



From Informal to Integrated: Leveraging Cross-Border Trade for Growth in Somaliland and Ethiopia

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Executive Summary

The interplay of colonial borders, interstate conflict, and state collapse in the Horn of Africa is vividly illustrated along the periphery between Somaliland and Ethiopia's Somali Regional State. This boundary, a militarized frontier during the Cold War, was redefined by the simultaneous collapse of the Somali and Ethiopian governments in 1991. The ensuing dynamics created new imperatives for both sides, the nascent, though unrecognized, Republic of Somaliland sought pragmatic ties for stability, while landlocked Ethiopia, following Eritrea's 1993 secession, was driven by strategic necessity to pursue access to the sea via Somaliland's Port of Berbera and Port of Djibouti, especially after the 1998-2001 Ethiopia-Eritrea border war.

On the other hand, informal cross-border trade has persisted for centuries, serving as a crucial livelihood strategy and economic necessity in a region of limited formal employment opportunities. Within the context of a prevailing poverty and paranoia, this sector dominantly offers substantial employment and income opportunities for women and the economically weak and disadvantaged people. As such, it plays an indispensable role in poverty reduction and the promotion of women's economic empowerment. A case in point is the Wajaale market, where female traders are the dominant participants, transporting goods informally from the border into the Ethiopian hinterland. However, the sector also involves

large businesses, corrupt officials, and sometimes bankers. Nevertheless, despite its vital role in local and regional economies, informal cross-border trade continues to be systematically neglected in policy circles.

This policy briefing examines the nature, drivers, and implications of cross-border trade between Somaliland and Ethiopia. The paper reveals a dynamic economic zone characterized by deep-rooted social and commercial ties, yet dominated by informal and often illicit transactions. The source of this informality is a complex interplay of factors, including prohibitive Ethiopian tax rules, the absence of a formal bilateral trade agreement between the two countries, Somaliland's lack of international recognition, price difference for the goods, social and cultural ties between the community, exchange rate fluctuation, and significant demand-supply gaps in both economies. The current situation is indicative of the possibility for economic integration, where the investment in the Port of Berbera by DP World and the ongoing corridor utilization negotiations offer proximity of the Somaliland port as an alternative option for investment for natural gas facilities and its export from Somali Regional State of Ethiopia, which present a transformative opportunity to recalibrate this relationship from one of tolerated informality to one of structured and mutually beneficial integration.

The briefing proposes several key recommendations to guide policymakers in Hargeisa and Addis Ababa. For the Governments of Somaliland and Ethiopia, the paper recommends:

- Accelerated bilateral talks to establish a formal trade agreement that simplifies customs procedures, eases tariffs on key commodities, and establishes a joint border management committee.
- Recognition that informal trade should become an option with low tax payment that sets the standard for the commodity traded to protect the safety and health of the consumers, on both sides.
- Somaliland must urgently enhance its domestic institutional capacity, particularly its Customs Department, Central Bank, and Immigration, to effectively regulate trade, financial flows, and cross-border movement of the people.
- Both governments should collaborate on developing critical infrastructure, such as integrated border posts, and invest in data collection and analysis to properly quantify trade flows.
- A strategic communications campaign is needed to educate business communities on the long-term benefits of trade formalization.
- Finally, for international partners, the recommendation is to provide technical and financial support for these capacity-building and infrastructure initiatives, recognizing that a stable, regulated, and prosperous cross-border region is a cornerstone for the broader Horn of Africa stability. The ultimate goal is to transform the periphery from a zone of evasion into a hub of regional economic integration, legal trade, as well as financial and capital flows.

Introduction

Informal cross-border trade constitutes a major form of informal activity in most Sub-Saharan African countries. In the Southern African region, though the informal cross-border trade activity makes up an estimated 30%-40% of the total trade between the Southern African region trade transactions, this informal trade presents unique benefits

to those engaging in such activities, but also presents unique challenges. Indeed, informal cross-border trade provides access to goods that are unavailable domestically to meet local demand (Koroma et al., 2017; IOM, 2021). According to Koroma et al. (2017) informal cross-border trade has proven to be more responsive to shocks compared to formal trade, especially in times of food crises.

Small traders are often forced to engage in informal trade because of barriers to entering the formal sector, including difficulty in getting access to travel documents or trading licenses, excessively long waiting times at borders, overcharging by customs officials, and inadequate knowledge of official procedures. Equally important, due to the nature of this trade and the lack of an adequate legal framework, traders are often faced with unique challenges (Aydiner-Avsar et al., 2019). These persistent challenges and hurdles include corruption, where officials solicit bribes to smuggle goods, harassment, and confiscation of goods, only to name a few.

In Eastern Africa, most of the informally traded industrial commodities are actually re-exports (i.e., imports that are exported without much value addition). In this area, borderlands have long been the epicenter of informal cross-border trade among the region's states (Ng'asike et al., 2020; Brenton & Edjigu, 2021). Wajaale, also known as Tog Wajaale, a commercial hub and a town located on the border between Somaliland and Ethiopia, is one of the most crucial and busiest cross-border trade centers in the Horn of Africa (Asnake, 2019; Bakonyi & Darwich, 2025). Generally, the dynamics of informal cross-border trade between Ethiopia and Somaliland are often-described as huge volumes of foodstuffs, that have a direct impact on the food security of Eastern Ethiopia. In addition, electronics, cosmetics, clothes, building materials, and other items are smuggled into Ethiopia, while inward flows include a wide range of items, such as teff, an indigenous fine-grain, vegetables, and

alcohol, that appear on the list of items that come from Ethiopia informally to Somaliland. The precise scale of informal exports and imports between the two countries remains largely unquantified; however, research by the Rift Valley Institute (2021) indicates a daily flow of approximately 42 trucks into Somaliland.

The Horn of Africa is a region where the legacies of colonial borders, interstate conflict, and state collapse have profoundly shaped local realities. Nowhere is this more evident than in the dynamic interplay between communities living at the territorial margins of established states (Mazrui, 2008). The border between Somaliland and the Somali Regional State of Ethiopia represents one such critical periphery. Historically, this border was a militarized frontier during the Cold War, a site of conflict between the former governments of Somalia and Ethiopia. However, the collapse of both regimes in 1991 ushered in a new era. For the Republic of Somaliland, though it remains unrecognized internationally by any country or international organization, it meant forging a pragmatic relationship with its immediate neighbor, Ethiopia (Rudinová, 2016). For Ethiopia, becoming a landlocked state, after Eritrea's separation in 1993, created an imperative to diversify its sea access, drawing its strategic gaze towards the port of Berbera as an alternative to the port of Djibouti.

This geopolitical shift, combined with deep-seated cultural, kinship, and historical trade ties between the Somali communities on both sides of the border, established a network that has fostered a vibrant cross-border economy. However, as this briefing details, this economy operates largely in the shadows of formality. The town of Wajaale, split by the border, epitomizes this reality. It is a bustling commercial hub where goods, labor, and finances flow with a fluidity that belies the absence of a comprehensive legal and regulatory framework. This briefing argues that while this informal system provides short-term subsistence and profit, it undermines investment, discourages formal

entrepreneurs, erodes consumer preference for the local goods, and ultimately constrains the sustainable economic growth for both countries' economies. The briefing outlines the key findings on the nature of this trade, analyzes its drivers, and concludes with a set of concrete policy recommendations aimed at harnessing this economic energy for the benefit of both states and their citizens.

A Tale of Two Economies: Imbalance and Informality

The informal cross-border trade has been going on for centuries. It is one of the opportunities offering livelihood sustenance on a continent where opportunities for formal employment are very limited and have been shrinking (Koroma et al. 2017). In the Horn of Africa context, informal cross-border trade remains one of the crucial sources of income for the people in the region. In Moyale, a border town between Ethiopia and Kenya, for example, informal cross-border trade plays an important economic role and is regarded as a critical source of livelihood for the pastoral inhabitants in the town and surrounding areas. Booming informal cross-border trade takes place along the border (UNECA, 2017). The Ethiopian state, however, views informal cross-border trade as illegal.

It is important to note that state actors and the local people perceive informal cross-border trade differently. The local population views it as a vital means of livelihood, generating income for thousands of pastoral and non-pastoral households on both sides and makes it a socially acceptable economic necessity, particularly in areas where alternative employment opportunities do not exist. To tackle this challenge, the Government of Ethiopia has adopted an initiative, "Petty Periphery Trade," which allows for a limited scale of such trade (Ibid; OSSREA, 2021). The initiative aims to curb illegal and informal trade across the border by making it possible for local traders to import basic commodities that do not reach the border area or are expensive because of the distance of border communities from the center.

Similar to Moyale, Wajaale, a border town at the newly built transport corridor to Ethiopia, better known as Berbera Corridor (Bakonyi & Darwich, 2025), is another informal economic zone where cross-border trade plays a vital role in the livelihoods of the local people. The Berbera Corridor is one of the key passages that supply goods and items to Ethiopia (Asnake, 2019). While there is no official recorded data explaining the volume of informal cross-border trade between Ethiopia and Somaliland, estimates suggest that goods and commodities amount to millions of dollars crossing the border between the two countries. However, one may question how Somaliland and Ethiopia can tackle this challenge and change this into an opportunity. One solution is to sign a trade agreement between the two countries that grants privileges to residents of the borderlands. The Common Market for Eastern and Southern Africa (COMESA), a regional economic integration organization with over 20 African countries as members, has a trade facilitation regime. The Simplified Trade Regime (STR) has been identified as one of the best cases of trade policy initiatives to promote trade activities of informal traders across COMESA borders (Koroma et al. 2017). Though Somaliland is not a member, Ethiopia, which is a member, can take the lead and facilitate the process.

This trade regime recognizes informal cross-border traders as important players in cross-border trade, allowing them to trade openly on a commercial basis using a simplified form for the declaration of goods. It also allows these traders to trade mainly on a duty-free basis, up to a reasonably high threshold of goods valued at US\$1,000 or less, without the need for a Certificate of Origin. However, the goods must be on an agreed Common List by both the exporting and importing countries (Ibid). This initiative has therefore directly addressed a key challenge: lengthy customs procedures and documentation requirements that often push informal cross-border trade out of compliance, particularly for small traders.

The Drivers of Informal Cross-Border Trade Between Ethiopia and Somaliland

Several key factors are pushing economic activity into informality, including the prohibitive Ethiopian tax structure. The Ethiopian Revenues and Customs Authority (ERCA) employs a complex, multi-layered tax system (i.e., customs duty, excise tax, VAT, surtax, and withholding tax) based on the international value of goods. For many consumer goods, the cumulative tax can exceed 100% of the product's Cost, Insurance, and Freight (CIF) value, making formal importation economically unviable (Sisay & Yohannes, 2009; USDA, 2015). In contrast, Somaliland uses a simpler, fixed-rate system based on the type of commodity, not its fluctuating value (MoFD, 2021). This exposes a stark contrast between the two countries' tax systems.

In addition, the lack of a formal trade agreement is another critical element. This means that there is no framework for preferential tariffs, quotas, or streamlined customs procedures. The 2005 Berbera Corridor Agreement, the development of the Port of Berbera by DP World, and the ongoing negotiations between the two sides offer strategic infrastructure agreements but do not address the underlying regulatory barriers to two-way trade. However, Somaliland's unrecognized status and the political limbo complicate state-to-state negotiations and limit Somaliland's capacity to engage fully with regional and international trade bodies, leaving a legal vacuum that informal networks fill.

Furthermore, and very importantly, there are demand and supply gaps. Ethiopian domestic production cannot always meet local demand for certain goods, creating a market that Somaliland-based traders are eager to supply. Similarly, cheaper fuel, vegetables and other goods from Ethiopia find an illegal market in Somaliland, circumventing official channels, and in the case of banned items like plastic bags.

Informality manifests in several distinct

types of transactions, including goods and commodities. A constant flow of smuggled goods moves in both directions. From Somaliland to Ethiopia, it is primarily re-exported consumer goods, clothes, cosmetics, and electronics, to name some. From Ethiopia to Somaliland, it includes illicit items like fuel (cheaper than imported fuel via Berbera), alcoholic beverages and plastic bags (both banned items), alongside legally imported but informally traded items like the indigenous fine-grain, teff. Moreover, the border is highly porous for people. Legal immigration through the Wajaale post sees dozens of crossings daily, facilitated by cross-border kinship ties. In addition, the town serves as a conduit for irregular migration, with flows fluctuating in response to Ethiopia's political and security situation, potentially increasing migrant flows.

On another note, livestock is another issue. There is a contentious debate over the origin of livestock exported via the Port of Berbera. Ethiopia claims a significant portion originates from its territory, while Somaliland argues most are domestically reared. This leads to Ethiopian authorities, including the Liyu Police of the Somali Regional State, intermittently restricting livestock movements, disrupting a traditional pastoralist livelihood and a key export sector for Somaliland.

A critical finding is the tension between the vibrant economic activity in the border zone and the authority of the central states. The people in the borderlands see the development of the Berbera Corridor and the formalization of trade as a source of concern and a danger to their economy, and, if not, as a direct threat to their informal businesses in the area and their connections with counterparts in Ethiopia. From the perspective of local people, the disruption of informal cross-border trade will extend far beyond the borderlands and affect goods reaching the hinterland of Ethiopia.

However, this briefing notes the presence of "strong influential non-state actors" in borderlands who challenge the state's ability to tax and regulate the economic activities

taking place in this economic zone. While customary institutions and cross-border clan ties remain strong, their relationship with formal state institutions is not always cooperative. This highlights a "center-periphery" disconnect, in which the realities and needs of border communities are not always adequately reflected in national policy, creating a governance gap.

Responding to the Challenges for Better Trade Relations

Generally, regional cooperation is a precondition for accelerated economic and social development. The Horn of Africa countries are mostly small economies; stronger regional cooperation should enable them to develop the region's natural resources. Somaliland, a former British Protectorate in the Horn of Africa, has remained a non-recognized state since 1991 and does not qualify for foreign direct investment or have relationships with multilateral institutions, such as the World Bank, the IMF, and the African and European Development Banks. On the other hand, Ethiopia, which is an agriculture-based economy with only emerging industrial development, has been a landlocked state since 1993. Ethiopia's landlocked status challenged its path to development.

The growing economic and trade transactions between Somaliland and Ethiopia amount to millions of dollars per annum. The development of the Port of Berbera and the construction of the Berbera Corridor will be a valuable addition to the already ongoing activities (Rashid, 2019). On the one hand, trade between the two countries has different dimensions, with diverse goods and commodities crossing the border in both directions. From the Ethiopian side, Somaliland imports various items, including khat, as well as wheat, onions, and potatoes, among others; on the other hand, Ethiopia restricts items crossing the border from Somaliland, regarding them as illegal, informal, and contraband. This is a significant challenge for trade between the two countries and needs to be curbed through a bilateral

agreement, while encouraging the business transactions taking place between the two countries and communities to flourish.

To address shared challenges linked to the development of the Berbera Corridor, Somaliland and Ethiopia established technical committees to deepen cooperation and coordinate on key operational issues, including port utilization, customs, and transit arrangements. A series of agreements and protocols have been developed to strengthen trade facilitation and harmonize border management procedures. These efforts are expected to enhance formal cross-border trade, improve economic resilience in the border regions, and advance regional integration consistent with the objectives of the African Continental Free Trade Area (AfCFTA).

Building on these developments, there is a pressing need to accelerate formal negotiations, with a focus on achieving tangible and mutually beneficial outcomes. Challenges remain significant, and further rounds of negotiation, both pragmatic and strategic, will be required to address them effectively. Indeed, the two countries are enthusiastic about collaborating across different areas and, in principle, on the economic front, which could make them peaceful, stable, and prosperous. However, creating such a region will require sacrifices from the parties involved. To do so, the two countries should recognize the need to formalize their trade activities through official agreements based on a win-win approach.

Implementing this measure will curb illicit cross-border trade – a practice that harms legal businesses and inflicts significant financial damage on informal traders whose goods are confiscated by law enforcement agencies. Therefore, the business communities in the borderlands should be educated about the benefits of legal trade by highlighting the risks and dilemmas associated with informal cross-border trade. Also, this would give less privileged and poor people an opportunity to benefit from the resources available in their respective

territories, particularly marginalised peoples in the borderlands.

Conclusion

The cross-border trade dynamics between Somaliland and Ethiopia present a complex picture of opportunity and challenge. The status quo, defined by extensive informal trade, is a direct consequence of policy failures and political constraints at the state level. While it provides short-term economic benefits to local communities, it is an unsustainable model that fosters loss of the limited resources they have and undermines the development of robust, transparent state institutions, in both Hargeisa and Addis Ababa.

The current moment, however, is ripe for change. The significant investment in the Port of Berbera and the Corridor, coupled with Ethiopia's stated desire for economic diversification and Somaliland's quest for economic stability and international engagement, creates a powerful alignment of interests. This briefing clearly demonstrates that the primary obstacle to harnessing the full potential of this relationship is not a lack of commercial activity, but the absence of a formal framework to govern it.

Therefore, the path forward must be one of deliberate and collaborative trade formalization. This requires political will from both capitals to engage in pragmatic dialogue, setting aside the complex issue of Somaliland's recognition in favor of concrete economic cooperation. By legalizing and regulating the trade that already exists, both governments can transform the Somaliland-Ethiopia border from a zone of economic evasion into a catalyst for regional growth, stability, and integration. The recommendations outlined in the executive summary provide a practical roadmap for achieving this transformation, turning the peripheries into a shared center of prosperity.

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About the Paper

This policy briefing examines the cross-border trade between Somaliland and Ethiopia, centered on Wajaale, and finds it to be a vibrant but predominantly informal and illicit economy. Key drivers of this informality include Ethiopia's complex tax system, the lack of a formal bilateral trade agreement between the two countries, Somaliland's unrecognized status, and regional supply-demand gaps. This situation leads to smuggling, financial flows outside official channels, and regulatory challenges. While providing some local short-term benefits, the status quo is unsustainable, causing long-term economic harm to traders, depriving both governments of revenue, and weakening state authority. The briefing concludes that a transformative opportunity exists, driven by projects like the Port of Berbera's development. It proposes a formalization roadmap involving a bilateral trade agreement, institutional capacity-building, joint infrastructure, and awareness campaigns to convert this border zone from one of evasion into a hub of regulated regional integration.

About the Institute

The Laas Geel Academy of International Relations is a premier institute in Somaliland dedicated to world-class teaching, training, and research in international relations, diplomacy, and security. Through innovative research, the Institute produces strategic research papers, briefings, and in-depth analyses on key political, economic, and security issues to offer actionable insights to Somaliland's policymakers. By fostering international collaboration through dialogues, workshops, and seminars with global partners, the Academy fosters cross-cultural exchange and elevates Somaliland's voice in global discourse. Committed to excellence, integrity, and inclusiveness, its mission is to cultivate skilled professionals and deliver multidisciplinary research on critical areas such as climate change, migration, geopolitics, infrastructure, and regional security, thereby serving as a beacon of knowledge, innovation, and development for Somaliland and the wider Horn of Africa.

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