By Pamela Hussein

AFRICA'S SHADOW ECONOMY

The "shadow economy" (informal economy) is no longer just an unregulated sphere in African and other global economies: it's responsible for absorbing millions every year in respective cash currencies

For some, it's turned into an opportunity for industries to cater to people and businesses who can't always afford to be on the grid.

According to the World Bank, the weighted average size of the shadow economy in sub-Saharan Africa is 38,4% of the region's gross domestic product (GDP). In Europe and Central Asia, it's 36,5%, while in high-income countries or regions, it makes up roughly 13,5% of GDP.

The informality of these shadow economies, however, also breeds many forms of corruption, from the illegal trade of goods and services to tax evasion or avoidance.

The faces of the shadow economy range from vending day-to-day products in bustling city centres to neighbourhood plumbing services. Hawkers with makeshift stalls, domestic workers and gardeners are just as much a part of it as shop-owners with a handful of staff.

What makes a shadow economy unique is its ability to appear formal, although its financial processes aren't on par with government or global regulations.

According to Daniel Monehin, Divisional President of sub-Saharan Africa at MasterCard, cash remains the common denominator that sustains these shadow economies.

"In many places, the wide usage of cash is symptomatic of a large informal economy. In some instances, this feeds corruption and bribery," he says. "This bad behaviour can be a substantial drag on the overall economy, suggesting that governments benefit by moving their citizenry away from cash."

According to an article in *The Economist* entitled *Black Hole*, getting an exact measurement of off-the-books activity in the world isn't always possible, but it's estimated that Thailand and Nigeria are among the regions with the largest shadow economies. This comes as no surprise, since the informal sectors in both countries account for more than 50% of their GDPs.

Tax evasion or avoidance, while not the oil in the cogs of shadow economies, nevertheless poses a serious challenge for governments. "The use of cash is in itself costly, especially for governments. According to MasterCard advisors, cash costs range from 0,5-1,5% of GDP, depending on the country," Monehin explains.

"And those GDP costs don't include tax evasion, corruption and other illegal activities. An estimated US$16 trillion is spent in cash every year in black and informal economies – cash that's untaxed and untraceable."

Following closely behind Nigeria's shadow economy is that of Egypt, which, according to the International Monetary Fund (IMF), accounts for 69% of its GDP.

Not all activity within the shadow economy is illegal: poorer economies tend to have more daily cash-based transactions than electronic ones. Typically, cash becomes more of a common language than a bank card would be when moving away from business nodes and suburban areas in African cities. The further out one moves, the harder it becomes to gain access to an ATM or make payments using bank cards.

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"Representing the majority of retail transactions conducted in Africa, cash still dominates in many places, with basic debit and pre-paid cards, as well as mobile money solutions, still showing tremendous growth potential," says Monehin. "The introduction of electronic payments to consumers and merchants (including small to medium enterprises) will help curb the amount of government revenue that's officially unaccounted for in grey economic activities."

What will continue to fuel Africa's shadow economies, according to him, is the difficulty in accessing sophisticated financial services, as well as poor penetration of financial services, creating a pool of unbanked and under-served masses.

Insufficient access to traditional financial services gave rise to cellphone banking, which has fast become a sophisticated means of sending and receiving money. This is in light of the fact that sub-Saharan Africa continues to have a high percentage of slum-dwellers (65%), which the African Development Bank estimates is the reason for the high rate of migration into the region's urban areas.

As more people migrate, greater numbers of them will opt to become self-employed or take up informal and sometimes illegal jobs to make ends meet. Individuals doing whatever it takes to keep themselves afloat means that a large number of people making up the economy go largely undetected, with no formal proof of income or taxation payments.

Zamathiyane Ndaba, Communications Officer at African Fertilizer and Agribusiness Partnership (AFAP), finds that beyond tax, law and governmental policies, shadow economies have become accepted areas where those without access to traditional services can thrive in their own ways, whether through technology or not.

"As with most industries, technology can play a huge role for some and maybe less so for others – for example, this is how entrepreneurs conduct their business online and reach out to donors and markets," Ndaba explains.

"Farmers might find less use for various technologies. As in formalised economies, shadow economies are robust, consisting of many different activities. In the past, agriculture was largely an unregulated and informal sector. Today, by virtue of the fact that there are private and government ventures investing and working in that sector, agriculture and the people working in it are part of a formal economy. Even a farmer who sells packets of maize on a street corner can provide a legitimate and documented source of income these days."

AFAP, which is rooted in fertiliser investment markets in the continent, has first-hand experience of the changing face of Africa's agricultural sector. Despite being relatively regulated and formalised, it can easily accommodate a combination of formal and informal workers due to its highly segmented framework.

According to *The Shadow Economy and Work in the Shadow: What Do We (Not) Know?*, a paper by Friedrich Schneider, a professor in the Department of Economics at the Johannes Kepler University of Linz in Austria, the larger the agricultural sector, the larger one can expect the shadow economy to be.

Some have no option but to become a part of the shadow economy, due ➤

to difficulty in obtaining formal employment. Others, however, willingly opt out of the formal economy, driven by the incentive of having a small enterprise or providing services free of regulation.

In countries such as Tanzania, where the shadow economy makes up 50-60% of the overall economy, as noted in Schneider's report, enterprises, services and occupations off the grid are an everyday part of life. This is coupled with the country's thriving middle class, who are expected to grow the next wave of African millionaires, with the majority of them already living in the capital city of Dar es Salaam.

"Shadow economies thrive in the developing world because many developing countries still provide an opportunity for growth: their economies are still emerging and many people are breaking into different sectors," says Ndaba. "It's also a thriving sector because many people still have a fear of officials and bureaucratic institutions."

She adds that the appeal of staying off the formal economic grid extends to avoiding the cost of registering a business (and therefore paying tax on it), as well as bypassing other customary operating regulations.

While governments still battle to bring their shadow economies into the formal economy, this informal sphere has provided an opportunity to extend the provision of basic goods and services to people who can't afford big-brand products.

One business that's managed to penetrate this market is the Bakhresa Group, whose Azam brand has been successful in providing quality, everyday products and services – from bottled water, wheat and maize flour to road and transportation services – at low prices. Azam has become a household name in both high- and low-income homes.

The group's founder, Said Salim Bakhresa, is capitalising on providing products made by Africans for Tanzanians.

Similarly, Safaricom's cellphone microfinance service M-pesa and Egypt's Fawry payment system were born of the need to access basic financial services among people whose geographical locations prevented them from doing so.

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Electronic payments can still boost economic growth and advance financial inclusion, which is why countries around the world continue to work towards making their payment systems less dependent on cash.

Bringing the shadow economy into the light will, however, be a tough lion to tame for African governments, particularly since they've become an integrated part of everyday interactions. Inclusive growth, according to Monehin, could be one solution to building a bridge between formal and informal economies.

"Inclusive economic growth is important [and has] benefits which are widely shared. What distinguishes it from other kinds of growth is its emphasis not only on increasing GDP, but also on increasing economic sustainability and equitability," he says. "Grey economies are a hindrance to inclusive economic growth."

For Ndaba, inclusive growth could include lowering taxes for small-scale entrepreneurs, giving them a greater chance of investing in their enterprises which, in turn, fuel job creation.

"If a government wants to rein in its shadow economy, it has to give its people incentives that make it worth their while to do business or work within the formal economy," she says. This could include providing access to formal jobs and basic financial services such as a credit line.

"They'd rather open a shop or provide a service small enough to make a living and not have to think about taxes and regulations. Governments would then need to look into lowering taxes for entrepreneurs."

For large economies such as Nigeria's, says Monehin, channeling the millions that are lost to the shadow economy and into its financial market will require more than stringent laws and incentives.

"Nigeria is Africa's largest economy. It's also one of the fastest-growing, with the IMF forecasting growth of 7,3% in 2014. To keep it on its current growth trajectory, it will be essential to bring the country's shadow economy, estimated to account for 77% of GDP, into the formalised economic stream," he says.

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