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# Trade facilitation and formalisation of trade

## Evidence from OSBPs in Uganda



### In brief:

- Trade costs in East Africa remain high, weighing on regional trade. Many engage in informal cross-border trade (ICBT) to avoid these high trade costs. ICBT is substantial. In Uganda, informal exports to its neighbouring countries are estimated to be equal to 38 percent of formal exports to these countries.
- This study examines what happens when trade costs are reduced, through the introduction of a border facility – a One Stop Border Post (OSBP) – which is aimed at reducing delays and corruption.
- The findings revealed through an original dataset of 876 traders collected at two border towns between Uganda and Kenya suggest only 5% of traders have switched their main border-crossing route since the introduction of the OSBP. A quarter of the respondents who cross the border informally suggest that they would stop trading if the official border post were the only choice of route.
- There are factors beyond official taxes that affect the prevalence of informal trade. Male traders and those who trade perishable products are more likely to trade informally. Other trade facilitation measures also matter, such as whether traders have participated in training sectors, and their knowledge of the Simplified Certificate of Origin.

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## Method

This study examines whether formalisation of trade can be achieved through a reduction in trade costs incurred at the official custom points. The vehicle for the reduction of official trade costs is the establishment of One Stop Border Posts (OSBPs). By combining two custom points into one single border facility, OSBPs are constructed with the aim of achieving speedier border crossings and less corruption (TMEA, 2016). I investigate whether the introduction of this type of trade facilitation can lead to a greater formalisation of trade between Uganda and its neighbours.

I test this relationship empirically in two steps with two data sets. Firstly, I use the existing ICBT survey data collected by the Ugandan Bureau of Statistics and the Bank of Uganda, and exploit the spatial and time variation across custom points of then introduction of One-Stop-Border-Posts (OSBPs). Guided by an augmented gravity model, in which I include informal trade, I use a generalised difference-in-difference estimation to examine whether the quarterly ratios of informal trade-to-total trade between Uganda and its neighbours at a certain border post change after an OSBP is introduced.

I then gather primary data to understand the factors influencing traders' border crossing routes and their trading activities after the introduction of the OSBP. A random sample was drawn from a census of 4757 shops and stalls conducted immediately before the survey was undertaken. I analyse responses from 876 traders.

## Key findings

- More than a third of cross-border traders who cross through the official customs office have reported a reduction in their border crossing times since the introduction of the OSBP. Survey results also suggest that border-crossing times have higher variance at informal border crossings compared to official customs.
- By comparing border posts which have introduced an OSBP to those that have not, preliminary results show that the informal-to-total trade ratio has decreased during the specific quarter in which the OSBP has been introduced, but there is a lack of evidence suggesting this effect persists in the next quarter.
- Trader-level data reveals that hardly any cross-border traders have changed their main border crossing route since the introduction of the OSBP. Only five percent reported switching route. Of that, less than three quarters switched from an informal border crossing to the official border post. The main reason for switching was because the other border crossing became too dangerous; other reasons included better facilities and lower costs incurred at the official border post.
- 19 percent of cross-border traders stated that they would not switch their border-crossing route for any amount of money. A quarter of them declared that they would cease trading if they could only trade through the official customs office.
- Although official taxes play a role, they do not entirely explain the choice of route used by cross-border traders: male traders and those trading perishable goods tend to cross through the informal border-crossing.
- Participation in other types of trade facilitation, namely training programmes run by various agencies, and having the knowledge of the Simplified Certificate of Origin (SCOO) is positively associated with the decision to trade formally. But not all cross-border traders who know about the SCOO will always use it: some never use it and some only use it occasionally. Over half of those who know about the SCOO continue to use the informal border crossings as their main trading route. Nevertheless, nearly all traders report that custom officers have accepted their SCOO without any problems.
- There are multiple agents involved in receiving payments from traders at both the formal and informal border crossings. Informal payments are present at both border points.

- The size of informal payments is higher for female compared to male traders. More generally, those who are trading perishable products also tend to be subject to higher payments.

## Policy recommendations

The number of OSBPs being planned and constructed has grown markedly over the past five years and much donor money has been invested into them. The project value of just one OSBP at Busia – a border town between Uganda and Kenya – was US\$1.25 million (TMEA, 2016). 80 OSBPs are being planned, built, or are in operation across sub-Saharan Africa (Tralac, 2016).

Results have indicated that a significant proportion of traders have benefited from the OSBP through reduced delays at customs. Other trade facilitation measures that were implemented such as providing training and having the knowledge of the Simplified Certificate of Origin are positively associated with the formality of trade. The procedure of completing the Simplified Certificate of Origin may need to be further simplified considering that, even those who do know of it, choose not use it all the time. Some of these individuals continue to prefer the informal border crossing as their main border-crossing route.

The short term impact of the introduction of an OSBP on formalisation of trade points to the persistence of trade informality. This could mean that total regional trade (the sum of both formal and informal trade) might shrink if formality is abruptly and stringently enforced. The potential loss of traders, and a potential reduction in the flow of goods (particularly staples), has important implications for the welfare of not just the traders themselves, but also for regional food security and the region's vulnerability to external shocks.