

Cross-border trade and enterprise formalization in Kenya

Capitalizing on new productive opportunities under AfCFTA

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Outline of the presentation

1. Cross-border trade and informality
2. Capitalizing on new opportunities under AfCFTA
3. Gaps and recommendations

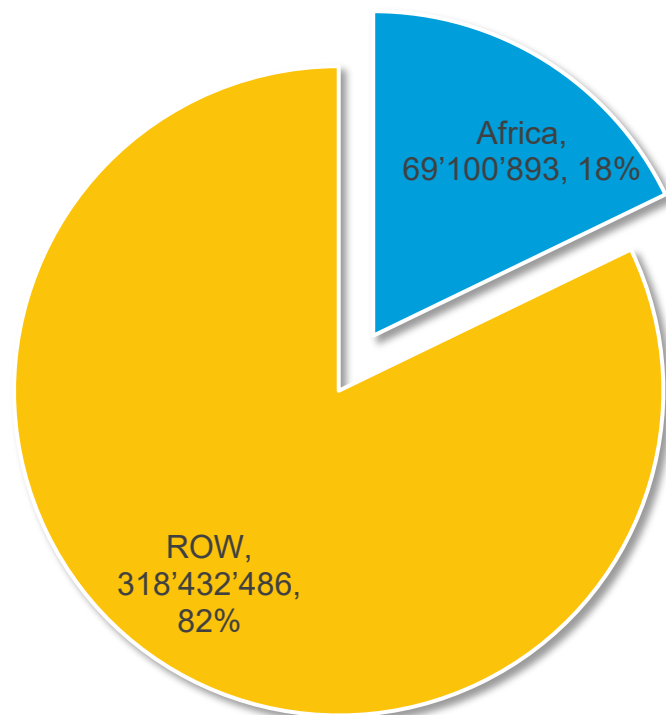


Cross-border trade and informality



The AfCFTA aims to expand intra-African trade, which only accounted for 18% of total recorded African exports in 2020.

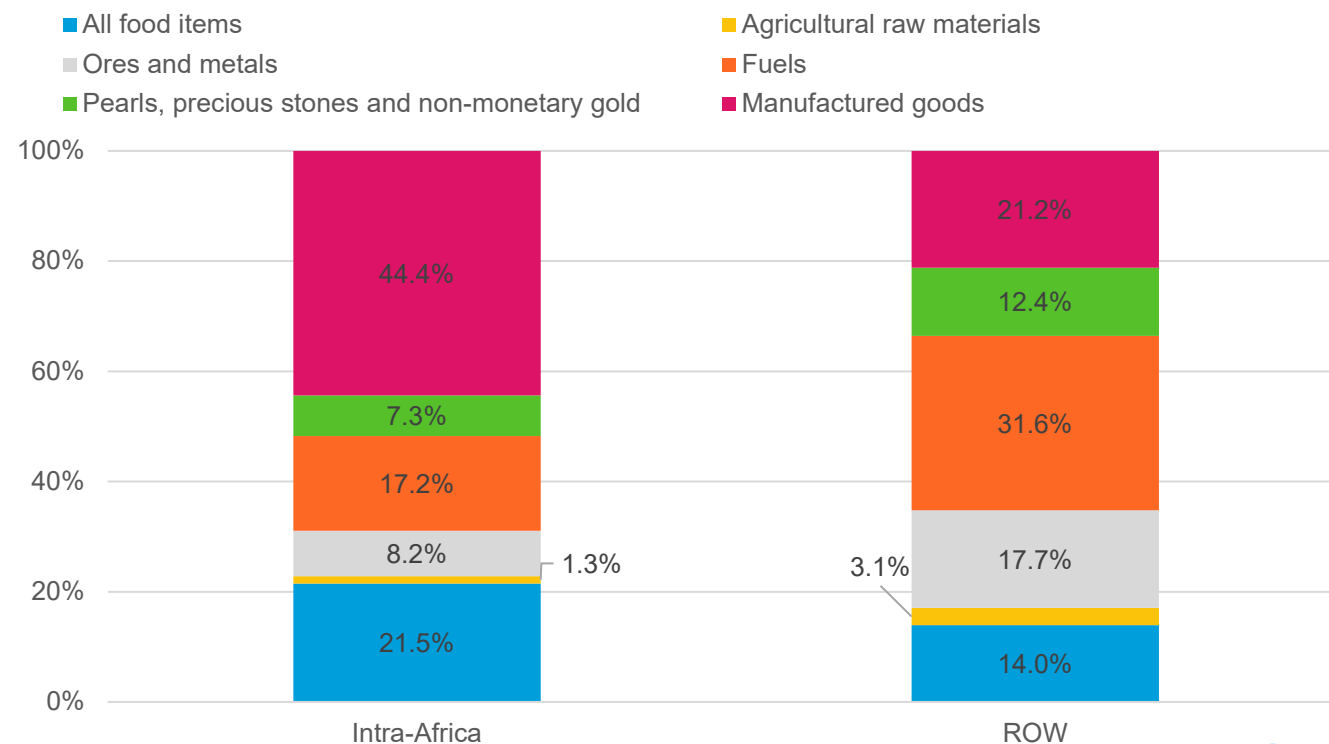
Share of total value of African merchandise exports, intra-Africa vs rest of world, 2020



Values: US\$ thousands

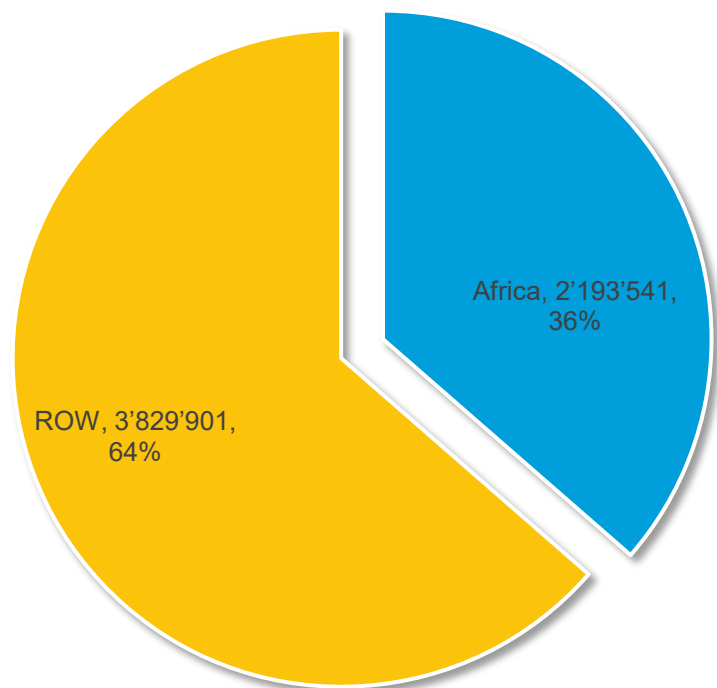
Source: UNCTADStat, <https://unctadstat.unctad.org/>.

Share of total African merchandise exports, by product group, intra-Africa vs ROW, 2020



More than a third of recorded Kenyan exports go to African countries, comprised mainly of manufactures and food items.

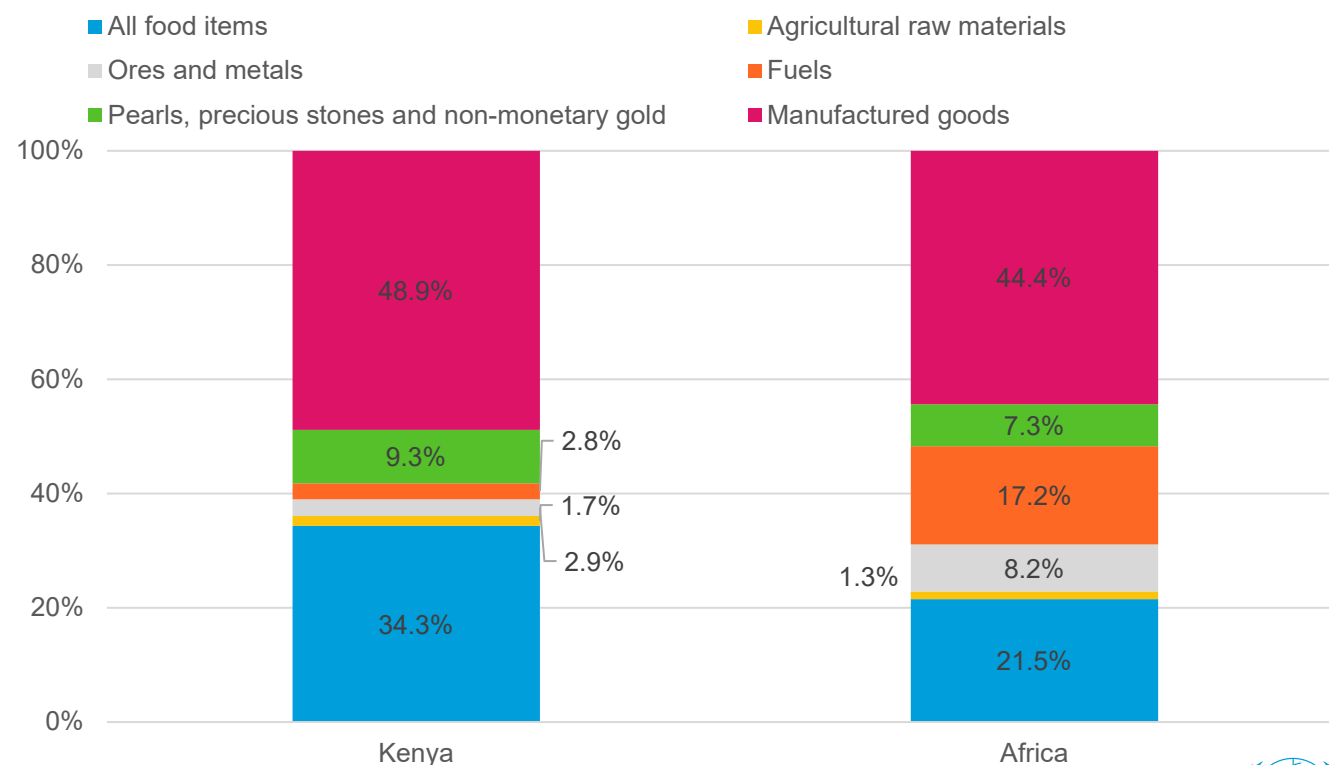
Share of total value of Kenyan merchandise exports, intra-Africa vs rest of world, 2020



Values: US\$ thousands

Source: UNCTADStat, <https://unctadstat.unctad.org/>.

Share of intra-African merchandise exports, by product group, Kenya vs Africa, 2020



Informal trade is prevalent in intra-African flows, with important impacts on trade and socioeconomic outcomes.

Example definition:

- Exports and imports of **legal goods and services** that trading countries fail to record or record incorrectly.
- Informal cross-border trade refers to the **flows**, not the trader, since both registered and unregistered traders engage in informal trade.

How:

- Avoiding official customs posts when transporting physical goods across borders.
- Misreporting (misinvoicing) the value or other details of declared cross-border flows.

Who:

- Predominantly micro and small enterprises, registered or unregistered.
- Women comprise an estimated 70-80% of informal traders in SSA.
- Lower education levels are more common, but participation among higher levels is growing.
- Traders are typically fully aware of relevant customs rules and procedures.

The magnitude of informal trade among some countries means reported trade flows and balances may not reflect reality.

What:

- Informal cross-border trade involves a variety of goods: staple food commodities, intermediate goods for industrial processing, e.g. textiles, low-quality consumer goods
- These distribution chains often channel informal trade in legal goods, alongside illegal goods, such as adulterated and fake goods, or those produced or obtained illegally.

How much:

- Prevalence and composition of informal cross-border trade varies by REC, country and border area, and by flow (import/export), for example:
 - Informal exports of food items represent an estimated 30% or more of total cross-border trade in West Africa and in the Horn of Africa.
 - Informal trade on the Kenya-Uganda border, mainly in agricultural commodities, represents an estimated 80% of official flows.
 - Informal trade represents an estimated 30-40% of total intra-regional in SADC and 40% in COMESA.
- As a result, official statistics for intra-African trade are often underreported, especially for food.

Despite its disadvantages, informal trade fills important gaps in the formal economy in Africa...

Advantages

Disadvantages

Traders

- Lower barriers to entry
- Reduced transaction costs
- Source of livelihood for women, youth, marginalized groups and the underemployed

- Difficulty accessing credit, skilled labour and other formal markets / services
- Ineligibility for social protection and government contracts
- Risk to personal safety
- Lack of protection under the law

Society

- Food security
- Lower prices on some goods
- Rational response to failures in formal markets and burdensome official procedures

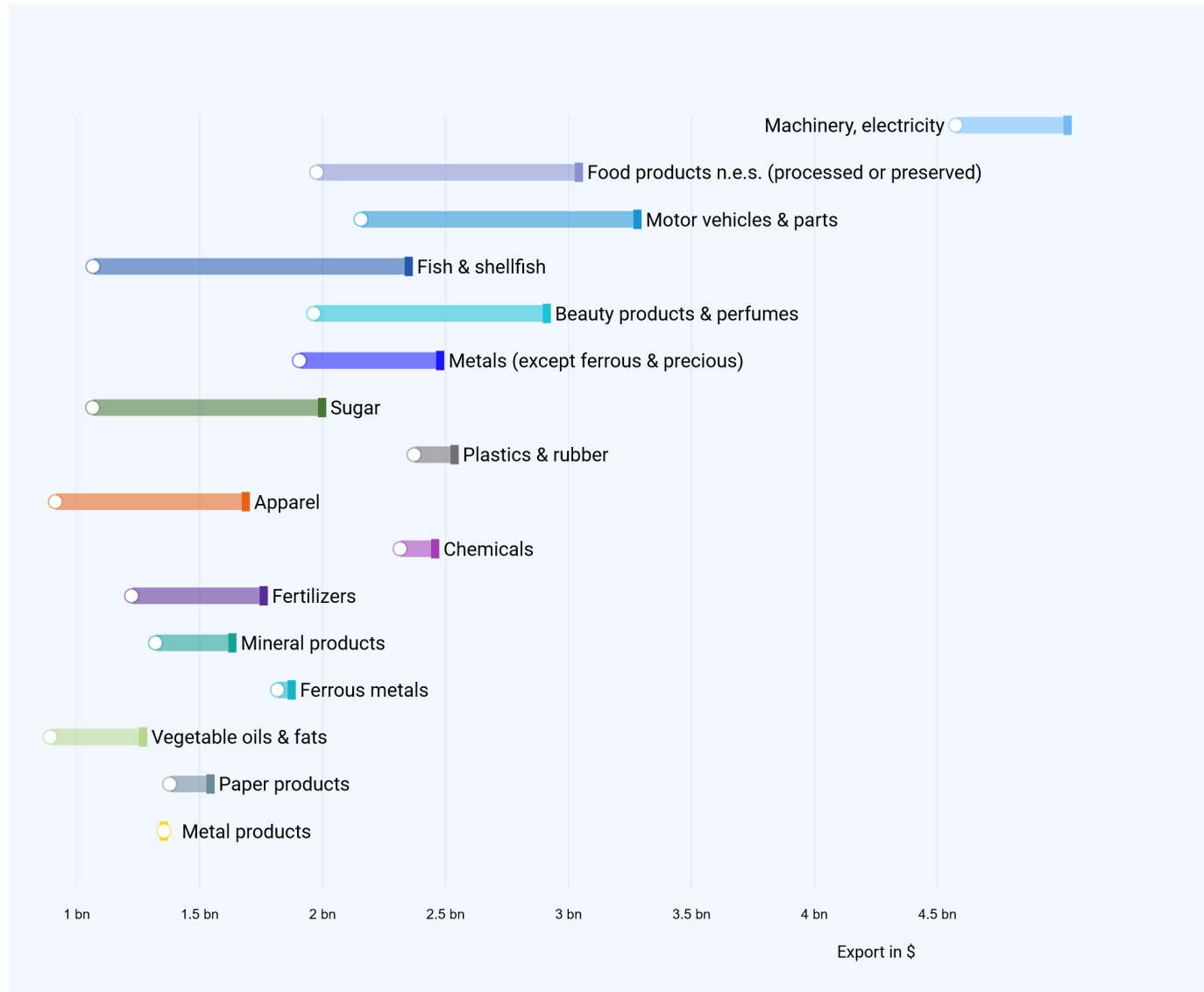
- Associated with increased corruption
- Data gaps on actual trade flows
- Difficulty in enforcing product and labour standards
- Lost tax revenue
- Unfair competition with formal, tax-paying firms

... so policies should focus on creating incentives to found formal enterprises, rather than on eradicating informal ones.

Capitalizing on new productive opportunities under AfCFTA



Under current tariff levels, estimated intra-African export potential is \$21.9 billion, led by vehicles, food and fish products.

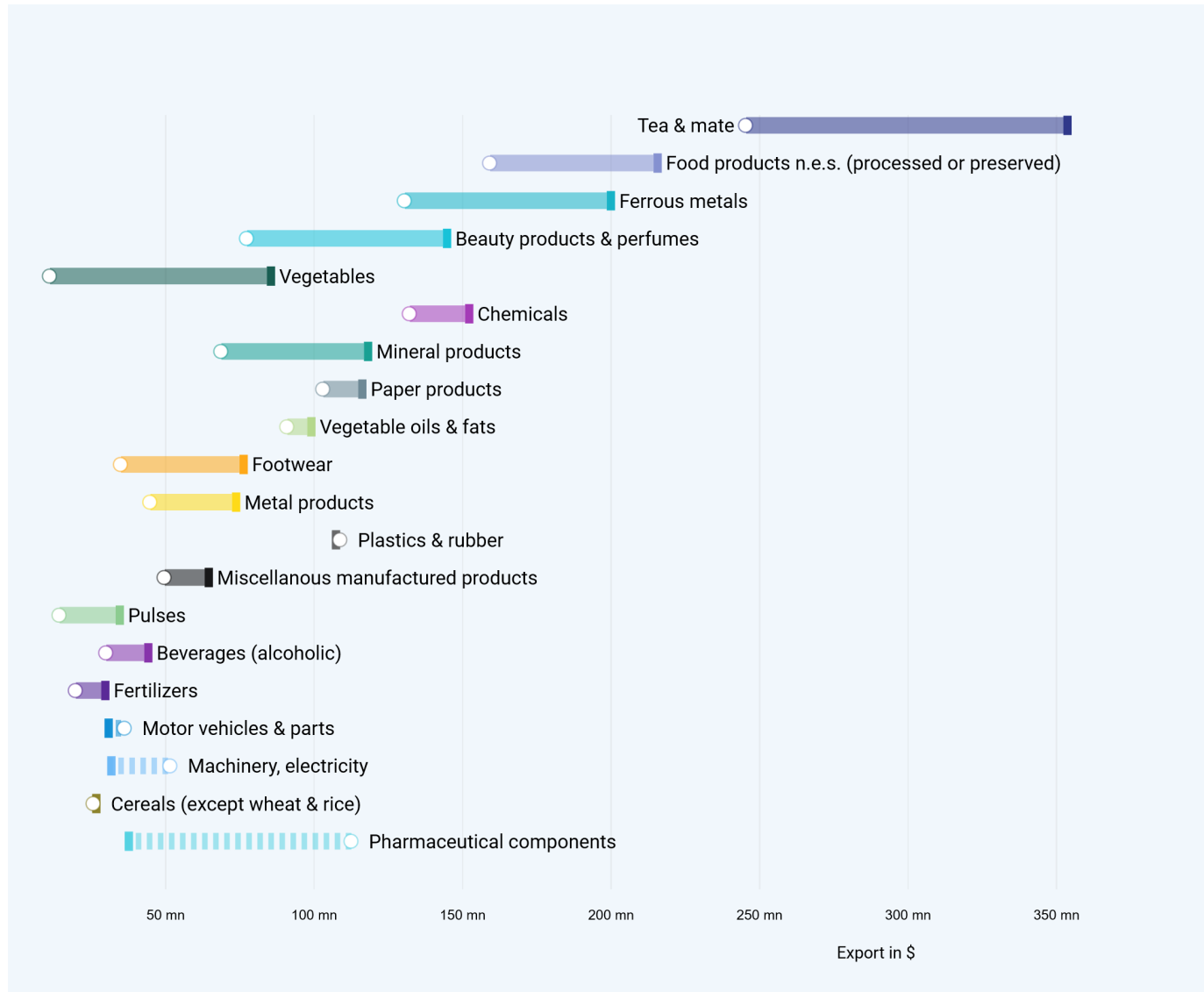


Africa's products with potential to Africa

Legend

- Export potential
- Actual exports
- Potential to actual exports gap
- Machinery, electricity
- Motor vehicles & parts
- Food products n.e.s. (processed or preserved)
- Beauty products & perfumes
- Plastics & rubber
- Metals (except ferrous & precious)
- Chemicals
- Fish & shellfish
- Sugar
- Ferrous metals
- Fertilizers
- Apparel
- Mineral products
- Paper products
- Metal products
- Vegetable oils & fats

Kenya's greatest intra-African export potential lies in processed tea, food and metal products .



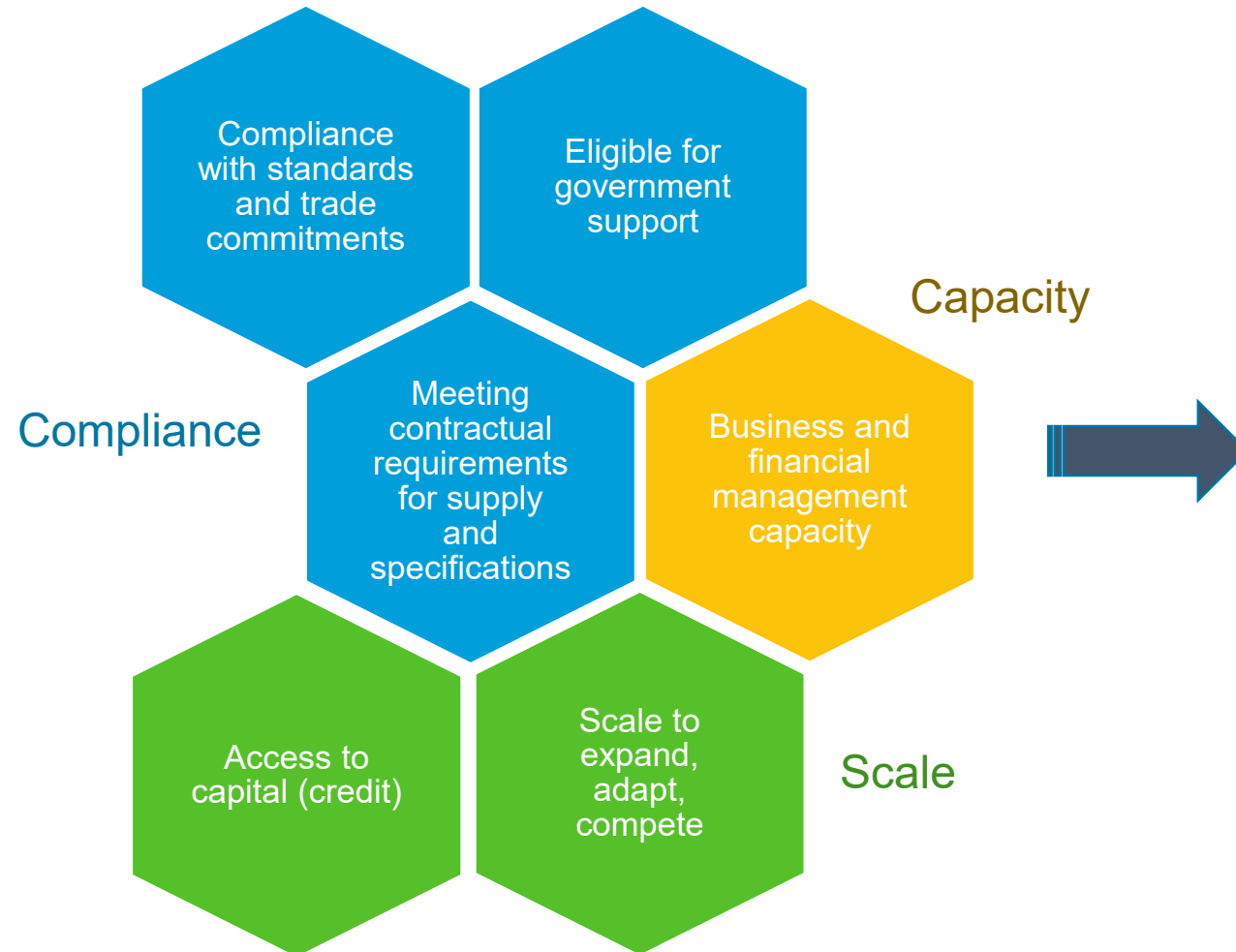
Kenya's products with potential to Africa

Legend

- Export potential
 - Actual exports
 - ◌ Potential to actual exports gap
- Tea & mate
 - Food products n.e.s. (processed or preserved)
 - Ferrous metals
 - Chemicals
 - Beauty products & perfumes
 - Mineral products
 - Paper products
 - Plastics & rubber
 - Vegetable oils & fats
 - Vegetables
 - Footwear
 - Metal products
 - Miscellaneous manufactured products
 - Beverages (alcoholic)
 - Pharmaceutical components
 - Pulses
 - Machinery, electricity
 - Motor vehicles & parts
 - Fertilizers
 - Cereals (except wheat & rice)

Capitalizing on RVC opportunities will flow through formal trade channels, favouring registered medium and large enterprises.

Selected firm requirements to participate in RVCs



Firm characteristics

- Medium to large scale enterprise
- Registered business, compliant with trade and tax regulations
- Meets minimum legal and financial eligibility for credit and/or equity financing
- Professional management

Gaps and recommendations



Gaps and recommendations

Business and trade facilitation

- **Gap:** Where entrepreneurs and traders face high transaction costs to obtain land, energy, credit and permits, informality will continue to flourish.
 - **Recommendation:** Reduce delays and costs to register a business, obtain land, export and pay taxes and, where possible, deliver these procedures through one-stop government offices.
 - **Recommendation:** Consider a harmonized tax – one payment for VAT, employment and income taxes – for small-medium businesses.
 - **Recommendation:** Create incentives for small enterprises to connect to the electrical grid, for example through grants and deferred payments.
 - **Recommendation:** Leverage ICT for official procedures.
- **Gap:** Implementation of facilitation programmes is often concentrated in Nairobi, limiting their effectiveness on firms and trade flows on border areas.
 - **Recommendation:** Continue to roll out and expand relevant “one-stop government” offices and services in border areas.

Gaps and recommendations (continued)

Formalization

- **Gap:** A focus on informal trade's disadvantages can lead to negative policies that seek to curtail informal trade, ignoring the underlying drivers of informality and the societal benefits it provides.
 - **Recommendation:** Use a “carrot”, not “stick” approach, focusing on creating incentives to create a formal business and declaring trade flows.
 - **Recommendation:** Develop a package of benefits associated with formalization, including, for example: access to social protection, government support and contracts, and credit – and actively promote them in the trading sector.
 - **Recommendation:** Foster the formation of associations of cross-border traders to advise policy makers.
- **Gap:** Informal business, trade and employment are linked, but policies are often uncoordinated.
 - **Recommendation:** Harmonize enterprise and employment formalization policies, for example by linking business registration with employee access to social protection programmes.

Gaps and recommendations (continued)

Business environment

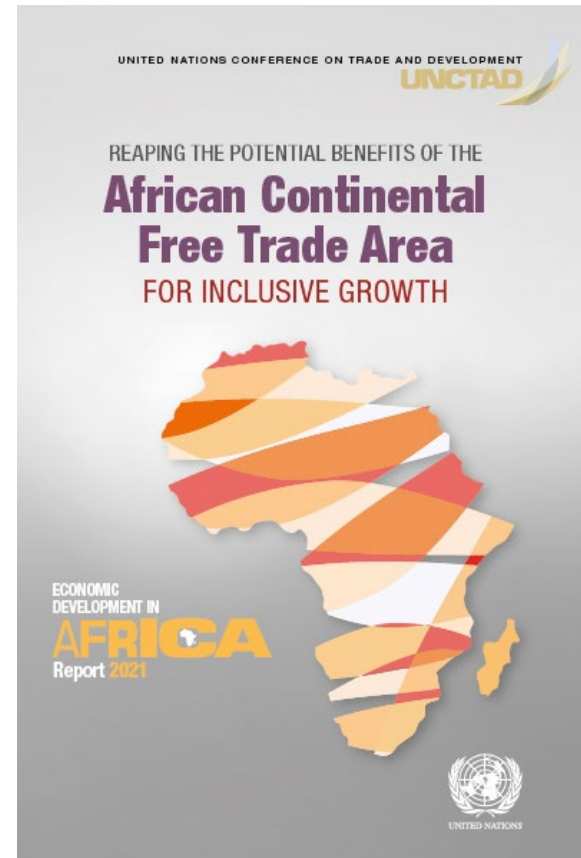
- **Gap:** Corruption in bureaucratic procedures and at the border continue to drive up transaction costs and drag down confidence among investors, entrepreneurs and marginalized groups who resort to informality.
 - **Recommendation:** Strengthen the budgets, independence and legislative tools for anti-corruption efforts at the border, revenue and enterprise development authorities.

Enterprise development

- **Gap:** Kenya has a vibrant private sector, but with a preponderance of micro and small enterprises that lack the managerial capacity to grow and compete in RVCs.
 - **Recommendation:** Provide capacity-building training and materials on business, financial and quality management and, where possible, coordinate their delivery with business registration and other enterprise development programmes.

For more on potential productive opportunities under the AfCFTA, see the Economic Development in Africa Report 2021.

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Thank you!

