Accelerating the Growth Momentum and Creating Better Jobs

Benin Country Economic Memorandum

Extended Executive Summary

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ABBREVIATIONS AND ACRONYMS

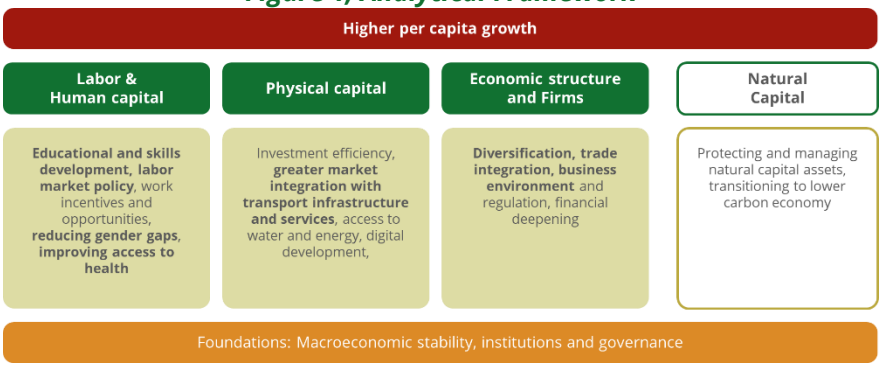
AfDB	African Development Bank
CCI	*Chambre de Commerce et Industrie* (Chamber of Commerce)
CEM	Country Economic Memorandum
CFAF	CFA Franc
CGE	Computable general equilibrium
COVID-19	Corona virus disease
CWON	Changing Wealth of Nations
DE4A	Digital Economy for Africa
ECI	Economic Complexity Index
ECOWAS	Economic Community of West African States
FDI	Foreign direct investment
FP	Family Planning
GCI	Global Connectedness Index
GDP	Gross domestic product
GVCs	Global value chains
HCI	Human Capital Index
IMF	International Monetary Fund
LICs	Low-income countries
LMICs	Lower-middle income countries
MFI	Micro-finance institution
MIT	Ministry in charge of Infrastructure and transport
PAC	Autonomous Port of Cotonou
PAG	*Plan d'Action du Gouvernement* (Government Action Plan)
PIM	Public Investment Management
PIMA	Public Investment Management Assessment
PP	Percentage point(s)
PPP	Public–private partnership
PSDSA	*Plan Stratégique de Développement du Secteur* (Strategic Development of the Agricultural Sector)
ROW	Rest of the world
SSA	Sub-Saharan Africa
TFP	Total factor productivity
TVET	Technical and Vocational Education and Training
WAEMU	West African Economic and Monetary Union
WB	World Bank
WEF	World Economic Forum

1. **Laying adequate foundations for a solid step up the ladder towards a middle-income economy is Benin's next challenge.** Economic growth has risen over the past decade, averaging 5.1 percent per year and positioning the country as one of the region's rising economies. In 2020, Benin officially transitioned from a low-income country (LIC) to a lower-middle income one (LMIC). Ambitious reforms in most recent years have opened the door to new opportunities while challenges - long-standing and new – continue. Growth remains volatile due to limited economic diversity and structural change. Labor productivity only marginally increased and - coupled with high population growth – has resulted in insufficient per capita income and human development gains. Entering into this phase, Benin can accelerate the structural transformation of its economy through new growth drivers capable of sustaining an economic acceleration, lifting labor productivity, and creating quality jobs for its labor force, especially youth and women.

2. **This Country Economic Memorandum (CEM) aims at supporting policy makers in their reform efforts.** A data driven CEM2.0 analysis and consultations were conducted, and three prominent issues were identified for deep dives: (i) raising productivity and competitiveness; (ii) supporting the demographic transition; and (iii) reducing the infrastructure gap. This choice also followed an analytical framework derived from growth theory (figure 1). By addressing these questions, the report aims at providing policy options. It builds upon the previous CEM (2009) and recent analytical reports emphasizing on the recent decade (2011-19). It is written against the backdrop of the COVID-19 pandemic, which affects the policy choices developing economies will need to make in the years to come, and its implications are therefore considered. Throughout the study, Benin will be benchmarked against regional averages including sub-Saharan Africa (SSA), Western Africa Economic and Monetary Union (WAEMU) countries, structural peers (Senegal, Togo, Rwanda) and aspirational peers (Morocco, Sri Lanka, Ghana) based on a data-driven dynamic benchmarking model (Matta 2018).

3. **The report is organized into four chapters.** The first chapter examines Benin's economic growth patterns to distill the key drivers and limitations of the current growth model. Based upon the analysis, the remaining chapters look at the following questions: *How can Benin grasp growth dividends from its demographic transition (Chapter 2)? How can better transport infrastructure and services fuel growth and economic transformation (Chapter 3)? Can trade increase private sector competitiveness and economic diversification (Chapter 4)? The main messages are summarized below, followed by key policy options.*

Figure 1, Analytical Framework



I. What will it take to accelerate the growth momentum and create better jobs?

Examining growth trends and patterns

4. **A small open economy, Benin has experienced robust growth over the past decade.** Supported by greater macroeconomic stability and a relatively favorable external environment, and reinforced by prudent economic policies, economic growth has risen over the past decade. Real gross domestic product (GDP) growth averaged 5.1 percent in 2011-2019, one percentage point (pp) above the SSA average (excluding high and upper-middle income countries), positioning the country as one of the region's fastest growing economies.

5. **Sustaining the economic performance and smoothing the growth volatility is a key challenge.** Highly volatile growth has accompanied most of the country's post-independence history, related to its dependence on commodity exports (cotton) and transit trade. While it is now more resilient than during the 1970s to 1990s, the cyclicality has been hard to break. The last decade (2010-2019) saw periods of high growth followed by years of steep decline, mostly due to external shocks. The most recent high-growth spell – from 2017-2019 – saw real GDP growing at potential for three years and averaging 6.4 percent. This was temporarily halted by the closure of the Nigerian border for 16 months from August 2019 and the COVID-19 global crisis. High volatility creates uncertainty in market expectations and impairs capital accumulation. It affects stable revenue mobilization and therefore undermines state capacity especially in public investment, redistribution, and poverty reduction (Deaton 1999; Easterly et al. 2000).

6. **Growth in recent years has been driven by a steady expansion of services, and increasingly, private investment.** The services sector has risen to prominence mainly thanks to the country's increasing role as a local trade and transit hub. Services have offered a wider path to jobs outside agriculture, but they remain dominated by low-productivity commerce and informal activities. Manufacturing has shrunk, raising the question of whether *premature deindustrialization* will hamper catch up and convergence (Rodrik 2016). Two fifths of the population are still engaged in informal rural activities, predominantly smallholder agriculture often associated with high rates of poverty. On the demand side, investment's contribution to growth has increased substantially in recent years, driven by private investment, primarily reflecting an increase in foreign direct investment (FDI) that has mostly been directed to the cotton industry, transport, telecommunications, and energy. Government investment and consumption have increased only timidly over the same period constrained by low domestic revenue mobilisation.

7. **The high growth momentum has failed to translate into sufficient income per capita gains.** While the country's real per capita income has increased, steadily closing the gap with the regional average, the average growth rate of 2.2 percent (2011-2019) remains low and falls behind its structural peers by 1 pp over the same period. At the current rate, Benin will catch up with the SSA average (excluding high and upper-middle income countries) within half

a decade. However, it will still take about 30 years to reach the mean of LMICs, and 50 years to enter the upper-middle income group.

What is needed for sustained growth acceleration?

8. **Productivity growth lags behind peer countries.** Most of the GDP per capita growth difference between Benin and its peers is explained by its significantly lower rate of labor productivity growth. Between 2001 and 2018, the output of an average Beninese worker increased 16.2 percent compared with 50.4 percent for a worker in Rwanda and 56.5 percent in Sri Lanka. Demographic factors (i.e., the growth in working age population) combined with slow labor productivity growth suggests that Benin is not taking advantage of its demographic transition to accelerate economic growth.

9. **Employment shifts have not translated into output changes.** The number of better (and typically waged) jobs that an economy generates is one of the key indicators of economic transformation in developing economies. Employment growth has gained pace in industry and services relative to agriculture since the 2000s: between 2011 and 2018, employment in agriculture fell from 44.7 percent to 41 percent, to be at par with services. However, the shifts have led to limited changes in the structure of output due to marginal productivity growth in services and the prevalence of informality. Informal employment accounts for 90 percent of total employment, the third largest share in SSA. Excluding informality in agriculture, the services sector employs almost two thirds of informal workers (INSAE 2018). Evidence suggests that formal firms are much more productive than informal ones (Aga et al 2019). In Benin, informal workers are between one quarter to one half less productive than formal ones due to differences in endowments such as education and their use.

10. **An overall acceleration in growth depends on the ability of boosting human capital and reducing gender gaps**. Benin's human capital development is inadequate for its per capita GDP level. It is estimated that Benin's next generation will be 20 pp less productive than the best performing aspirational peer (Sri Lanka) and 40 percent as productive as they would have been if they had enjoyed full health and education (Human Capital Index, HCI 2020). Half of the active population has no education. While levels are improving for the younger generations, many children still lack proficiency in basic skills. Benin ranks 123rd out of 156 surveyed economies on the Gender Gap Index (WEF 2021), indicating the persistence of significant gender gaps across all areas. Women are over-represented in the informal economy (95 percent of women have informal jobs) compared with men (85 percent).

11. **Physical capital is improving, but its quality is still insufficient.** Led by private sector investment (which represents close to 80 percent of the total), Benin's total investment has steadily increased since 2010. As a share of GDP, it averaged 23.6 percent during 2016-2019, above the WAEMU (22.3) and SSA (21.5) averages. Despite the sustained increase, the quality of the capital stock remains low with access to infrastructure lagging behind most peers, particularly in transport. Financing the large sectoral needs is a challenge. It will rely on improving the quality of public investment efficiency (IMF 2020) while increasing domestic

revenue to create fiscal space for productive investments and ensuring debt sustainability, and attracting adequate private financing for infrastructure.

12. **Economic diversification and deeper linkages with the global marketplace are needed to promote competition and integration, and to attract technology and capital inflow.** Exporting firms are on average three times more productive than comparable non-exporting firms in Benin. This suggests that deepening trade integration and diversifying into services and other sectors where it has a comparative advantage, could support future productivity growth and formal firm creation. While the country has come a long way in diversifying away from cotton exports, commodities are still prevalent in the export basket (cotton, cashew nuts). They accounted for more than 70 percent of all formal exported goods in 2019, higher than all peers except Ghana and Rwanda. In contrast, openness to services exports remains the lowest of all peers, and lower than expected given Benin's level of income. The expansion of global value chains (GVCs) over recent decades has supported productivity growth in those developing countries that integrated into global markets, while FDI is a key feature of GVCs and is associated with productivity spillovers through the increased availability of cheaper, better quality, or more varied inputs. Deepening market integration, connecting people and creating agglomeration economies through transport infrastructure and services should catalyze additional opportunities, taking advantage of Benin's geographical position as a key node in two important regional corridors.

13. **Accelerating economic growth and creating better jobs, to build a middle-income economy, will require tackling new and persistent challenges.** At Benin's level of economic development, increasing productivity growth is important, but so is focusing on enhanced human and physical capital accumulation. While the economy has been spared by the worse of the COVID-19 crisis, the shock has reinforced the need to focus on structural reforms that address long-term challenges and ensure that economic recovery is sustainable and inclusive. The report suggests three key areas of focus: (1) reducing gender gaps, improving human capital and labor markets; (2) improving transport infrastructure and services to enhance connectivity; (3) integrating into trade to enable economic diversification.

II. Reducing gender gaps, enabling human capital, and improving the quality of the labor market, to create economic benefits from the demographic transition.

14. **Benin has an opportunity to benefit from the demographic transition if the right set of policies are in place.** Benin is still a pre-dividend country. With a rapidly growing population (3 percent) and an average fertility rate at 4.8 children per woman which is substantially higher than that of structural peers (4.3), the bulge of working-age population (15-64) will double from 4 to 8 million in 30 years. Considerable potential exists should total population growth slow and future fertility rates decline fast enough, eventually leading to *the demographic dividend.* The latter refers to an accelerated economic growth that can arise from the increase in the share of the working-age population in the total population of a country, as

experienced by Europe and Asia over the last century (Bloom et al. 2009). Adequate policies need to accompany the process. Improvements in *gender parity, quality investments in human capital, and a reform of the labor market* will play an important role in ensuring that demographic change contributes to economic growth.

Reducing gender gaps is crucial to sustain the demographic transition

15. **Large gender gaps could undermine the demographic transition.** Gaps in social and economic opportunities between women and men remain large and have improved little over the last two decades. In 2021, Benin ranked 123 out of 156 countries in the Gender Gaps Report, better only than Morocco among its peers. It ranked bottom for educational attainment and political empowerment and was below peers' median ranking for health.

16. **Fertility rates can be reduced by improving human development outcomes for women.** These include maternal and child mortality, and education. Reductions in fertility rates are mostly driven by a decline in mortality rates as lower mortality (especially infant mortality) reduce the desire for more childbearing (Herzer et al 2012). High levels of child, infant and maternal mortality result from gender inequalities that may prevent women from receiving the quality of care essential for ensuring healthy pregnancies and deliveries. Though maternal and child mortality have declined in Benin, they have done so more slowly than in structural and aspirational peers. For example, between 2010-2018, Senegal and Rwanda saw their maternal death rate decline by one third, while it only dropped by 14 percent in Benin. Similarly, despite shrinking for younger generations, there are substantial gender gaps in education, particularly in secondary school due to early dropout. Girls have a 12 to 23 pp lower completion rate than boys (WB, Benin Global Partnership for Education Project). Research shows a fairly robust causal relationship between women's education and fertility decline, as well as improved maternal and infant health care.

17. **Social norms help perpetuate high fertility rates and gender inequalities**. Social norms and legal restrictions largely shape the *agency* of women and girls, including on important life decisions about family, education and health. For example, the unmet need for modern contraception in Benin is estimated at 35.3 percent in 2020 (FP 2020). As a result of mixed changes in social norms and socioeconomic gender gaps, women's age at first birth has increased slowly despite urban-rural unevenness and the fact that the time between births has remained constant in the past 20 years. Despite more than halving since the 1970s, close to 20 percent of women are married before the age of 19.

18. **Reducing gender gaps in Benin can have large per capita growth benefits.** Policies that improve human capital and labor markets will help close the gender gap and accelerate growth. Modelling suggests that lower fertility and reduced gender productivity gaps in agriculture and services would help drive an additional 0.35 pp increase in average annual GDP growth and an additional 0.81 pp increase in average annual per capita growth, over the period of 2022-2035. By 2035, GDP could increase by 13.4 percent relative to the baseline, mostly driven by closing productivity gaps in the service sector. By then, per capita GDP will also increase 11.9 percent relative to the baseline, mainly driven by a lower fertility rate that leads to higher labor force participation, particularly for skilled and unskilled females.

Investing in health and education systems will build vital human capital accumulation

19. **Countries investing in human capital have managed to sustain higher rates of growth.** A good example is South Korea during the late 1960s-1980s (Lee 2019). In Benin, public health expenditure as a share of GDP is extremely low (<1percent, or 4.2 percent of total expenditure), reflecting Benin's limited revenue mobilization which constrains spending capacity. Education has been much better funded, representing about 20 percent of the total budget over the same period. However, spending remains low when measured as a share of GDP (3.3 percent) and has been declining. Public spending efficiency is nonetheless relatively adequate in education and health (IMF 2020).

20. **Access to education and health have improved, but quality is still low.** Since the 2000s, Benin has achieved full primary schooling and almost tripled enrolment in secondary schools. Yet large gender gaps and poor quality of education are hindering the adequate formation of the next generation of workers. Teachers' education has been improving but it is still behind structural peers, and while student-teacher ratios have been declining, they remain slightly above peers at 40.9 in 2019. Progress in the health sector has been slow, despite increasing investments in response to the COVID-19 crisis. The quality of healthcare services is inadequate, and the quality of hospitals has not improved over the period 2015-2018. Large disparities exist in access to education and health between rural and northern regions and the opposite in the south.

Improving the quality of the labor market is paramount to absorb youth and women

21. **Despite the high employment rate, the labor market does not generate enough good jobs**. While most of the working age population in Benin is active in the labor market (72 percent), and the unemployment rate is low, there is a large prevalence of underemployment and self-employment. Formal jobs account for less than 10 percent of employment, with women overly represented in the informal economy (95 percent of jobs). The prevalence of informal employment creates significant vulnerability for workers as they are not covered by safety nets. Because of the distortions it creates, pervasive informality affects labor productivity and economic growth.

22. **Low productivity growth reflects a large informal sector**. Labor productivity has increased slowly, reflecting low quality jobs in services and agriculture. Worker productivity marginally increased in the last two decades, growing slower than for most peers (except Togo). It is a quarter of the level in Sri Lanka and a third of Morocco's. Agriculture and services are the biggest employers – both sectors account for about 80 percent of total employment – with women predominantly employed in the tertiary sector. While employment has grown out of agriculture consistently in the past decade, the services sector has failed to create higher quality jobs. Wages and incomes are also generally low, except for skilled wage jobs: 49 percent of unskilled employees earn the minimum wage or below. Low earnings reflect underemployment, and the unskilled nature of the labor force.

23. **Entering the labor force is more difficult for women and youth than it is for adult men, and there are large gender gaps.** 13.4 percent of working-age women are inactive (not working and not in school) twice the rate for working-age men. The inactivity gender gap

declines with age, suggesting it is linked with reproductive age for females, and that it fades with time for men. Young people who fail to find adequate wage jobs in the first years of active life move later into self-employment as a second-best option. Youth (15-34 years) are also much more likely to earn below the minimum wage, and women are twice as likely to be underemployed – particularly in rural areas. Inequalities are larger for women overall. The productivity gaps between men and women were 19% in agriculture, and 54% in the services sector. At every level, from the most unskilled to the most senior, in wage and non-wage employment, women earn less than men.

24. **Active labor market policies and programs can play a crucial role in improving the jobs quality of existing labor markets.** Over the coming decades, Benin's labor market will come under increasing pressure from an additional four million workers. Programs to insert these workers into the labor market and increase the productivity of the active population are crucial. Many existing programs support labor market development and participation directly or indirectly but are significantly fragmented and have limited coverage. Further, while one-third of the programs target youth, none target women specifically. The new National Employment Policy (2020-2025) and Technical and Vocational Education and Training (TVET) strategy (2020-2025) offer a promising way forward. Spending on labor market programs and social assistance will need to increase. Current spending is below 0.15 percent of GDP. While larger than some neighboring countries (like Cote d'Ivoire), with around 140,000 young people expected to enter the labor market every year, it would cost close to US$ 140 million per year (or CFA 77 billion) to offer entrepreneurship support to all new entrants to the labor market (seven times the current amount). OECD countries spent between 0.25 percent of GDP (USA) to 3 percent of GDP (Denmark) in the sector in 2018. Besides these programs, supporting the competitiveness of the private sector and promoting private investments are a complementary policy path.

III. Improving transport infrastructure and services to better connect people and markets, reduce economic distance, and create agglomeration economies

25. **As a small open economy, Benin's economic growth depends on its connections with the region and beyond**. In 2019, its neighboring countries accounted for more than two-thirds of its official international flows of trade, capital, information, and people (Global Connectedness Index 2020). Nigeria is by far the most important, accounting for 41 percent of all linkages. As with other countries in SSA, most of Benin's trade is carried by the region's trunk road network, comprising strategic trading corridors linking deep seaports to economic hinterlands. By connecting people and markets and ensuring service delivery and access to education and health, transport is key for productivity growth and human capital accumulation. Between 2016 and 2019, the formal transport sector was the third largest contributor to GDP growth on the supply-side, after agriculture and other services; and represented approximately 9 percent of GDP. Yet, the current level of infrastructure and associated services is insufficient

and has not kept up with need. As Benin aims at greater integration into global value chains (GVCs) and to take advantage of regional markets, improving its transport backbone is crucial.

Better transport infrastructure and services are needed to build the backbone of a competitive economy

26. **Central to Benin's economy, the Autonomous Port of Cotonou (PAC) has gone through major improvements in the last decade, but still trails its closest competitors**. The PAC is among the most important ports in West Africa, alongside Abidjan, Lagos, Lomé, and Tema. It channels 90 percent of foreign trade, and contributes to 80-85 percent of customs tax collection and about 40 percent of total tax revenues. Following major improvements to infrastructure and modernized operations, it has seen a continuous increase in freight traffic. Despite this, it has not kept pace with its closest neighbors, Lomé (Togo) and Tema (Ghana), who have registered rapid improvements, and are emerging as the leading hub ports in the subregion. The cyclical uncertainties linked to the economic and geopolitical developments in Nigeria, as well as Lomé's ambitious development programs, are some of the main reasons behind this trend. In this context, the PAC's ambitious expansion project in progress (2019-2023) is crucial for it to protect its position, keep up with regional competition and support greater economic competitiveness.

27. **Road transport needs improvement in quality and quantity.** Road transportation accounts for 93 percent of passenger transport and 73 percent of freight (AfDB 2017). Yet, paved national roads in Benin account for less than 50 percent of all roads, a situation that is worse than in all its structural peers. While the situation has improved thanks to the ambitious Government Action Plan (PAG 2016-2021), quality remains poor due to low and inconsistent development of road paving, lack of maintenance, insufficient control, and the absence of overload penalties. The capacity of the government to maintain the road transport network and expand coverage raises some complex trade-offs due to financing constraints. As with other countries in the region, rail and air modes are also below potential.

28. **The quality of transport services has stalled and Benin faces increasing competition in connecting landlocked countries through regional corridors.** Transport services along regional trade corridors are essential to improve the competitiveness of the sector. Much of the transport price burden in SSA is related to the overall regulatory and market structure issues of freight logistics. While Benin is keeping up with the regional average on logistics performance, its performance has worsened since 2010. Chief amongst these services is the trucking industry. Most of the local transport capacity is from informal truckers with old fleets; international haulage activities are undertaken by small private operators; prices are not regulated, and overloading is common due to unenforced regulations. As a result, the country is losing its edge in regional corridors.

29. **Investing in complementary policies (trade facilitation and trucking regulations) will boost the gains from upgrading in transport corridors.** The welfare gains from upgrading several major regional corridors in West Africa, notably the Dakar-Lagos corridor are quantified in a recent study (Lebrand, *forthcoming*). Benin stands to benefit mostly from lowering transport costs in the Abidjan-Lagos portion of the corridor, with benefits on real wages expected to be among the highest. Complementary investments in reducing border

delays would increase the gains from road investments from 1 percent to close to 10 percent. Benin gains from accessing the Nigerian market more seamlessly. Reducing transit delays along the corridor should bring large income gains for most regions of the countries that are crossed by the new corridor.

Connecting people and markets and creating agglomeration economies can boost productivity growth

30. **Economic distance between northern and southern regions accentuates spatial disparities.** Transport infrastructure and services connect people and markets. Between 2009 and 2021, population growth, urbanization and investments in infrastructure have improved market potential in the south and near urban centers. In contrast, three-quarters of the country – mostly rural, and where half of the population still lives – is trailing behind, accentuating spatial disparities. The inequalities in transport infrastructure and services create large economic distances between leading and lagging regions. High domestic transport costs, and lack of adequate services, pose a major challenge to the economic integration of subnational regions and limits their potential for specialization and scale economies.

31. **Rural accessibility remains limited and constrains agricultural producers.** Efforts have been made to improve rural infrastructure through various agriculture rehabilitation programs, notably the Strategic Development of the Agricultural Sector (PSDSA) 2017-2025. Despite the investments, however, only 22.6 percent of the country's rural population lived less than 2km away from an all-weather road in 2016 – a small improvement on the 18.1 percent recorded in 2009. The monitoring of roads investments and maintenance is poor and has deteriorated since 2016. Poor rural road connectivity constrains producers (especially in the north and during the rainy season) from transporting produce in good condition to hubs in the south and onward to markets abroad. Prioritization of rural roads, strengthened road asset management and adequate financing of periodic road maintenance is contemplated in the current reform agenda

32. **Improved transport infrastructure and services can support human capital accumulation.** Access to health and education providers is affected by the availability of reliable and affordable transport services, especially for the poorest (World Bank 2021). In Benin, more than half of women aged between 15-49 from the lowest income quintile report that distance to a health facility is a barrier for seeking treatment. Due to large spatial disparities, the average time to reach a health facility in the country is 3 hours, increasing to more than 7 hours in places like Malanville. Improving road safety and vehicle quality standards also supports human capital accumulation. SSA has the highest levels of under-5 mortality from air pollution, and Benin is among the worst affected with 85 deaths per 100,00 children. Similarly, lack of safe infrastructure and vehicles and enforcement of road safety regulations, lead to high fatality rates, with Benin exceeding regional averages.

33. **Better urban mobility should help trigger agglomeration economies in an increasingly urban country.** Urbanization has been steadily rising since the early 2000s is concentrated in four main urban areas. Cotonou is the most important (with Abomey-Calavi, Porto Novo and Parakou), and accounting for about one-third of the country's GDP and hosting 1.8 million inhabitants in 2018. This expansion creates huge volumes of commuter traffic,

exacerbated by the fact that the city is a major hub for regional and international transport. Many SSA cities offer proximity but limited productivity (Grover et al. *forthcoming*). So far, Benin's urban development fits this pattern. In Cotonou, limited transport infrastructure and services (73 percent of traffic is on two-wheelers) reduce mobility. Improving road traffic management, pedestrian infrastructure and transport services would reduce congestion and negative externalities such as pollution. In turn this could support the development of a more sophisticated private sector able to drive the process of structural transformation through better jobs outside agriculture.

Adequate financing with a stronger regulatory framework is a prerequisite

34. **Sustainable financing is crucial for a modern transport sector.** As in many LMICs, Benin has substantial transport needs while public financing is highly variable and has only increased in the last two years. Most of the annual budget of the Ministry of Infrastructure and transport (MIT) is domestically financed, and while transport's share of the national budget has increased in the last two years, the gap between needs and actual finance remains large. Transport represents one quarter of the Public Investment Plan (2020-21). Road asset management in general remains weak. Road data management systems are poor and hindered by the lack of annual updates. Greater private sector participation in infrastructure creates both potential benefits and risks. In its current form, the legal public-private partnership (PPP) framework has shortcomings when compared with international best practices due to the broad definition of PPPs and limited rules and oversight (e.g., budgetary control during execution is not specified and there are no rules regulating unsolicited proposals, Schwartz et al. 2020).

35. **Strengthening institutions and regulations governing transport and investment, can yield large gains.** Overall, transport regulations are not well enforced, despite the adoption of regional standards, because of weak implementation capacity and oversight. The weak implementation encompasses road safety norms, vehicle standards, and weight regulations. Currently transport legislation mainly focuses on national and extra-urban road networks, intercity and goods transport, and the role of the government and its agencies in these areas. The role of the government in urban mobility is poorly defined, and the concept is not emphasized in the sectoral legislation with municipalities having limited regulatory powers for urban transport and management due to lack of funding. As the country exits the COVID-19 crisis and starts to consolidate its fiscal stance, adequate prioritization, and transparent selection and monitoring will be crucial to ensure returns on investments.

IV. Diversifying exports, upgrading informal transit trade, and strengthening integration for greater economic and productivity growth

36. **By inviting competition and forging integration, trade drives economic diversification and private sector deepening.** Throughout its post-independence history, Benin has relied on external growth drivers such as commodity exports (cotton, cashew) and transit trade with Nigeria, taking advantage of its strategic geographic position. This approach

has however limited the scope of structural change. The reliance on the Nigerian market, through re-export activity, continues to subdue the development of a higher-productivity manufacturing and services sectors. Many of the characteristics that enable firms to take risks, become more efficient, grow larger and innovate are still nascent; while small cross border trade is prevalent. Accelerating growth will depend on Benin's ability to create a dynamic private sector – both formal and informal. Upgrading its linkages with the region and integrating into GVCs can catalyze greater economic diversification and competitiveness. The reopening of the border with Nigeria in 2021, and the ongoing negotiations for the African Continental Free Trade Area (AfCTA) provide a significant opportunity for regional integration and export-led growth.

Reducing exports' concentration and informal transit trade for greater stability

37. **Benin is catching up with peers in terms of trade openness.** Merchandise exports and imports in absolute terms and as a share of GDP – a common measure of openness - have been increasing since 2014. Total goods exports have gained 20 pp of GDP between 2011 and 2019, rising from 47 percent of GDP to close to 65 percent of GDP. It now exceeds the LMIC and SSA average and has caught up with structural peers. Trade openness to services has also increased but is below the level expected by its GDP per capita. Trade in services can be a key determinant in Benin's participation into GVCs (World Bank 2020). A structural current account deficit results from imports consistently exceedingly officially recorded exports, due to the underreporting of large volumes of transit trade, especially to Nigeria (Golub et al. 2019).

38. **Export products and markets are relatively concentrated, with commodities dominating the export basket.** Primary products are predominant exports throughout the last decade. Benin's main staple crops are cotton, cashew nut and oilseed crops, along with some wood and metal products. Cotton remains at the top, representing about 30 percent of exports in 2017-19 as the country became the main cotton producer in West Africa for the 2018-2020 campaigns. About 76 percent of cotton exports are destined for Bangladesh and India. Product diversity remains lower than that of most of its structural peers, Togo, and Senegal. Its markets remain much more concentrated than for all structural peers except Rwanda. For product diversification Benin lags relative to its structural peers (78.4 percent of total exports composed of top 5 products). For market diversification, 75 percent of Benin's exports go to its top 5 export partners – this is more than for its peers, though it is less dependent than Rwanda on its top export partner. South Asia is the main destination of total official recorded exports, with SSA trailing far behind in third place.

39. **Intraregional trade is underreported as informal trade remains pervasive.** While SSA appears to be the third destination of total recorded exports value (UNCTAD), transaction level data (from customs) suggest firms export primarily within the region: the largest number of firms exported to SSA, followed by South Asia, Europe/Central Asia, and East Asia. The pervasiveness and persistence of informal trade distort the perception of trade dynamics. A comparison between customs data and surveys of informal traders suggests an underestimation of 50 percent for imports, and by about 85 percent for exports (Bensassi et al 2018). Product diversity in regional trade is underestimated in official statistics. Benin relies heavily on customs revenues from this trade although the overreliance has been declining in recent years thanks to reforms in tax administration and tax policy. In 2016, half of its tax

revenues were customs duties, a fourth linked to re-exports with Nigeria, but these were down to 40 percent in 2019 (World Bank, ICR Report 2020). Supporting small-scale cross-border trade is also important to improve living conditions in border districts.

40. **Participation into GVCs is nascent.** GVC participation boosts export and economic diversification. Countries with higher participation rates are more likely to increase their outputs, consequently, reducing the concentration rate of products and markets (WDR 2020). Benin's participation into GVCs is nascent. Although larger than for structural peers like Togo and Senegal, it still falls into the category of *limited commodity exporters*. The country could gain in the transition to more sophisticated participation in GVCs. The path toward greater integration into global value chains, for a commodity exporter like Benin will require a multipronged strategy covering different policy areas. Similarly, a more enabling FDI regime could boost Benin's potential in manufacturing and services.

Diversifying the economy through new export opportunities and greater regional integration

41. **The scope for future diversification of merchandise exports is large.** Benin shows a significant *latent diversification potential* in manufacturing goods due to a historical knowledge of producing numerous and diverse goods, which is indicative of opportunities to further diversify the export bundle if the right endowments are in place. At the same time, its scope for diversification has improved between 2007 and 2018, based on the *fitness measure for economic development*. Relative to other countries in SSA, Benin has improved the most, increasing its rank 31 places between 2007 (141st) and 2018 (113th) with 19 out of 24 sectors improving including apparel, leather, textile products, furniture, plastics, and metals. Primary metals, crops, wood, and forestry display the highest levels of competitiveness. Agro-foods, textiles, clothing, and wood products were identified as an area for export diversification and growth, consistent with the Revealed Comparative Advantage (RCA). Fruits and vegetables are among the sectors with highest potential growth. Improving cold chain logistics both for road and air freight is key to this.

42. **Services provide opportunities for a wider range of exports and a broader base of domestic activities.** Benin's services export is relatively diversified but trails behind comparator countries in terms of level and growth. Both travel and other services categories have almost remained at the same level since during 2010-18. Transport and financial services show the strongest performance, the first doubling and the latter growing 6 times as much. Services provide opportunities for a wider range of exports and a broader base of domestic activities and can act as a catalyst for economy wide productivity (Nayyar et al *forthcoming*).

43. **Creating more stable market relationship, and taking advantage of opportunities from the African Continental Free Trade Area (AfCFTA) would support diversification**. Successful export growth and diversification require not only entry into new export products and markets but also the survival and growth of export flows (Brenton et al. 2010). Two out of three export relationships don't survive for two consecutive year, placing its export survival rate below that of its peers. The survival rate is highest for firms exporting to ECOWAS and the EU. In terms of survival by product group, the highest survival rate is for wood and metal products while those in manufacturing (chemicals and machinery) are the lowest. From a policy perspective, understanding the main challenges to export survival is key to promoting

diversification. The AfCFTA is another opportunity to forge stronger integration into regional markets, and to strengthen relationships with neighboring countries such as Nigeria. At the heart of the benefits from the AfCTA is Benin's position within regional corridors.

44. **Strengthening trade relationship with Nigeria should reduce growth volatility.** Nigeria is the main trading partner (including unrecorded flows), and the destination of 25.2 percent of its recorded exports in 2019 (WITS). It has been its fastest growing export market over the last five years, with a population 2000 times as large. Traditionally, Benin has used its proximity, the relative greater competitiveness of its port and the porous borders to supply Nigeria via its land border through the re-exports of goods that face import restrictions in the latter. As a result, imports are dominated by products that are mostly destined for transit trade, notably rice for which it is the 6th largest importer in the world. Evidence using GPS data shows that cross-border flows are mostly concentrated along the Southern corridor between Lomé and Lagos through Cotonou, but that a significant share of crossings also happen along the rest of the border. Tensions between Benin and Nigeria escalated in 2019 with the closure of Nigeria's land borders in August 2019. It led to a general decrease in border crossings as well as a reallocation across border crossings, mostly from official border points to outside of official border points. The announced reopening of the border in early 2021 offers an opportunity for improving relationships.

Strengthening the ecosystem for diversification

45. **Exporting firms can increase the competitiveness of the private sector.** SMEs dominate the formal private sector, but firm creation is weak and those that exist fail to generate commensurate value added. New formal business entry density grew from 0.31 in 2013 to 0.54 in 2018 (WDI), the lowest among peers except Senegal**.** Low productivity and average capacity utilization suggest large inefficiencies. Overall, manufacturing firms tend to perform significantly better than services; and so do large firms (100+ employees). The value added per worker for large firms is more than 4.5 times as high as for small firms and almost three times as much as for medium firms. Exporting firms are also more competitive and can boost productivity in the tradable sector. They have three times the value added per worker than non-exporting firms. Expanding the size of the export-oriented sector is important to increase positive spillovers from trade (Dix Carneiro et al 2021).

46. **Tackling constraints to exports and technology adoption will support productivity growth.** The three main obstacles to exports, as reported by firms, are customs procedures, transportation costs and the implementation of existing trade agreements. The most important obstacle to exports, by far, are customs procedures. Further, 23.5 percent of firms reported transportation costs as a major obstacle to exports. The third most important issue is cargo handling and port procedures or requirements. While transportation costs may not be straightforward for the government to address in the short-term, customs, cargo and port procedures can represent quick wins to increase exports. The main reasons preventing technology adoption by firms are the high costs compared to benefits, a lack of information, and difficulty in access to finance.

47. **Reducing the costs to accessing global markets will support greater integration and diversification.** Tariff policy matters for export competitiveness and diversification. As a

member of ECOWAS and WAEMU, two partially overlapping regional agreements that have a common external tariff (CET), Benin does not have full independence to set its own tariff policy or to pursue preferential trade agreements (PTAs) on its own. It still displays slightly higher costs compared to structural peers in the WAEMU. Transport costs and non-tariff measures (NTMs) faced by firms - which have a higher coverage and a greater frequency per covered product than most of its peers in the WAEMU – could explain this. Reducing these barriers, including weak customs and border procedures through trade facilitation could allow greater gains from trade for all types of traders, including small scale cross border ones.

The way forward to a strong middle-income economy

48. **Table 1 highlights selected policy options arising from the analysis in each chapter.** The policy options presented have been prioritized to be compatible with implementation capacity, drawing on the analysis within the report and experience gained from projects and the countries it is benchmarked against. Each chapter provides detailed actions. The highlighted measures below were chosen for their impact and the fiscal implications and timeframe for reforms are included indicatively.

Table 1: Selected policy options	Timeline for implementation	Fiscal Implications
Attain demographic dividends		
1. Increase coverage to family planning services. Adopt the application decrees of the sexual and reproductive health law of 2003, that reinforces access to contraception, regulates sale and imports of contraception for overall access to sexual and reproductive health including family planning.	Short term	Low
2. Increase girls' education – particularly secondary and in rural areas. Policy options include interventions such as school subsidies (to provide school kits, manuals, menstrual products, others) or cash transfers to maintain girls at school (best practice in Malawi), as well as reducing gender-based violence.	Short-to Medium term	Medium
3. Reduce the fragmentation of labor market programs, improve targeting through the finalization of the Unified Social Registry.	Medium term	Medium
Connect markets and people		
4. Strengthen road asset management. Ensure the new SIRB has identify dedicated and predictable funding sources for road maintenance and rehabilitation based on the 'user-payer' principle to apply structured user charges to cover the full cost of road maintenance and rehabilitation, traffic management, and road safety enhancements; and reinforce the capacity of road agencies and asset management systems.	Medium term	High
5. Strengthen the prioritization tools for rural road investments. Multi-Criteria Decision (MCD) models have become widely used as the main prioritization tool for road investment in recent years.	Medium term	Low (with potential fiscal gains)

6. Strengthen the PPP framework. Enhance the definition of PPP; strengthen rules and oversight mechanisms; and regulate unsolicited proposals.	Short-term	Low (with potential fiscal gains)
Diversify the economy through trade		
7. Increase customs efficiency and more effectively facilitate trade. This includes improving automation, implementing a modern risk management and audit system as well as moving forward with an Authorized Economic Operator system.	Medium-term	Medium to high
8. Improve the conditions of SSCB traders. Put in place measures that can help simplify, streamline, and/or decentralize existing procedures and requirement; consider increasing the number of women staff in the ranks of border agencies; Improve border infrastructure through low-cost interventions (surveillance cameras, lighting facilities, night patrol guards).	Medium-term	Medium
9. Develop a cross-government approach to the AfCFTA: Develop a strong cross-government and private sector consultation process and inform negotiations in view of ratifying AfCFTA.	Short-term	Low

Notes: short-term (1 year); medium-term (2-3 years); long term is +3 years; fiscal implications are estimated as low: affordab within current spending structure; medium: requires budget reallocation; high: need further reform, funding sources and do revenue mobilization.

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