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Nigeria's Booming Borders

The Drivers and Consequences of Unrecorded Trade

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Executive Summary and Recommendations

Nigeria's economy is of a complexity and dynamism unparalleled in West Africa. With a domestic market of perhaps 180 million people and a manufacturing base far outstripping that of any neighbour, it has the scale and weight to become the engine of trade growth across the entire region. Despite the modest personal spending power of Nigerian consumers, the weakness of transport and technical infrastructure, financial and administrative hurdles and the gradual pace of regional economic integration, Nigeria already generates vast cross-border trade involving networks of sophisticated activity across a diverse range of commodities. At the end of 2014, Nigeria's recorded external trade stood at ₦24,435.3 billion ($135.8 billion). Yet official statistics paint only part of the picture and cannot capture the massive volumes of informal export and import activity.

The scope for sustained regional growth in trade remains significant. Across West Africa, output and consumption have been growing steadily for over a decade, accelerated by rapid urbanization and almost impervious to the global financial crisis and repeated Sahelian droughts. The region's economies are still expanding, with 4 per cent growth in real GDP projected for 2015, despite the decline in international prices for the oil, minerals and tropical crops that West Africa sells to the world. It is highly probable that this positive trend will continue – as it undoubtedly needs to if the 15 countries of the Economic Community of West African States (ECOWAS) are to reduce poverty, malnutrition and underemployment and generate better, more diverse livelihoods for their growing populations.

And for no country are these imperatives greater than for Nigeria, which is not only Africa's largest economy, accounting for well over half the GDP of ECOWAS, but also the most populous sub-Saharan country. It is the unmistakable giant in this regional narrative, a nation with extraordinary potential, opportunity and transformative capacity.

Informal trade: a pragmatic response to today's realities

Despite this positive picture, there are powerful reasons why Nigeria's vast external trade remains largely informal, unrecorded and untaxed – and this fact leaves much of the country's economic potential unrealized.

A substantial proportion of Nigeria's cross-border trade currently flows through informal channels. There are strong indications that unrecorded flows through the key economic corridors between Nigeria and its neighbours are several times greater in volume than the amount of trade that is officially reported. This of course also reflects the scale of domestic informal business within Nigeria itself: one estimate is that unrecorded or informal activity could account for as much as 64 per cent of Nigeria's GDP.

There is a temptation to view informal trade as a marginal, grassroots cultural phenomenon, a throwback from a traditional way of life before national boundaries were drawn, or as something quite detached from the realm of formal trade relations. Such perceptions are reinforced by the apparent vibrancy of day-to-day economic life. Trucks line up at official border crossings and bump over muddy back-roads, motorbikes stutter along laden with fuel tanks, barges slip through coastal creeks, and battered cars with raised axles weighed down by sacks of grain or cement trundle along border tracks. In crowded city markets and remote villages, across Lagos and the animated streets of Kano, and all along Nigeria's 4,047 km of land borders, deals are done and goods and money change hands.

But this bustling – and growing – resourcefulness needs to be firmly interpreted within the context of the economic challenges confronting Nigeria today. Given the country's current sobering economic outlook, this critical perspective is even more urgent. Reduced revenues from crude oil, Nigeria's main export and the source of 80–90 per cent of its government's foreign-exchange earnings, have once again put the country under pressure to insulate itself better from the perennial cycles of oil-market boom and bust and improve the socio-economic stability of the country. A deeper understanding of the unrecorded side of Nigeria's non-oil external trade is key to this process and can offer its government a critical opportunity to pursue a path of economic growth that is less volatile and more sustainable.

Nigeria's context of booming unrecorded trade flows, the networks that operate them and the financial flows that underpin them are, in fact, a response to the obstacles and complications that impede trading through formal, monitored channels. The dynamism of this flourishing and growing informal traffic is the cumulative result of current economic and governance conditions. The result is to damp down constantly the potential growth in Nigeria's formal external trade.

Economic actors of many kinds respond to this context in different ways. Large companies do persist with formal trading, because the scale of their operations makes their activity more visible and because they have the money and skilled resources to overcome logistical barriers, satisfy labyrinthine administrative procedures and soak up additional costs. Still, some large companies can be found combining formal and informal channels to get business done in Nigeria, and in many respects the boundary between the formal and informal is blurred.

For small and medium-sized economic operators, estimated in 2012 to account for almost half of Nigeria's GDP, the cost of importing or exporting formally is considerable and going under the radar is a compelling alternative. The sheer practical difficulty of trading through the officially regulated channels can be enormous, and in very many cases insurmountable. Rules and procedures designed to impose structure and supervision are in fact applied in a manner that creates difficulties for entirely legitimate business operations.

Between cost, regulatory and capacity hurdles, today's environment for cross-border trade ends up serving as a strong disincentive to formalization. This is not to say that trading informally is without costs or challenges; but long-established systems provide a practical alternative to officially regulated channels.

Drivers of informality

By accident rather than design, Nigeria and neighbouring countries have built up a formal economic and governance framework that drives the vast majority of exporters and importers into informality. It is a picture of staggering complexity, but a number of significant factors can be highlighted.

- Formal processes for clearing customs are slow, complex and expensive. Nigerian businesses must produce at least nine documents in order to send an export shipment and at least 13 documents in order to bring in an import consignment – in both cases this is significantly more than in many other emerging economies. Procedures are complex, and ports and border crossings have too few modern technical installations such as large scanners capable of scanning whole containers on vehicles.
- Foreign-exchange and banking regulations are enforced in a manner that is so rigid and dysfunctional that it serves merely to push most smaller traders into the incompletely regulated parallel exchange market – because this is the only practical and affordable way that Nigerian importers can use their holdings of local currency, the naira, to exchange directly into CFA francs to make local-currency payment to their suppliers in the neighbour countries in the franc zone.
- Corruption and unofficial 'taxation' are a heavy burden on traders; major border highways have become rich sources of revenue for illegal patronage networks within state agencies. Customs officials act both as assessors of duties and as collection agents, multiplying opportunities for graft and creating a culture in which they are able to set up unnecessary 'checkpoints' to extract unauthorized 'taxes' from traders and transporters on main roads in border areas. This type of corrupt activity means that supposedly formal channels of doing business are replete with informal practices and delegitimized. Traders often prefer to use smuggling routes, where they may be stopped less frequently and will therefore pay fewer bribes.

Hobbled economies, lost opportunities

This situation is not cost-free – for Nigeria as a society and trading economy, for its business people, or for the government at federal and state level. Nor, over the longer term, is it good for West Africa as a whole. The effects of informality are complex, but a number of specific impacts can be identified.

- The state loses direct tax revenues that would be generated by formal cross-border trade. This is not just siphoned into the informal economy; some is lost entirely. For instance, the expense and difficulty of using Nigeria's own ports leads many shippers to opt for Cotonou in Benin or Lomé in Togo, thus paying customs duties and tariffs on landing in those countries, instead of paying them to the Nigerian authorities.
- Informal trade undermines the social contract. Traders feel the government provides no services in return for any taxes they might pay, so they have little incentive to formalize and pay tax or duties. This in turn means that the state lacks the resulting resources to pay its officials, improve physical infrastructure or implement reforms.
- There is a further knock-on effect that removes non-trade business activity from the reach of federal and state domestic taxation. That is to say, having stayed outside the formal process for importing or exporting, businesses will often find it easier to keep other affected areas of their activity, including value addition and processing, also in the informal, and thus untaxed and unregulated, space.
- Informal trade helps to sustain a permissive environment for mismanagement and corruption. Illegal payments to smooth the trade are part of a process in which graft by government officials becomes commonplace and extremely difficult to uproot. Every day tens of thousands of these unofficial payments are made, none of them destined for the government's coffers. Money paid as cash bribes is a resource that should either be retained by businesses as legitimate profit or paid in taxation to federal or state authorities.

- Informal trade is beyond the reach of Nigerian national or ECOWAS regional policy-making. A huge slice of private-sector activity is unmeasured and poorly understood. This lack of information and transparency undermines effective policy planning for almost every sector of the economy, including agriculture, fuel supply and manufacturing. It affects issues ranging from foreign-exchange payments to technical standards. Being outside the regulatory framework, informal trade does not comply with health, safety or environmental standards, or with international technical norms, and has no incentive to do so, as the main competitive pressure is to hold prices low. This traps economic activity at the low-quality, low-tech end of the scale, just at a time when rising labour costs in Asia are creating competitive scope for Nigerian manufacturers to produce a wider and more sophisticated range of products.
- Nigerian-made goods are already competing with Chinese products across West Africa. But many of these goods are exported through informal channels, thereby excluding manufacturers from most support on offer, whether from government – for example, through the Export Expansion Grant (EEG) – or from institutions such as the Nigerian Export-Import Bank (NEXIM). The Nigeria Export Promotion Council (NEPC) tries to fill the gap, but its scope for action is limited where trade is informal. Because of the general difficulties faced by most manufacturers and other informal traders in demonstrating equity and a healthy balance sheet, this exclusion from financial support also inhibits their access to finance from the formal banking sector.

Policy recommendations

There is keen engagement and interest within government and the business community in exploring how to create an environment more conducive to formal trading activity, as evidenced in research interviews with senior policy-makers in Nigeria, Benin and Niger. From northern to southern Nigeria, the response of business people was that they would welcome the opportunity to pay taxes, but only if they received assurance that these payments represented a contract with government guaranteeing that conditions for business would be improved.

If Nigeria is to fulfil its real potential as the trading engine of the West and Central African regional economy, policy-makers need to create an environment that encourages trade to flow through recorded channels. They should seek to understand the needs of business and take the steps that will allow exporters and importers to operate formally and thus enhance the long-term efficiency and quality competitiveness of the Nigerian and wider West African economy.

The issues addressed in this report concern business and the wider private sector in Nigeria and across the ECOWAS region. However, as the largest economy and biggest market in West Africa, Nigeria is strategically placed to take a lead in addressing these challenges.

The government of Nigeria can make the greatest impact in developing a more functional trading environment within Nigeria and shape the business landscape across the region.

Therefore, the recommendations that follow are in large part within the domain of the responsibilities of the government of Nigeria but also draw in other partners, private and public, domestic and international, who all have important contributions to make in enabling Nigeria to build a competitive economic future.

Recognize informal realities

The Federal Government of Nigeria should recognize the dynamic informal business community as a fundamentally positive national asset. But only when this recognition manifests itself in the implementation of reform will it be truly meaningful. The government should view its taxi drivers, wholesale and retail marketers and distributors, private educators, hairdressers, mobile phone card vendors, transporters and shop owners as economic partners who can help to build growth, prosperity and employment prospects.

The Nigerian government must also be realistic and transparent about the drivers of informal activity. Nigeria cannot seal its borders; nor can it abolish West Africa's parallel currency market. If the conditions for trading formally are too difficult or expensive, business people will simply move their goods by informal routes instead. If small traders cannot make or receive cross-border payments easily and cheaply through the officially regulated financial system, they will simply turn to the unregulated parallel market. They cannot be stopped from doing so.

Facilitate formal trade

The government should therefore give absolute priority to measures that simplify formal trading procedures and make it easier and less costly for exporters and importers to move their activity into the formal realm. The current environment in which trade issues are reviewed and policies are formulated is fragmented and disorganized. Numerous practical measures, some costly but many quite inexpensive, could help formal trade flow more smoothly and assist businesses in the transition from informal to formal operation. Key steps should include measures to:

- ***Strengthen the resources and capacity of the newly enlarged Federal Ministry of Industry, Trade and Investment.*** This would create a clear policy lead and expert focal point for tackling trade issues. It would help to coordinate action across all key government ministries, departments and agencies, as well as public and private stakeholders. It would also advance reforms that will make it easier for exporters and importers to operate formally. The NEPC is already doing much to assist exporters, but there is a need for better coordination across all branches of government in collecting, consolidating and sharing trade information, reviewing trade policies and creating incentives for traders to formalize their activities. Nigeria's National Bureau of Statistics (NBS) also has a significant role to play over the coming years in measuring and capturing more of Nigeria's external trade, and its capacity to do so depends heavily on increased funding and technical support.
- ***Improve basic facilities that support traders.*** This could include improving the efficiency of existing single-window (one-stop) border posts and expanding their number to handle formalities at key crossings, installing truck parks, internet and basic office premises in markets, all-weather surfacing on market access roads, online booking for trucks to enter ports, and so on.
- ***Simplify bureaucratic procedures imposed on business.*** These must become less of a deterrent to smaller traders. For example, the procedures and criteria for accessing the EEG could be simplified.

Minimize opportunities for corruption

It is beyond the scope of this report to offer solutions to the challenge of corruption in Nigeria. But it is incumbent on the government to design and implement systems that minimize opportunities for graft by officials. In particular, it needs to:

- ***Reorganize institutional responsibilities for assessing duty/tariff liabilities and revenue collection.*** Customs and tax administration services should be integrated in a way that transfers the official responsibility of customs revenue collection to the Federal Inland Revenue Service (FIRS) only, while the Nigeria Customs Service retains authority for the control of consignments, ensuring compliance with the law and regulations, and assessing the liability of shipments for duties and tariffs. This would improve efficiency and information-sharing, and mitigate against informal payments at border crossings; in this way each service would act as a check on the other. Greater cooperation and coordination between both services would also be fostered through this arrangement, and there is the potential for revenue enhancement as a result of joint strategies to address tax fraud and evasion.

Approve a simple system between commercial banks for cross-border payments

The current arrangements are a massive disincentive to trade formalization, and one of the most consistent causes of complaint from business. West Africa's integration and the development of formal trade within the region should not be kept waiting for the distant day when a single currency may be set up. The urgent priority for regional central banks should be to ensure that cross-border trade payments can be easily made under the monetary regimes that exist now in Nigeria and in the member countries of the West African Economic and Monetary Union (UEMOA).

- ***The Central Bank of Nigeria and BCEAO, the central bank of UEMOA, should urgently conclude the revision of cross-border commercial banking regulation*** to allow banks to operate simple services for small and medium-sized businesses to make trade payments directly from naira to CFA francs and vice versa.

Foster stronger and deeper neighbourly relations

There is a tendency to see informality as something that benefits neighbouring countries while causing problems for Nigeria. But in reality there are benefits and downsides in both directions and there is a readiness among neighbouring states to promote formalization. This goodwill can be matched by Nigeria. Workable solutions can be achieved through the various directorates of ECOWAS and bilateral commissions such as the Nigeria–Niger Joint Commission for Cooperation and the Nigeria–Benin Joint Commission.

ECOWAS is gradually constructing a framework for West Africa's international trade. This should improve conditions for business to operate formally, through measures such as the Common External Tariff (CET) and the draft Economic Partnership Agreement (EPA) with Europe. As the implementation of these measures reaches the final crucial stages, Nigeria will need to engage more fully with a mindset of enlightened self-interest. Germany, Europe's biggest economy, is engaged at the highest levels in shaping European Union policy in a way that protects its national interests and strengthens its global influence. Nigeria has a similar weight in ECOWAS and capacity for influence. Therefore, Nigeria should:

- ***Give high priority to engaging in the shaping of ECOWAS trade policy and the community's stance in international negotiations. Prioritize the incorporation of ECOWAS trade policy into Nigeria's national legal and policy framework.*** Civil service and diplomatic posts dealing with these issues and in the ECOWAS secretariat itself should be categorized as senior prestige roles requiring expertise and thus viewed as an avenue for promotion. Public officials in these positions should be fully trained to analyse technical aspects of trade issues using modern techniques.
- ***Take the lead specifically through the Nigeria Immigration Service (NIS) and Nigeria Customs Service (NCS) in fully incorporating into domestic law and promoting the ECOWAS Protocol on Free Movement of Persons.*** This would assist formalization of cross-border trade, deepen regional economic integration and strengthen domestic economic growth. Harassment at the border is a major complaint of Nigerian traders and their West African counterparts. Border management agencies should prioritize procedural overhauls and staff training to reduce the time spent by citizens of ECOWAS member countries in going through formalities at Nigeria's borders.
- ***Collaborate with fellow ECOWAS countries to develop an ECOWAS trademark.*** This would promote consumer awareness of products of regional origin and, potentially, bolster demand, notably in sectors such as cotton textiles, where local design and quality are viewed as positive selling points. The attraction of securing the trademark and the authentication this can offer would give businesses and manufacturers an incentive to formalize their activity.
- ***Implement the ECOWAS Informal Trade Regulation Support Programme (ITRSP).*** This was budgeted at €65 million in 2013 but is yet to be launched due to a lack of funds. Because of its critical importance to the economies of all member countries of ECOWAS, it could be funded on a cost-sharing basis between regional members and international partners. Alternatively, the €6.5 billion pledged by the European Union, its member states and the European Investment Bank for activities linked to West Africa's EPA Development Programme for the 2015–20 period could be a source of funding.

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Cover image: 'Made in Nigeria' trademark on selvedge (margin or edge) of printed fabric at a market stall in Torodi, Niger, March 2015.

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