An Assessment of the Informal Sector Trade in Kenya

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This study assesses the nature and practice of cross-border trade in Kenya with a view to filling the information gap on its patterns and key characteristics, a gap that has hitherto acted to hinder effective policy formulation. The study relies on information from a number of cross-border monitoring survey initiatives mounted by various institutions over the years. The study finds that informal cross-border trade accounts for more than 40 percent of the GDP and is therefore almost equivalent to formal trade. Efforts should be made to conceive policy suggestions that would optimize both formal and informal trade from the viewpoint of the national economy.

Keywords: cross-border trade, exports, Horn of Africa, informal, Kenya.
1.0 Introduction

Kenya shares territorial boundaries with several countries, all of which are her trade partners both formally and informally. These include Uganda, Tanzania, Sudan, Ethiopia and Somalia. Despite this, the international trade activity of the informal sector variously referred to as informal trade or informal cross-border trade (ICBT) between Kenya and these countries is not adequately documented.

1.1 Definition of Informal Cross-border Trade

ICBT refers to unrecorded business transactions undertaken across borders based mainly on popular economy. The traders involved do not submit tax returns at the end of each financial year; hence the resultant transactions are not captured in the national accounts statistics.

Dongala (1993) posits that informal trade occurs if there is unregulated and large-scale trade involving many participants; the scale of operation is smaller than in the formal sector; requirements in the formal sectors such as registration are minimal or even non-existent and, whenever they exist, are avoided with relative ease; there is ease of entry and exit; there is rampant evasion of trade-related licenses and/or taxes like import licenses or export taxes; there is use of parallel foreign exchange markets; participants evade paying international trade-related taxes but pay local taxes and licences to sell in local market places; traded goods originate from both formal and informal sector sources; and all goods are traded at market prices.

1.2 Participants in ICBT

Most participants are individual traders, a large proportion of which are women and micro, small and medium sized enterprises. They include locals, migrants and even refugees, particularly from Ethiopia, Somalia and Sudan, who are based in refugee camps close to their countries of origin. The migrants and refugees tend to carry out trade between Kenya and their home countries by taking advantage of their knowledge of local customs, products and networks.

A number of such traders are not registered at all, and therefore operate entirely outside the formal economy. Others are registered in Kenya but avoid trade regulations and duties either fully or partially. This is actualized in two ways. In the first instance traders simply avoid the official border posts and use unofficial routes. This is the preferred option of small scale, small volume traders. This is made easy by the porous nature of Kenya’s borders. The other option, preferred mainly by large volume traders, is to pass through the posts but resort to such illegal practices as under-invoicing, misclassification of goods or even misdeclaration of country of
origin with a view to paying lower tariffs, of course with the connivance of the customs officials.

On the whole, ICBT transactions across the Kenya/Uganda and Kenya/Tanzania borders involve buyers, sellers, brokers and middlemen, transporters, loaders, couriers, store owners, security personnel, money changers and informal money lenders. A significant number of these roles are performed by women and youth. At the Kenya/Uganda border, persons with disabilities play an important transportation role using their wheelchairs.

Due to shared cross-border trade characteristics, and for ease of analysis, Sudan, Ethiopia and Somalia are, for purposes of this study, grouped together in their ICBT with Kenya under the Horn of Africa (Northern Frontier). ICBT in the Northern Frontier is based on long-distance movement of livestock and other commodities across vast, hostile territory and so is largely the preserve of men. Trade here involves an intricate network of traders, financiers and transporters. Mahmoud (2003) estimates that more than 20 actors are involved in any one transaction along the approximately 800km route from Southern Ethiopia to Nairobi. Market participants include herders, brokers, middlemen, trekkers, loaders, truckers, security personnel, veterinary officers, money lenders, wholesale traders and hay merchants, among many others.

1.3 Types of Goods Traded
Goods traded informally across Kenya’s borders originate from Kenya, for example refined petroleum products; from international markets, for example electronic goods and vehicle parts; or even from the neighbouring countries, for example bananas from Uganda, beans from Tanzania and livestock from Somalia and Ethiopia. Such goods are sourced from both formal and informal sectors.

The types of goods traded vary from one border post to another. They include small volumes transported by individuals crossing the border carrying goods on their head, back or in hand, walking on foot, pushing a cart or wheelbarrow, or riding a bicycle or motorcycle or a wheelchair, as well as large volumes transported in trucks and containers by land, in dhows, canoes and steamships across lake Victoria to Uganda and Tanzania, in container ships across the Indian Ocean to Tanzania, Somalia and far away destinations or by air. Surveys indicate that the largest share of informally traded goods is traded in small volumes.

A number of cross-border monitoring survey initiatives have been mounted by various institutions over the years, notably Uganda Bureau of Statistics (2006, 2007, 2008); The Regional Agricultural Trade Intelligence Network (2007); The Famine Early Warning Systems Network (2007); and Ackello-Ogutu and Echessah (1997, 1998) among many others, to monitor informal trade between Kenya and her
neighbours by observing different border points. The findings are unanimous that a substantial proportion of cross-border trade in Kenya is in staple food commodities, including maize, rice and beans.

The surveys show that maize is the most traded good, accounting for 68 percent of all informal flows. The volumes informally traded at times exceed many times over the volumes formally traded. Maize is followed by beans and then rice (Lesser and Leeman, 2009). In the period 2004-2006, informal maize imports from Uganda were valued at US$73 million. Over the same period, formal imports of maize from Uganda to Kenya were valued at US$16.5 million. More specifically, in 2004, 92 percent of the total maize imports from Uganda were traded informally. In 2005, this figure was 81 percent and in 2006, it was 78 percent.

Petroleum products are also widely traded informally between Kenya and her neighbours. Ackello-Ogutu (1996) estimates that about 25 percent of petroleum fuel (petrol, diesel and paraffin) consumed in Uganda is imported informally from Kenya. This they estimate to cost the Uganda government about US$1.2 million annually in lost tax revenue. Quite a number of goods traded informally between Kenya and her neighbours are actually re-exports, i.e., imports that are exported by Kenya or her neighbours without any value addition. They include low-quality consumer goods such as clothes, shoes, electronic appliances like TVs and fridges, motor vehicle spare parts, bicycles and bicycle parts. Others include vegetable products, tea, coffee, sugar, non-alcoholic beverages, cement, tobacco, electrical apparatus, fish, and agricultural raw materials like cotton, bananas and groundnuts, among others.

Kenya’s Informal Trade with Tanzania

Kenya’s informal imports from Tanzania are mainly agricultural food commodities and fish. Maize is the leading item followed by beans, fish and rice, in that order. Others include yams, carrots, tomatoes, cassava, cabbages, cow peas, sugar, rice, bananas, millet, maize meal and groundnuts. Kenya’s agricultural food exports to Tanzania include wheat flour, bread, root crops, sugar, rice, bananas, maize meal, milk and coffee. Most agricultural commodities traded are largely influenced by the food items grown around the border and in the neighbouring districts.

Data on informal trade in industrial goods between the two countries show movements in both directions for most of the commodities, but overall informal trade is in favour of Kenya. The main export items include cooking fats/oil, toiletries, petroleum products, beer, margarine, car and bicycle parts, sweets and biscuits. Other industrial exports of significant value include salt, soft drinks, construction materials (cement and corrugated iron sheets), new textiles, charcoal, timber, plastic wares, soap, mattresses, perfumes, electronic goods, leather products, polythene bags,
second-hand clothes, human and veterinary drugs, and general merchandise. Trade in most of these items is caused by low cost prices in countries of manufacture and high profit margins in the neighbouring countries.

Kenya’s Informal Trade with Uganda

Uganda is Kenya’s largest trading partner in the region. ICBT between the countries therefore involves an exchange of substantial quantities of both agricultural and industrial goods as well as forest products. Over the period 1994-1995 for instance, Ackello-Ogutu and Echessah (1997) estimate the total annual value of informal trade between the two countries at US$146 million, compared to the total annual value of formal imports, which stood at US$96 million over the same period. This suggests that the volume of trade between the two countries is grossly underestimated in official documents.

The items of trade are more or less the same as those between Kenya and Tanzania. Maize is a key import item from Uganda. Others include beans, sorghum, simsim, choroko, millet, groundnuts, rice, cassava and yams. Fish is another major import item from Uganda. Ackello-Ogutu and Echessah (1997) observe that the bulk of fish found on Kenyan beaches actually originate from Uganda and that this trade is closely tied to informal exports of Kenya’s manufactured commodities to Uganda. Other imports include charcoal, wood fuel, timber, re-exports of textiles and bicycle and car parts. Leading informal exports to Uganda include petrol, cooking oils/fat, beer and wine. Others are soft drinks, cigarettes, toiletries, hardware, textiles, wheat flour, bread, milk, maize flour, confectionaries, sugar and salt.

Kenya’s Informal Trade with the Horn of Africa

Sudan, Ethiopia, Eritrea, Djibouti and Somalia are important informal trading partners to Kenya. Trade with this group of countries is unique because they border the Northern Frontier, a vast, hostile and insecure part of Kenya, which is also home to the largest refugee camp in the region. Given the political instability and incessant conflicts in countries in the Horn, the border posts along this frontier are quite porous, and the bulk of refugees hosted in the camps are therefore mainly citizens of the same countries. A natural offshoot of this is a thriving ICBT involving foodstuffs, textiles and electronic goods among many others, as well as a slew of illegal commodities, including arms.

Cross-border trade in livestock is the most significant form of trade in this region. Dalleo (1975) observes that this practice pre-dates the colonial period. As a commodity, livestock has features that make it particularly amenable to ICBT even in the poor security conditions typical of the Northern Frontier. It is a living and mobile
commodity that can be transported overland rather than on roads, and can easily be moved across borders. A high proportion of trade in livestock is therefore done informally, unlike trade in other products which can be trucked across borders. Little (2007), contends that 95 percent of the trade in livestock is actually informal. The usual practice is to move livestock across the borders on foot. For every 100 cattle moved on foot, there are normally three trekkers and an armed security person. In most cases, trade is done through middlemen and brokers who identify potential buyers and sellers.

ICBT in livestock in the Horn has another important dimension. In most cases it complements and even finances cross-border trade in grains and other food products. This has been widely documented along almost all the ICBT routes in the region including Southern Sudan/Northern Kenya (Gurele and Lautze, 2000), Southern Ethiopia/Northern Kenya (Teka, Alemayehu and Ayele, 1999; Mahmoud, 2003) and Southern Somalia/Northern Kenya (Little, 2000; 2006).

A common practice for many livestock traders is that once they sell, the proceeds are used to purchase grains and other food products that cross the border for sale in the deficit areas. Other popular products in this region include pasta, biscuits, food aid and electronics. In many cases they backhaul their purchases using the same trucks. Umar (2007) estimates that about 25 percent of livestock traders in Kenya/Ethiopia/Somalia ICBT are involved in the sale of staple foods, most of which are informally imported from Somalia and purchased by revenue from livestock trade.

2.0 Financing ICBT in Kenya

Participants in ICBT rely on a range of informal institutions to set up and support their businesses. In the Kenya/Uganda border region, Ackello-Ogutu and Echessah (1997) estimate that only 4 percent of traders have access to formal sources of finance. In the Horn, less than 10 percent of traders have access to such sources. According to Little (2007), more than 95 percent of credit used in ICBT in the Horn is obtained informally from kinsmen, friends and associates.

In Kenya/Uganda ICBT, 32 percent of traders obtain start-up capital from relatives, friends and kinsmen, 53 percent from personal savings and 11 percent from savings societies (Ackello-Ogutu and Echessah, 1997). A popular source of short-term funding in Kenya/Uganda ICBT are the informal money changers, who also double up as money lenders. They advance loans with a maturity of one day, at interest rates that are above 10 percent per day.

In Kenya/Tanzania ICBT, Ackello-Ogutu and Echessah (1998) estimate that only about 5 percent of traders have access to formal sources of finance. The rest obtain
their start-up or even business expansion capital from informal sources. Sixty-nine-point-five percent of traders obtain finance from personal savings, 2.1 percent from Savings and Credit Societies, 21.1 percent from friends, relatives and kinsmen, 5.3 percent from commercial banks and 2.1 percent obtain supplier credits.

Informal financing of ICBT in the Horn is particularly critical, because it is about the only option available to traders. In the Kenya/Somalia and Kenya/Ethiopia border regions in particular, informal financing arrangements help minimize the risks associated with carrying large sums of money in an unstable environment. The usual practice is for traders to convert their earnings into dollars in informal money houses in Nairobi, then “wire” back the same to informal money houses situated at the border, where the money is picked up by their business associates. The informal money houses charge a commission of 3 to 6 percent to wire the money to different locations, as opposed to 10 to 12 percent charged by formal financial institutions (Little, 2007). This is the Hawala System. In some cases, traders convert all or part of their earnings into tradable goods which are then picked up by a designated wholesaler at the border.

Mahmoud (2003) records a practice where a trader who sells animals in Nairobi transfers his cash earnings to a designated wholesaler at the border. The wholesaler uses the same to purchase goods in Nairobi which are then hauled back to the border. The wholesaler instructs a business associate at the border to repay the livestock trader or his associate. The associate receives the money and then re-initiates the process of procuring livestock movement back to Nairobi. This informal practice then allows both traders to conduct business without having to transfer cash across vast, insecure territory.

3.0 Access to Market Information

Effective flow of information is critical to any market system. ICBT buying participants need to know the variety and quality of goods available in the market, where they are and what price they command. The sellers, too, need to know what is in demand and at what price. An effective market mechanism is therefore dependent on how well informed market participants are. An important part of the structure of informal markets is therefore sources of market information.

In Kenya/Uganda ICBT, Ackello-Ogutu and Echessah (1997) report that 70 percent of market participants obtained market information by word of mouth, through friends, relatives and business colleagues, 18 percent obtained information from market signals, 4 percent from the media and 7 percent from other sources. The Uganda Bureau of Statistics (2008) reports that 51 percent of traders accessed market information mainly through friends, relatives and neighbours, 48 percent visited the
markets physically, 48 percent accessed information through their contacts with fellow business colleagues and associates and 21.6 percent through radio. Other sources of such information include middlemen and brokers. In Kenya/Tanzania ICBT, Ackello-Ogutu and Echessah (1998) report that 65.8 percent of the traders obtained market information from interpersonal communication, 14.1 percent through market signals, 11.8 percent through orders from buyers, 7.2 percent from the media, and 1.2 percent from market visits. (The Bureau of Statistics data cited here reflect an allowance for overlap among the various sources, where the figures presented by Ackello-Ogutu and Echessah in both cases total roughly 100 percent.)

Kenya’s informal transborder trade with countries along the Northern frontier is largely based on traders, brokers, middlemen and financiers, all of whom work together in tightly woven and intricate networks bound together by common kinship, religion and/or ethnicity. Market information is largely obtained only informally through word of mouth, and the flow of information is dependent on brokers and middlemen and their social networks. In the region of the Kenya/Somalia border for instance, actors on either side of the border are from the same ethnic group. More often, they draw on a common language and identity to pass on market information and facilitate transactions. This reduces substantially the cost of monitoring and enforcement.

Conflicts are regular occurrences in this region. In such times, these networks assume more significance. Flow of market information is curtailed, as actors turn inwards to transact only with those they trust, know well or can converse with in a common language. This can have devastating consequences for the market, as some groups are excluded from participating in the market. Little (2003) and Green et al. (2006) document the emergence of specific clan-controlled market networks in the region of the Southern Somalia/Northern Kenya border, and ethnic-based markets in Marsabit town in Kenya.

4.0 Incentive for Cross-border Trade

Several factors have conspired to promote informal trade between Kenya and her neighbours. Key among them are the generally high levels of import and export duties on selected commodities. Levin and Widell (2007) contend that the extent of informal trade is directly correlated with the average applied tax rate (e.g., tariffs and VAT) in the importing country. They estimate that in 2004 for instance, a 1 percent increase in the overall tax rate imposed on imported goods from Kenya led to a 3.8 percent increase in tax evasion on those goods.
Another incentive to informal trade is the existence of communities that transcend borders. Such communities share a lot in common both culturally and socially. They speak the same language, intermarry and own land on either side of the border. These particularly strong social networks lead to cross-border trade because of long-standing knowledge of the customs, products and networks of each other. Examples include the Somalis on either side of Kenya/Somali border at Mandera; the Luos along Kenya/Tanzania border at Isebania and Muhuru; the Samia on Kenya/Uganda border at Busia; the Sebei on either side of Kenya/Uganda border at Mt. Elgon; the Maasai along the Kenya/Tanzania border at Namanga and Loitokitok; the Bukusu/Wagisu on Kenya/Uganda border at Luahaha and the Turkana along the Kenya/Uganda/South Sudan borders among many others.

Long-standing wars and conflicts in neighbouring Sudan and Somalia and, earlier on, in Uganda, ensured that citizens of these countries living near the borders relied more on Kenya than on their own countries for supplies. This provided, and still provides, an incentive for people from either side of the divide to secure goods from where they are available and sell to areas of deficit. This situation has encouraged a steady back-and-forth flow of goods and services.

Informal trade is not illegal in its entirety. But the corruption that thrives at the border points has ensured that such illegal aspects as under-invoicing or mis-specification of ports of origin continue. There seems, as well, to be some degree of tolerance of informal trade activities by the government. At the Busia border point for instance, persons with disabilities cross the border with abandon on wheelchairs that are openly stuffed with goods (Uganda Bureau of Statistics, 2009).

Poor road infrastructure, which hinders access to some domestic markets, has led traders, particularly farmers, to take their produce to external markets that are within reach. This has been particularly observed along the Kenya/Tanzania border at Tarakea and Holili.

ICBT is a major source of livelihood for people living in communities near the borders who participate to earn incomes with which to support themselves and their families. Another incentive is the allure of lucrative markets in neighbouring countries which lead to high profit margins for traders. The informal trade between Kenya and Uganda for instance is sustained because the relative prices are higher in Kenya. This provides traders with the incentive to cross over with their goods. These activities are aided by the relative ease of convertibility between the regional currencies, especially through the informal foreign exchange markets that thrive at the border posts.

Kenya, like the rest of East Africa, has long and cumbersome customs procedures that lead to delays in clearing goods. On average, such delays last anywhere between
30 and 40 days, thereby occasioning huge losses for traders. This, coupled with complex regulatory requirements that are in most cases unclear or even unknown to traders, acts to compel many traders to engage in unrecorded trade.

5.0 Conclusion

The average share of informal sector trade in Africa is estimated at 43 percent of the official GDP (Lesser and Leeman, 2009). This makes the sector almost equivalent to the formal sector. Its existence is therefore a source of serious policy dilemmas, as countries grapple with what to do with it. Opinion is divided on whether the informal sector should be streamlined into the formal sector or whether it should be facilitated to play a complementary role.

In Kenya’s national trade policy (Republic of Kenya, 2009), for example, the overall policy for the informal subsector is to focus on mainstreaming informal trade into the overall economy by focusing on its growth and graduation into formal trade status through the provision of business development services. The overall policy framework is, however, silent on ICBT. The Uganda Bureau of Statistics (2009) recognizes the contribution of ICBT to the overall growth of the economy and recommends that the sector could benefit from initiatives like provision of infrastructure, access to easy credit, development of business and marketing skills and harmonization of trading policies across neighbouring countries, among other measures. A number of authors have also suggested putting in place appropriate trade-facilitating measures, such as reduction of trade transaction costs arising from import-export trade procedures, with a view to curtailing informal trade (Lesser and Leeman, 2009).

This disharmony in policy approaches is the result of, one, the limited appreciation of the contribution of ICBT to the economy owing to its very nature, and two, the misconception that formal and informal trade are two very different trade practices that can be dealt with by different sets of policy measures. We argue that the two are so intricately intertwined that it’s very difficult to distinguish between what is formal and what is informal. Evidence of this interconnectedness arises whenever policies directed at formal market channels start to affect informal channels and vice versa.

An example to do with maize is illustrative. Maize that is informally sourced from transborder markets may eventually be sold through a licensed retail outlet or find its way to a licensed miller’s factory, from where it may be processed, packaged and exported formally. Similarly, livestock that is trekked informally is sold to Kenyan traders from the Northern frontiers, who transport and sell the same to a state
corporation, the Kenya Meat Commission (KMC). KMC will proceed to process, package and formally export some of its products and release the rest to the formal economy for domestic consumption. In this process, livestock will be officially taxed at the various markets it passes through, thereby generating significant amounts of taxes and revenues from licences and permits for the formal sector, as well as unofficial payments in the form of bribes to government personnel and offices.

In conclusion we suggest, therefore, that formal and informal trade are complementary, and it’s almost impossible to eliminate the latter. In fact, at some border points it’s the only trade option available. Efforts must therefore be made to conceive policy suggestions that would optimize both from the viewpoint of the national economy.
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