Non-tariff barriers and regional integration in the East African Community

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- We conducted surveys with a representative sample of over 1,500 traders in markets near the Kenya-Uganda border, as well as a census of border clearing agents, before and during the COVID-19 pandemic.
- Larger traders are more likely to engage in cross-border trade, likely because the fixed costs of trade barriers mean that per-unit costs fall heaviest on smaller traders.
- Fees and non-tariff barriers at the official border encourage substantial informal border crossing.
- Reforms to reduce non-tariff barriers, especially the fixed costs that fall heavily on small traders, may encourage more formal cross-border trade, increasing competition and raising government revenues.

POLICY BRIEF 43441

FEBRUARY 2022

This project was funded by IGC Uganda

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Introduction

In recent years, the East African Community (EAC) has instituted several changes in regional trade policy. These include the introduction of a common market, the One Stop Border Post (OSBP) procedures, and the single-window policy, a simplified trade regime clearance procedure for small traders. These reforms are generally targeted at simplifying the process of clearing the border, with a goal of reducing non-tariff barriers (NTBs) and facilitating greater trade within the region.

NTBs may be particularly prohibitive to small traders, as the hassle and costs of clearing the border may not be worth the profit they would make from trading small volumes of goods. This can have two effects. First, it may unintentionally concentrate market power at the border, which can influence the degree of competition in domestic markets within each country. Second, it may encourage small traders in particular to engage in informal or illegal border crossing, which not only reduces formal customs revenues, but also requires traders themselves to incur the additional costs and risk of informal trade.

This brief presents lessons learned from two studies that investigate trade, NTBs, and informality within the EAC, with a particular focus on goods traded between Kenya and Uganda.

Overview of the research

In the first study (Bergquist, Grant, and Startz 2021), we collected surveys from 518 agricultural traders located in Kenyan markets within 30 kms of the Kenya-Uganda border (primarily the Malaba and Busia border crossing points). A majority of traders found in these markets are small and medium size, transporting foods by foot, bicycle, motor- bikes, or small carts. Some traders moved goods only within Kenya (domestic traders) and others moved goods across the border (international traders, who primarily import goods from Uganda into Kenya). We complemented this data with surveys of 77 clearing agencies that have emerged to help traders navigate this border clearing process. We surveyed both officially registered agencies and unregistered freelance or "briefcase" agents. In these surveys, we asked both traders and agencies about their revenues and costs, barriers faced during cross-border operations, and the kind of services the clearing agents offer in an attempt to mitigate these barriers.

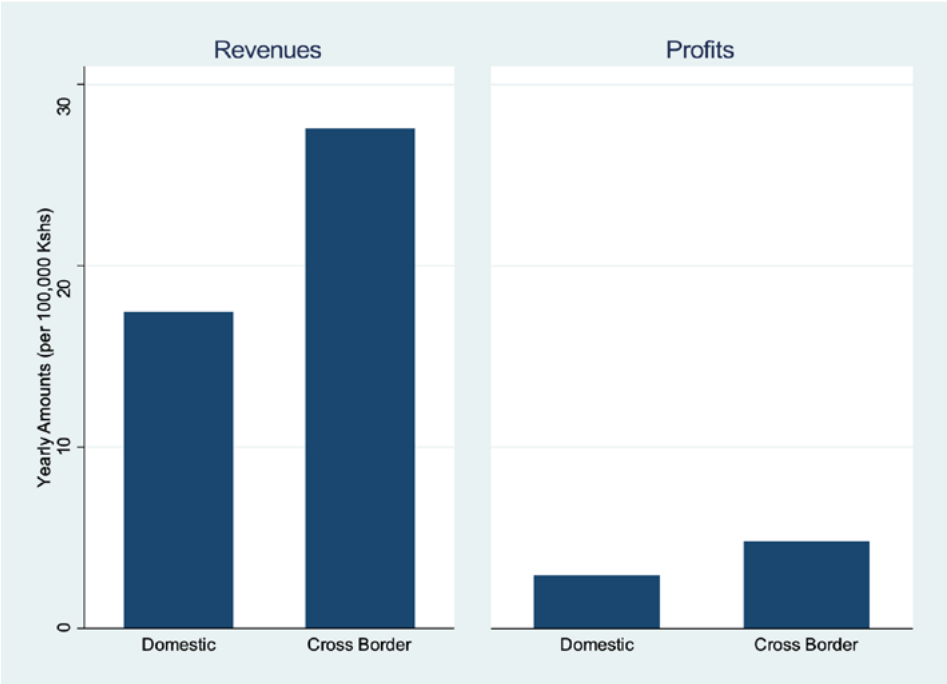
In the second study (Wiseman 2021), we collected high frequency data from a representative sample of 1,100 small-scale traders located in Kenyan markets situated within 40 kms of the Kenya-Uganda border. This project focuses on traders who either trade agricultural goods (grains, vegetables, fruit, fish) or shoes and clothing. Traders either trade domestically (45 % of traders at baseline) or cross the border to source their goods in Uganda (cross border traders - 55 % of the sample at baseline) through official or informal border crossings. The panel includes over 15 rounds of surveys from February 2020 to the end of 2021, including a period where trade restrictions were imposed in response to the COVID-19 pandemic. The project takes advantage of

this large shock to reveal behaviours about traders and gain insights into how traders and markets adapt. The findings outlined here focus on February 2020 to February 2021[1].

Finding 1: Larger traders are more likely to engage in cross-border trade

About 69% of traders in our sample have engaged in cross border trade at least once in the past year, while 31% are purely domestic traders. We find that those who engage in cross-border trade tend to be younger and located closer to the border, though we find no differences by gender or access to cell phones (perhaps because access is fairly ubiquitous). Most starkly, we find that traders who engage in cross-border trader tend to be larger, in terms of both revenues and profits. For example, cross-border traders

Figure 1: Cross border traders are larger



Note: The p-values for a t-test of difference in means are 0.051 for Yearly revenues and 0.014 for Yearly profits.

Finding 2: Trade barriers fall heaviest on small traders

What explains the fact that larger traders are more likely to engage in cross-border trade? We find evidence of economies of scale in both transport and border crossing costs. Table 1 summarises the processes at the official border crossing for cereals, as reported by our interview subjects. The top panel describes each step, along with the time and fees associated with completing that step. The bottom panel presents, for each mode of crossing the border, which steps are required. Note that the process for clearing goods at the official border crossing can

1 1A RCT focused on the role of information in reducing trade costs was carried out in April 2021.

Table 1: Process for clearing the border

Steps	Contract clearing agent	Obtain passed clearance entry	Obtain EAC simplified certificate of origin	Obtain exit note	Obtain KEPHIS release	Obtain National Biosafety Authority release	Obtain port health/public health services release	Obtain KEBs release	Obtain KRA release	Obtain KRA final release	Agency follow up on bond
Duration	Depends on negotiations	1-2 Days	5 mins max	5 mins max	10-30 mins	10-30 mins	10-30 mins	5-20 mins	5-30 mins	5-10 mins	1-2 days
Fees (Ksh)	2000 commission for agent (negotiable). Client pays all other expenses	10,000 - 15,000 (bulk) 8,000 (single)	10 (purchase a copy of the form)	0	22.5 for > 10,000 90Kg bags 42 for <10,000 90Kg bags	1,000 (flat statutory fee)	1,000 (flat statutory fee)	6,200 (flat statutory fee)	Fees: 0	Fees: 0	Fees: 0
Mode of clearing the border											
Indirect assessment using clearing agent (>USD 2,000)	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No
Direct assessment (< USD 2,000)	No	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No
Mamas/Bicycle Boda Bodas Aaggregating	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No
Mamas/Bicycle Boda Bodas to Busia kenya (N.B pay about 65 Ksh per bag to police as bribe	No	No	No	No	No	No	No	No	No	No	No
Transit	Yes	Yes	No	Yes	No	No	No	No	Yes	Yes	Yes

be done by either the trader or an agent. For goods worth more than $2,000, the trader must use a registered clearing agent. For goods under $2,000, there are several options for the trader. The trader can clear the goods by himself or using an agent (a process called "direct assessment"). Alternatively, a good number of small traders choose to carry their goods on bicycles ("boda bodas") either to aggregate on the other side of the border or to sell as retail directly in the border town of Busia, Kenya.

Border costs appear to be small relative to other costs such as purchasing stock and transportation, although they are larger with respect to profit margins. Tariffs and taxes account for less than 1% of total costs. Other related costs, including corruption and/or border facilitation fees, account for less than 1% as well.

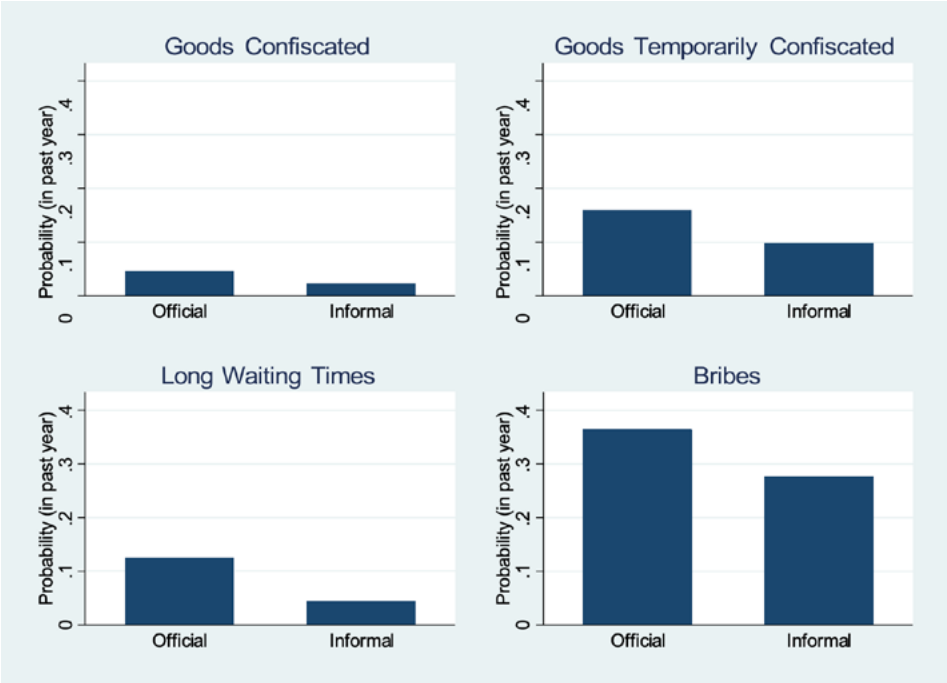
However, we do see that these costs fall disproportionately on smaller traders. Many of these costs are "fixed costs," which do not scale with the volume traded, and which may therefore be prohibitive for smaller traders. There are also advantages for larger traders when working with agencies to facilitate trade, as these agencies offer dis- counted pricing for large quantities traded. For maize, for example, the average agency charges 82 KSh per bag to facilitate the crossing of 60 bags, 41 KSh per bag for transactions of 120 bags, and 16 KSh per bag for transactions of 300 bags. Therefore, on a per unit basis, the cost of border crossing falls heaviest on smaller traders.

Finding 3: Fees and barriers at the border encourage informal border crossing

Informal trade is very common. Out of the 69% who are cross-border traders, 25% of them mainly cross the official border while 75% prefer using the non-official border crossings. In addition to avoiding official fees such as taxes and tariffs, informal crossing points also offer the benefits of reduced non-tariff barriers, including shorter waiter times and less frequent good confiscation (though many crossing at informal points do pay a "facilitation fee" to local police), as shown in Figure 3.

Who engages in informal cross-border trade? Those who reside close to the border are more likely to engage in informal border crossing, but we see no significant differences by gender or years of experience. The largest traders use office border crossings, while medium and small traders often avoid barriers at the border by using informal crossings.

Figure 3: Comparison of official and informal border barriers



Note: The p-values for a t-test of difference in means are 0.257 for Confiscated goods, 0.110 for Temporarily confiscated goods, 0.008 for Waiting times and 0.120 for Bribes

Finding 4: Pandemic-related trade restrictions had different effects on different types of traders

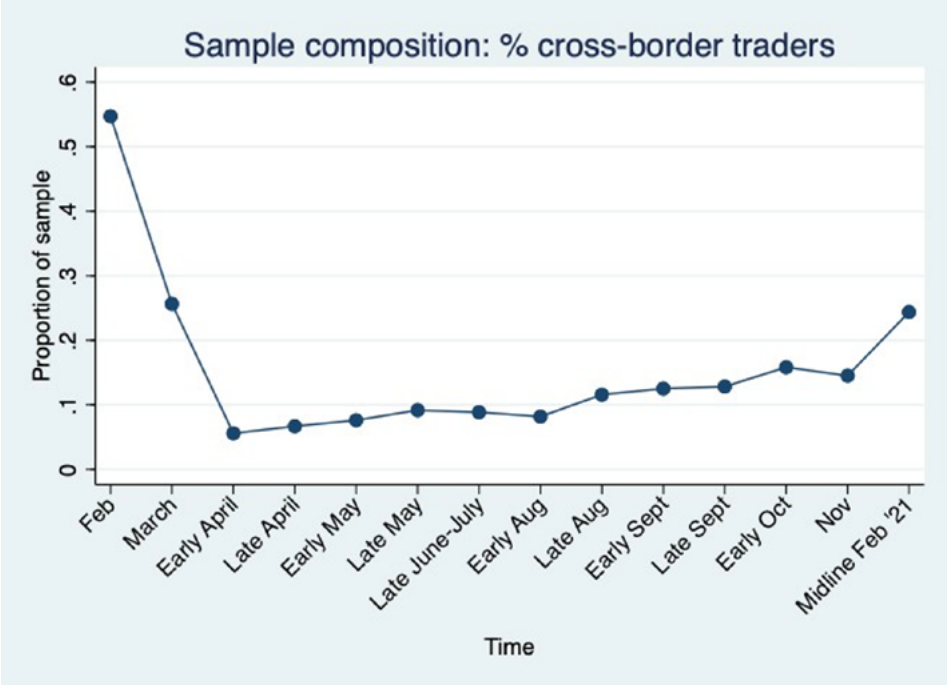
Small-scale traders could no longer cross the official border due to the closure imposed between April and October 2020. This affected traders and forced over 20% of traders to shut down their business. Sales and profits also suffered during the first few months of the restrictions with average sales falling by 37% and profits by 54%. For most traders, the shut-down was short term and traders recovered within a few months. Indeed, by the end of 2020, 90% of traders in the sample report being in business.

Traders are differentially affected by these trade restrictions. For example, traders' decline in profits disproportionately affected women who continue to have lower profits and recover more slowly than men, despite the fact that women are more likely to stay in business.

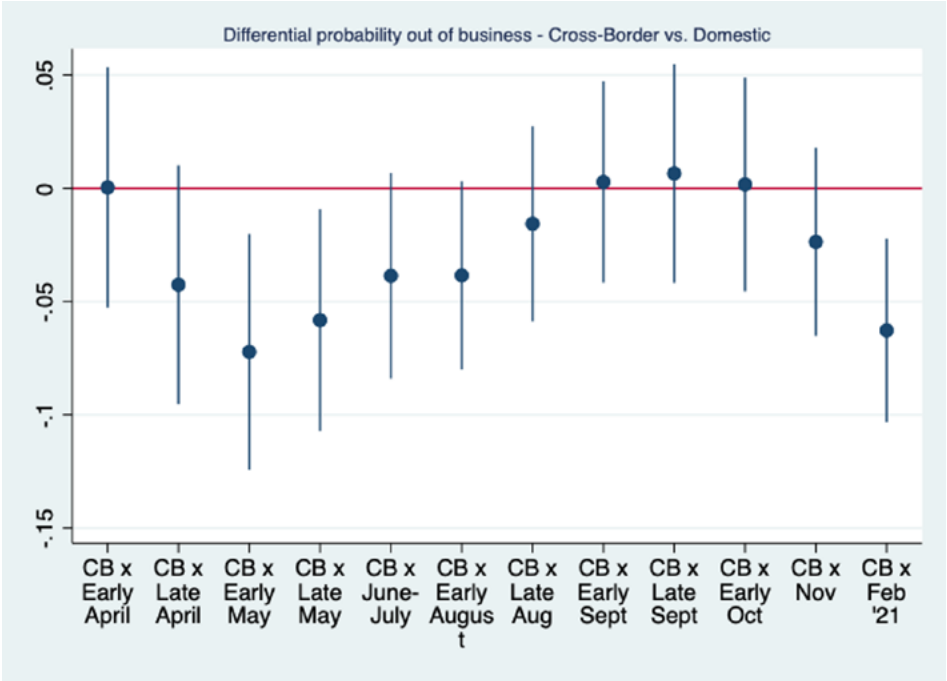
Variations in resilience also rely on traders' ability to find new supply chains and/or new trade routes. The closure of the official border creates a significant disruption for cross border traders' supply chains as they can no longer reach international suppliers. Whereas 55% of traders were cross-border traders in February 2020, only 6% remain in April and 15% in November 2020 (Panel a of Figure 4). This shift, however, is not due to cross-border traders going out of business, but instead from switching to domestic suppliers. Despite having to find new suppliers, cross-border traders (CB) are less likely to be out of business compared to domestic traders (Panel b of Figure 4) as they switch todomestic suppliers, potentially crowding out initial domestic traders.

Figure 4: Cross border traders are less likely to be out of business as they switch to domestic suppliers

A) Significant drop in cross border traders



B) Cross border traders are less likely to be out of business



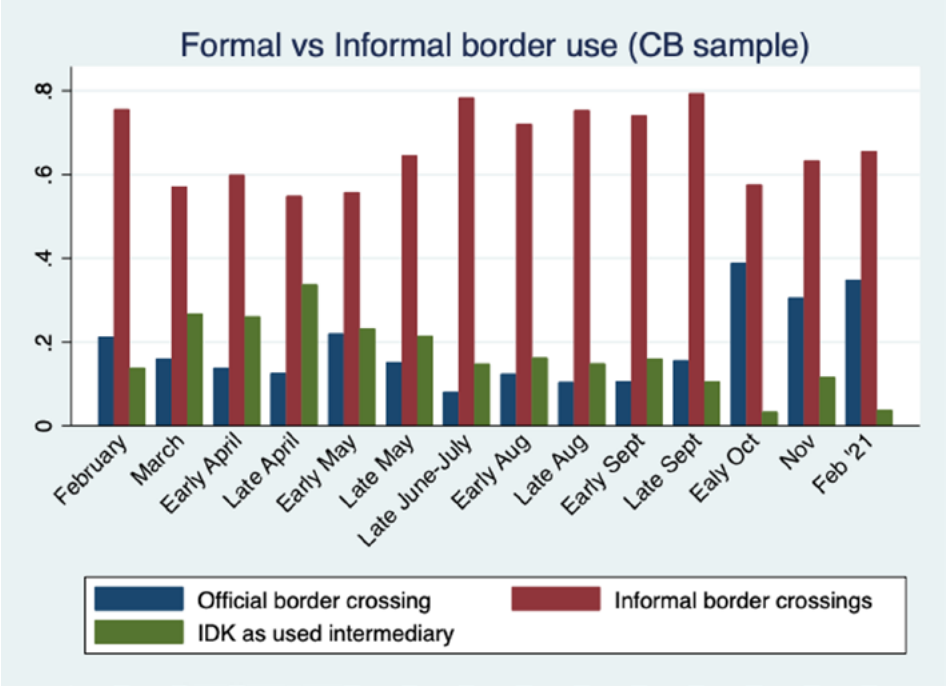
Finding 5: There are large inter-dependencies between formal and informal trade

A majority of cross border traders in the sample at baseline (63%) used informal routes, usually located on either side of the official border post. This allows them to avoid taxes and tariffs, quality control, and other bureaucracy required at the official border posts. Trading through informal routes, however, doesn't eliminate all border costs. Police officials have strategically positioned themselves at the main informal

crossings to collect bribes against passage. Bribes paid vary by quantity of goods transported, by type of goods, as well as by trader.

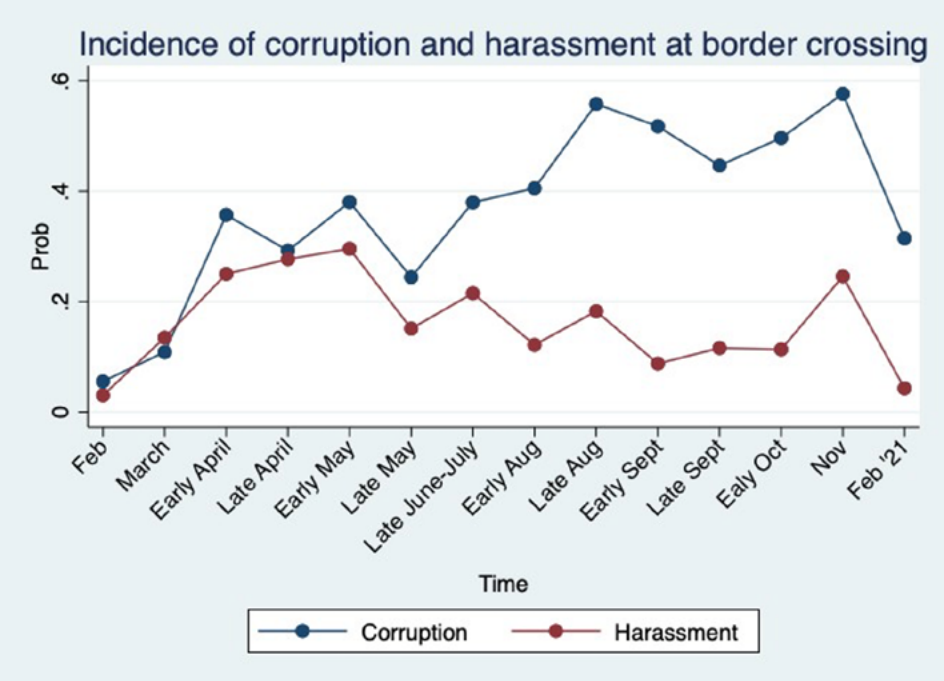
After the closure of the official border crossing, traders who opt to continue to cross the border switch to informal border crossings. Figure 5 shows that traders rely increasingly on informal trade routes: informal border crossings were used 1.8 times more com- pared to official border crossings at baseline, compared to 6 times during the closure of the official border. The pattern for trade flows is similar. Informal trade enables some cross-border trade to continue, despite border restrictions. The increased reliance on in- formal trade due to the closure of the formal crossing can be related to an elasticity of informal trade with respect to formal tariffs: changes in border costs at the formal border will not only have consequences on formal trade flows but also affect informal trade.

Figure 5: Formal vs Informal border use: cross border sample



There is also evidence of inter-dependencies in the costs incurred along formal and informal trade routes. Closure of the official border not only pushed traders toward informal crossings, but also affected the costs of using them. Costs at informal border crossings take the form of bribes. The incidence of harassment increased from 3% to 30% after the border closure, the incidence of corruption increased from 6% to 38%, and the level of bribes more than a doubled. With the closure of the official border crossing, traders lose one of their main outside options, increasing the police's bargaining power to request higher bribes, more often (Figure 6).

Figure 6: Incidence of corruption and harassment increase with closure of official border



Policy implications

- **Targeting NTB policies at smaller traders – or simply reducing the fixed costs associated with border-crossings – may encourage greater entry by smaller traders into international trade**

  We see that it is the larger actors who engage in cross-border trade. Consistent with this, we see evidence of the existence of fixed costs associated with border crossing. This suggests that policy reforms designed to lower the fixed costs associating with crossing the border have the potential to increase entry by smaller traders into cross-border trade, which might in turn increase competition among these traders.

  Several such policies have been implemented in recent years. For example, the Simplified Certificate of Origin is a trade facilitation document that was introduced in 2007 for clearance of goods that have been grown or produced in the EAC partner states and whose value is less than USD 2,000. In the EAC, 370 products currently qualify for clearance through the simplified certificate of origin. Reforms such as these may be useful in offsetting the disproportionate burden of the fixed costs of border crossing that otherwise falls heavily on small traders.

- **Reducing NTBs may encourage greater formal border crossing and therefore raise government revenues**

  Unnecessarily complex or inefficient border policies may discourage cross-border trade or push those who do engage in this trade into informality. Both represent losses to potential government revenue.

Simplifying border crossing procedures, including reducing wait times, may encourage greater formality in cross-border trade. Initiatives such as the introduction of the One Stop Border Post program, which is designed to reduce these wait times, may be of use here.

- **Take into account the existence of informal trade when designing policies**

  It is crucial to include informal trade and traders in the picture when designing trade policies or reforms. Trade facilitation policies therefore should include policies both targeted at formal and informal crossings. Moreover, when considering policies, it is important to take into account that changes targeted at official crossings will have spillover effects on informal crossings (and vice versa). For example, raising tariffs at official border crossings may also affect the level of corruption at informal crossings.

- **Small-scale traders have unique features that require separate consideration**

  Many small-scale traders operate on foot and have very different business models than large-scale truck traders. In most developed economies, there is separation between goods and people, which allowed governments to impose restrictions on people's mobility during the COVID-19 pandemic with limited impacts on the mobility of goods. However, in the EAC, this separation is not as clear cut. Closing official borders to people while keeping them open to trade vehicles had a substantial impact on trade while people continued to move across informal border crossings.