

# Informal Cross Border Trade between Ethiopia and its Neighbors: Origin, Magnitude, Determinants, and its Implications for Socio-Economic Development

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## Executive summary

Informal cross-border trade refers to trade in legitimately produced goods and services, which escape the regulatory framework set by the government, as such avoiding certain tax and regulatory burdens. Informal trade thus refers to goods traded by formal and informal firms that are unrecorded on official government records and that fully or partly evade payment of duties and charges. Informal cross-border trade (ICBT) is a major component of the informal economy, and may exceed formal cross-border trade in value in certain African countries. As is the case for Africa, trade between countries in the Horn of Africa, the geographic focus of this study, is largely unofficial and unrecorded. Though Ethiopia trades both formally and informally with neighboring countries, its formal/official trade with its neighboring countries is tiny in magnitude and erratic in nature. On the other hand, ICBT is a pervasive economic activity in Ethiopia and across its porous borders. Hundreds of thousands of all types of livestock and bulk of coffee, vegetables and Khat originating from Ethiopia are smuggled to neighboring countries. Despite the various endeavors made to control ICBT, it showed expansion in terms of the items traded, areas covered and number of people involved. Such rapid growth of ICBT is seen as a threat to tax system, trade regime and the overall development of a country.

Proliferation of ICBT has important ramifications for tax and foreign exchange revenues, development financing and economic growth of the country. Considering the pervasiveness of the activity in Africa, some scholars argue that an assessment of regional trade in Africa cannot be complete without including informal cross-border trade among African countries. Illicit trading activities across Ethiopia's porous

border are widely viewed as invasive socio-economic perils deep-rooted in the trade regime. This study is motivated by the presence of rampant illicit trade activities outside the formal business activities in Ethiopia and the concomitant socio-economic implications, the limited success story, and importantly considerable gaps in the extant studies. Thus, this study sets out to explore the (overseas) origin, extent, pattern, and trend of ICBT between Ethiopia and its neighbors using evidence from multiple trading routes. Besides, legal, policy and institutional analyses of ICBT will be made. Lastly, by employing econometric modeling, it also intends to estimate and analyze the causes of informality of cross-border trade and assess its socioeconomic impacts on the Ethiopian economy.

To inform policy actions for or against ICBT and up scaling of Ethiopia's effort in controlling ICBT, it is important to scrutinize the major overseas origin of unofficially imported goods; and quantify the extent, causes and socio-economic benefits and costs of ICBT. While case studies are insightful, important policies may not be adequately drawn from separate case studies made at one or two trading routes/borders. In fact, providing evidence based justification and suggesting strategies on ICBT necessitates a detailed assessment of the dynamics of ICBT at national level. Therefore, this study will undertake a comprehensive study of ICBT between Ethiopia and its neighbors. The findings of this study would be instrumental in designing appropriate policies/strategies for the Ethiopian Customs Commission who oversees such type of trade. Since Ethiopian Customs Commission experts will participate in the study, the resulting outcomes are expected to be used by the government and implementation is expected to decrease the negative effects and maximize potential benefits of ICBT.

**Box 1: Summary of research components (*Sub-thematic areas*) and their respective objectives;**

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**Sub-theme I: ICBT in Ethiopia: Characteristics, Overseas Origin, Magnitude, and Pattern**

(Moti M\*, Tasew T., Kiflie W., Dawit H., Degu S.)

- ✍ To investigate the nature ICBT along trading routes
- ✍ To explore the origin and pattern of ICBT goods
- ✍ To estimate the magnitude and trend of ICBT

**Sub-theme II: Determinants of ICBT between Ethiopia and its neighbors: an econometric**

**analysis** (Tasew T\*, Kiflie W., Dawit H., Degu S., Moti M.)

- ✍ To estimate and analyze the underlying determinants of ICBT
- ✍ To find out the major causal factors of ICBT

**Sub- theme III: Policy, Legal and Institutional Analyses of Informal Cross Border Trade  
between Ethiopia and Its Neighbors**

(Kiflie W.\*, Dawit H., Tasew T., Degu S., Moti M.)

- ✍ To analyze national and neighboring countries trade policies in comparative perspective
- ✍ To examine the legal framework related with ICBT
- ✍ To analyze structure, procedures and enforcement capacity of ICBT related institutions

**Sub-theme IV: Socio-Economic Impact of ICBT in Ethiopia: Strategies and Policy Options**

(Dawit H\*, Tasew T., Degu S., Kifle W, Moti M.)

- ✍ To estimate the economic impact of ICBT on tax revenue loss, foreign exchange loss and government revenue loss
- ✍ To examine social impacts of ICBT on border community and trading routes
- ✍ To suggest intervention strategies and policy options to manage ICBT

\*refers sub-theme leader