppressed demand for goods normally offered by the commercial networked inefficiency of formal suppliers who quite often face tremendous liquidity problems (Kieck, 2010).

Ogalo (2010) argues that despite its significant contribution to the economy, scale cross-border trade remains largely an informal sector and the voices of the traders are seldom heard. Statistics on this subsector are still estimated and there are no clear and targeted programs to formalize and enhance competitiveness of the subsector so as to enable traders take advantage of the benefits of regional integration.

Traders have not even been able to take advantage of the simplified customs processes and procedures available for them at the border under the Simplified Trade Regimes (STR) established by both the EAC and COMESA. (Martinez-Zarzoso et al 2007)

There is enormous potential for trade to drive growth and poverty reduction in the region. ICBT has considerable opportunities where traders can benefit from in a range of goods and services.
The trade has contributed to food security and has increased employment in the EAC countries. Trade across borders is essential to improve access and lower prices for critical inputs into economic activities including the exports of other goods and services. ICBT between these countries has improved access of consumers to basic food products and to increase the returns to farmers.

Equally important is the fact that ICBT activities are, in general, labor intensive. For example, the activities of transporting across the border small quantities of merchandise (mainly as a strategy to avoid confiscation) requires a large labor force before the goods are reassembled on the other side of the border for onward transportation.

According to the study findings ICBT trade plays a positive role on poverty alleviation by providing employment and incomes. This role is important, particularly in view of the fact that more than two thirds of the population in this two countries live in absolute poverty.

3.6.5. Implications of ICBT on the economy of the EAC member states.

As stated in most of the literature reviewed in this study, ICBT contributes to the economies of EAC countries in various ways. It enables small-scale entrepreneurs to escape poverty and to meet the education, housing and other basic needs for a significant number of dependents as well as creating employment opportunities for a number of people. Often, ICBT traders employ people in their home countries and in the countries where they source their goods, some of whom would otherwise have no employment as formal-sector employment has been shrinking. In some cases, ICBT is a second job to civil servants and private sector employees who are under-employed; it has also provided employment to some people in the region who were unduly retrenched following economic restructuring that was occasioned by structural adjustment.
programmes (SAPs). For those who are under-employed, ICBT has provided a supplementary source of family income.

From a consumer's perspective, ICBT brings the benefit of lower prices of the informally imported products since they evade a lot of costs. Some of the ICBT traders have establishments in the Cities where they sell their products at more competitive prices compared to same products purchased through formal channels and sold in supermarkets. In addition, the low prices they offer have sometimes increased the competitive pressure on firms operating in the formal sector. In this perspective, informality may have the effect of promoting price efficiency, especially where the formal sector were initially raking in supernormal profits.

However, contrary to the perceived benefits of ICBT, it is also true that formal firms are more productive than informal ones, due to scale and scope economies, access to capital and technology and more advanced methods of production and distribution.

This suggests that significant productivity gains would be achieved more in our economies by transferring production from low-productivity informal firms to more productive formal firms or by facilitating the formalization of informal firms. In that case, thus, the unfair competition from ICBT players may have the long-run effect of reducing competition and such may prevent the more productive formal firms from entering or expanding in the market. Therefore, because of the benefits associated with formalization of businesses, formal firms may offer even lower prices in the long run if informality in business was eliminated. Thus, when assessing the benefits or harm to competition from ICBT, competition authorities should consider whether to focus their analysis on short-run or long-run competition concerns of ICBT. In addition, the incentive to innovate and invest (without effective intellectual property regime) could be significantly reduced in an informal trading environment. Those who develop new products in
the region are likely to gain from trading their products across the region through formal channels; otherwise, informal traders may ruin chances of such innovators ever recouping their investments in the innovation. A large informal sector could also deprive governments of much needed tax revenue (such as VAT) which could have been reinvested into energy and infrastructure development, which are some of the critical priorities of EAC.

However this study has established that it is mostly the formal firms engage in ICBT that hurt the EAC economies more than is perceived of the small informal traders. These formal enterprises understand international trade rules better, and also know how to escape certain costs; they also have stronger economic might to deal in larger quantities than their small informal counterparts which are merely running survivalist enterprises.

The big formal firms engaging in ICBT are capable of ‘facilitating’ their way across borders through several informal ways, thus evade taxation and other regulatory measures and as a result deny governments massive revenue. This point could also explain why it is mostly the names of small traders recurring in the Kenya Revenue Authority’s offence report because the big shots are able to bribe and get off their names from being recorded in the register to keep their public image untainted.

From the Uganda Bureau of Standards’ surveys of 2005, 2006 and 2007, it can be established that EAC economies involve in significant trade with each other but a big percentage is in the informal form, hence such statistics miss out in the official national statistics which our policy makers rely on in stipulating policy directives. In this case, ICBT could influence the development of economic policy objectives by skewing the reliability of (trade, income and labour market) data. The other negative effect of ICBT in EAC is that its mere existence breeds a culture of corruption among public administration officials, including traffic and border police
force and Customs officials, who are seeking for economic rents from ICBT. Furthermore, ICBT
may hinder further investments in local (formal) SMEs; these may include infant industries
susceptible to ICBT competition, which constitute the majority of the private sector in EAC and
are key drivers of to regional development.

3.6.6. Factors influencing Informal Cross Border Trade in EAC

According to Perry et al (2007), the level of corruption in the country and the rigidity of labor
regulations (e.g., ability to hire and fire workers) are positively correlated with the incidence of
informality. Similarly, increased taxation, social security contributions and (labor market)
regulations are important drivers of informality (Schneider, 2006). With regard to ICBT,
Hernando De Soto (2000) sees its growth as representing a normal market response to overly
cumbersome, rigid, time-consuming and inefficient bureaucratic export/import procedures and
regulations; these factors can significantly increase the cost of both joining the formal economy
and operating within it.

The UNECA (2009) study analyzing the gender dimension of cross-border trade in EAC finds
that the women involved in ICBT prefer to continue trading, largely, the same way as they have
done for many decades gone by; these traders show little evidence of knowledge of the EAC
Customs Protocol. In actual fact, they are less motivated to know how the Protocol can benefit
them and they perceive the opening up of trade under the evolving EAC Customs Union Protocol
and promotion of formality as an interference and threat to their livelihoods.

(Meagher, 1997; Peberdy 2000; Little 2001; Meagher 2003; and Matorova, 2008), however,
concur that the main push factors towards ICBT are to be based on the lack of formal
employment fueled by inappropriate economic reforms (such as structural adjustment
programmes, SAPs), rising rural-urban migration in search of often non-existent employment, and, low wages from the formal employment pushing people to look for other ways to supplement their incomes.

According to these studies, the recent rise of the informal sector, and growth of ICBT, is mainly a structural backfire to the market liberalization policies of the 1980s and 1990s; it is an indictment on the SAP policies which prematurely exposed EAC economies to unfair external competition and also reduced the government interventionist policy spaces and as thus ended up creating more poverty and unemployment than they were meant to create them.

There is no need to explain the fact that poverty and unemployment would inevitably push people to the search for alternative sources of income, and ICBT is one such alternative. Meagher (2003:57) concludes that for many parts of Africa the overall effect of SAP has resulted in a significant expansion of informal cross-border trade and that, today, the informal sector is responsible for a majority of jobs created annually.

The literature on informal economy abounds with several reasons explaining its continued existence and growth in EAC. To surmise this analysis, we can say that there is no one cause for growth of ICBT; rather, an array of factors has conspired either as incentives that pull traders or as problems that push them to engage in ICBT. In the context of EAC, some of these factors are discussed here under. The informal cross-border traders, especially small-scale traders, have little knowledge of the benefits of trading within EAC; they also have inadequate information on the existing trading opportunities. This is exacerbated by there being no simplified written rules that the traders could refer to; if at all, the available information is not in a reader-friendly format – they exist only as legal texts such as protocols.
It is therefore, difficult for the traders, especially given their near-nil technical knowledge, to know their benefits and rights when trading within EAC. This has resulted into situations where customs officers exploit the traders' ignorance by, for instance, demanding duties on goods that are not supposed to attract duties.

Generally, the rise in transaction costs deriving from requirements of compliance with formal trading procedures is significantly high relative to the profit margins of the small-traders – considering they don't enjoy economies of scale as their large formal counterparts. For instance, the requirements and process in registering business and complying with import-export regulations is excessively burdensome; naturally, this plays a role in attracting many traders into the informal trade. Such costs have been estimated to even constitute as high as 15 percent of the total trade transaction value (OECD, 2002).

The experience of most small traders is that when they follow the formal channels of trade, their costs of transactions rise significantly, especially, given little scale economies as they deal in small quantities of goods. It is generally difficult, for instance, for the small traders to acquire certificates of origin which are issued away from the border stations yet their businesses are stationed at these borders.

Hence, some of them would rather take short-cuts than spend time and resources looking for these certificates. A small informal trader could be dealing in tomatoes today, if they are in high demand and the next day in wheat or maize depending of the how demands for these products swing across borders. They could also have a mix of several different classes of goods in very small quantities. Given this nature of trade, it is not economically practical for them to acquire all the necessary documents, such as business registration and obtaining certificates of origin, for each of the products they deal in. Due to the long delays at the border before goods can be
cleared, not only does this lead to depreciation costs, but traders are also forced to spend unplanned nights as they await clearance of their goods, this can take several days depending on the nature of the good being cleared. This raises fears, especially, for women traders with regards to their own security as there are also no safe affordable accommodation provisions at the border towns. It also exposes their goods to robbery or they are compelled to incur additional cost of hiring a security person to guard against such. As a result, some traders have opted for informal ways of importing goods if that may help them avoid the costs associated with delayed clearance at the borders. Related to the above point is the finding that the slow process of clearance of goods at the border may be a deliberate practice to obtain economic rent/bribe (‘facilitation payments’) from traders who naturally would want their clearance to be expedited. Under such cases, a trader may be allowed to pass without undergoing full checks as may be required. Traders are, therefore, attuned to this corrupt culture and they engage in informal trade with justified confidence.

The formal enterprises engaging in ICBT are well endowed with better education and so they understand international trade rules better than their small informal counterparts which are merely survivalist enterprises; they also have stronger economic might to be able deal in larger quantities than small-scale ICBTs; and, because of their stronger economic might they are also able to afford ‘facilitating’ their way across borders through several informal ways, thus evade taxation and other regulatory measures.-Other push and pull factors explaining the continued existence and growth of ICBT in EAC are embodied in the fact that it is generally easy to enter ICBT than to follow the long bureaucratic process involved in formal business. Besides, certain ICBT activities are more profitable and viable only to small businesses.
The increasing growth of ICBT was also established to be connected positively to the weakness of economies of EAC. The relapse of the formal sector employment, traced mainly to the advent of structural adjustment programmes (SAPs), has seen the informal sector grow by absorbing the labor force being laid-off from the modern private sector, especially, over the last two decades when EAC economies have been experiencing economic downturn.

Retrenchments, low pay in formal jobs, inflation and currency devaluations are also factors that have created pressures on real wages and search for informal income supplements. The increase in rural-urban migration in search of often non-existent employment was also established to be playing a role in the growth of the informal sector as a viable alternative source of employment. Another factor that was established by the study is that individual traders and businesses that are not registered at all and escape domestic taxes and regulations are most likely to conduct trade informally since most of their operations (whether domestic or international) are informal.

Poor infrastructure at the official border posts also emerged as a factor that increases costs of trade and may sometimes push traders to unofficial trade in order to avoid further incurring costs of clearance at the border-crossing posts. Difficulties in getting entry permits into neighboring countries when cross borders also emerged as contributing factor to informal cross-border trade. Non-recognition of one Partner State’s trade documents by customs officials of another Partner State, especially where documents have not been harmonized contributes to increasing costs of following the formal trade channels.

Lack of proper education on the part of traders was also established to make traders timid of seeking the necessary information on how they could benefit from available opportunities of the EAC Customs Union, hence, such traders would rather engage in informal cross-border trade.
Changes in the fiscal policy also had an influence on the scale of ICBT. For example, according to the UBS (2007) study, the decline in informal imports from Kenya was seen to be occasioned by a ban on imports of polythene bags which dominated the informal imports sector in the previous years. Similarly, appreciation of the Kenyan shilling relative to other EAC countries was also established as making imports from Kenya somewhat expensive thereby affecting informal trade considerably.

Tariff and cross-border price differentials also contribute to ICBT growth. The volume of informal trade imports from Uganda to Kenya was observed to have reduced in 2006 as Ugandan traders found the neighboring countries like Sudan and DRC offering higher prices than Kenya. This direction of trade was also related to the political stability and economic recovery which was setting in Sudan. Food insecurity conditions in one Partner State and food abundance in another Partner State was also established to have the effect of providing incentive to engage in ICBT as traders rush to make quick profits by transferring food products from the country with abundant food to the one with deficit. Furthermore, measures that negatively affect access to trade finance can motivate small firms and entrepreneurs to trade informally. For example, where traders have had difficulties in contracting formal credits, they have sometimes turned to informal sources of generating finance like ICBT.

Finally, cross-border trade is likely to be influenced by the quality of road and transport infrastructure. Poor roads system can result in poor access to a country’s own domestic market or to its established (official) border posts; they also raise costs business and reduce profits for traders. In this case, traders would often choose to use to most effective and economical route, hence possibly avoiding formal border posts where they would be subjected to other costs.
### 3.7 Analysis on the awareness of the Customs Union Protocol by Cross Border Traders

A study by East Africa Business Council (EABC) 2008 shows lack of awareness on Customs Union among various traders in East Africa as indicated in the table below.

Table 6: Availability and content of information on EAC Customs Union

<table>
<thead>
<tr>
<th>Form/type of information received</th>
<th>Burundi</th>
<th>Kenya</th>
<th>Rwanda</th>
<th>Tanzania</th>
<th>Uganda</th>
</tr>
</thead>
<tbody>
<tr>
<td>EAC Customs Management Regulation</td>
<td></td>
<td>25%</td>
<td>27%</td>
<td>25%</td>
<td></td>
</tr>
<tr>
<td>Rules of Origin/Certification of Origin</td>
<td>11%</td>
<td>9%</td>
<td>19%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>CET</td>
<td></td>
<td>31%</td>
<td>9%</td>
<td>19%</td>
<td></td>
</tr>
<tr>
<td>General Information on EAC Customs Union Implementation</td>
<td>6%</td>
<td>33%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Harmonization of seed treaty</td>
<td></td>
<td>3%</td>
<td>27%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Have not received any information</td>
<td></td>
<td>38%</td>
<td>67%</td>
<td>18%</td>
<td>64</td>
</tr>
</tbody>
</table>
The analysis above demonstrates that availability of information on EAC Customs Union instruments among businesses is rather low and at worst unavailable as brought out in Burundi, Rwanda and Uganda.

This is supported by a study by Mugisa et al (2009) that indicates the lack of adequate public awareness about the Customs Union as one of the main challenges hindering the implementation of the EAC Customs Union. This is as a result of the negotiation of the Customs Union that took a long time before it was launched in 2005. There has been no time allocated to the sensitization of the stakeholders and, particularly the traders, in the member states about what was to come. They were not sensitized on the mechanisms and benefits of the Customs Union to allow them to position themselves to take advantage of the benefits. As a matter of fact, the Customs Union Protocol does not provide for the involvement of the private sector in the process of implementation and to this extent the public/private sector partnership has not been enhanced.

There is also lack of awareness of the Customs Union Protocol among most of the traders as a result of language barriers. Article 137 of the EAC Treaty provides that English is the official language, while Kiswahili is the lingua franca of the EAC. Currently, however, almost all the EAC laws are exclusively in English. Unfortunately, not all the traders can speak or understand English. Many traders in the region even in the original Partner States (Uganda, Kenya and Tanzania) are not able to understand the legal, administrative texts and documentation written in English. Moreover, Rwanda and (particularly) Burundi use French and to some extent Kiswahili as the medium of communication (Mugisa et al, 2009).

Slow or none implementation of the Act has resulted in traders not taking up the protocol seriously. There has slow or none implementation of the above Act by Partner States. The Act provides for withdrawal of national standards in order to adopt the regional standards. However,
this has not happened at the pace expected. As a result, Partner States have run parallel standards national and regional regimes sometimes confusing the traders.

The study also established a number of informal cross-border traders who are well aware of various provisions of the customs union at least in general terms including most of the regulatory requirements. However, they attribute their continued engagement in informal trading activities to the presence of physical and technical barriers.

Major players in informal trade are women and the youth, who either carry their commodities on bicycles or cross on foot. For instance, certificates of origin are issued away from border stations and so traders would rather use short-cuts rather than spend time and resources looking for these certificates.
CHAPTER 4
CONCLUSIONS AND POLICY IMPLICATIONS

4.1. Conclusion

The research has established that ICBT has both advantages and disadvantages. Though it is a source of employment that assists in eradicating poverty and contributes towards food security in the region, it also causes harm to the government in terms of loss of revenue and puts the population on the countries at risk as most informal cross border commodities are not cleared at the borders for human consumption.

It has also established that the EAC Customs Union Protocols is not well known and understood by most of the cross traders as a result of the language used in the protocol as well as lack of sensitization.

The UNECA (2009) study analyzing the gender dimension of cross-border trade in EAC finds that the women involved in ICBT prefer to continue trading, largely, the same way as they have done for many decades gone by; these traders show little evidence of knowledge of the EAC Customs Protocol.

In actual fact, they are less motivated to know how the Protocol can benefit them and they perceive the opening up of trade under the evolving EAC Customs Union Protocol and promotion of formality as an interference and threat to their livelihoods.

Other studies (Meagher, 1997; Peberdy 2000; Little 2001; Meagher 2003; and Matorova, 2008), however, concur that the main push factors towards ICBT are to be based on the lack of formal employment fueled by inappropriate economic reforms such as structural adjustment programmes, (SAPs), rising rural-urban migration in search of often non-existent employment,
and, low wages from the formal employment pushing people to look for other ways to supplement their incomes.

According to these studies, the recent rise of the informal sector, and growth of ICBT, is mainly a structural backfire to the market liberalization policies of the 1980s and 1990s; it is an indictment on the SAP policies which prematurely exposed EAC economies to unfair external competition and also reduced the government interventionist policy spaces and as thus ended up creating more poverty and unemployment than they were meant to create them.

Poverty and unemployment would inevitably push people to the search for alternative sources of income, and ICBT is one such alternative. Meagher (2003) concludes that for many parts of Africa the overall effect of SAP has resulted in a significant increase of ICBT.

The common problems encountered in transacting informal trade included; visa restrictions, duties and taxes, licensing, access to finance for trade, sexual harassment, and non-uniformity in customs and immigration regulations within EAC, which requires a multifaceted approach to be employed in order to minimize these problems.

4.2. Policy Implications

The informal cross border traders are in dire need of market information, financial services, and understanding of their role in the EAC regional integration process.

The traders require information on available market for their products, access to loans, value addition and the opportunities offered under EAC Customs Union Protocol.

Information is very valuable in facilitating cross border trade. The governments of EAC should promote the establishment of information centers for people involved in informal cross border trade, to enable them access information on cross border procedures and policies.
The EAC governments should educate their citizens on the Customs Union Protocol. When the people are aware, then they can be able to understand the opportunities available as well as any challenges that they may face. In this case, when formalization initiatives start, the informal cross border traders would have an easier time adjusting. When they truly understand the impact of the Customs Union Protocol, the informal cross border traders can know their rights and the duties of border officials hence prevent their being taken advantage of at the border posts.
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