

## The Critical Role of Informal Trading with Nigeria

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### I INTRODUCTION

Benin's approximately 800 km north–south border with Nigeria plays a critical role in Benin's economy. Nigeria's population of around 190 million is nearly twenty times larger than Benin's and the differential in gross domestic product (GDP) is even larger, with Nigeria's output equal to nearly forty times Benin's, reflecting Nigeria's oil wealth rather than a higher standard of living. Thus, the economic relationship between the two countries is necessarily asymmetrical, with Nigeria's influence on Benin much more powerful than vice versa. Moreover, Nigeria's combination of massive oil wealth, interventionist economic policies, and high levels of corruption has led to pervasive distortions and inefficiencies.

It is in this context, during the first oil shock in 1973, that Benin adopted a development policy centred on serving as an 'entrepôt state' vis-à-vis its neighbours, particularly Nigeria (Igué and Soulé, 1992). That is, Benin aimed to expand its role as a trading hub, importing goods and re-exporting them to Nigeria, thus profiting from the distortions in Nigeria's economy. Heilbrunn (1999) aptly described Benin as the 'Flea on Nigeria's Back'.

Benin's dependence on Nigeria is not apparent from official trade statistics, with Benin's reported trade with Nigeria accounting for only about 6 per cent of Benin's exports and 2 per cent of Benin's imports in 2015–2017.<sup>1</sup> These official

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<sup>†</sup> Deceased.

<sup>1</sup> Based on data from International Monetary Fund (IMF) *Direction of Trade Statistics*, <https://data.imf.org/?sk=9D6028D4-F14A-464C-A2F2-59B2CD424B85>.

statistics are very misleading, however, as they ignore the huge unrecorded informal trade between the two countries (Benjamin et al., 2015). As we discuss in detail in this chapter, Benin imports very large quantities of consumer goods that are subject to high import protection in Nigeria and then transships them to Nigeria through elaborate institutional mechanisms. Conversely, Benin illegally imports a large proportion of its petroleum products from Nigeria, where consumer prices are highly subsidised. This two-way informal cross-border trade (ICBT) has in the past accounted for a large share of Benin's income, employment, and fiscal revenues. Recently, however, the volume of this trade has dropped considerably due to a recession in Nigeria, revealing its fragile foundations. This chapter will analyse the nature, institutional foundations, and consequences of ICBT between the two countries, and it will draw out policy implications.

ICBT is pervasive in sub-Saharan Africa, reflecting a confluence of historical and institutional factors: artificial national borders established in the colonial era and maintained after independence; porous borders between contiguous nations; a long history of regional trade pre-dating the colonial era; kinship groups that transcend national borders; weak border enforcement capabilities; corruption of high- and low-level officials who profit from collusion with traders; and, perhaps most importantly, lack of coordination of economic policies among countries sharing these borders (Golub, 2015). We will show how these factors play out in a particularly dramatic way in Benin.

An interesting dimension of regional ICBT is the intense competition between Benin and Togo for informal access to the Nigerian market. Togo is less well situated geographically than Benin for transshipping to Nigeria, since goods coming from Togo must go through Benin or Niger, but Togo compensates in part through lower taxes and fees (Golub, 2012). Although land-locked, Niger is also heavily involved in smuggling to Nigeria (Hashim and Meagher, 1999); so too is Cameroon, though to a lesser extent (Golub and Kobou, 2019).

Benin has developed elaborate institutional mechanisms to support ICBT, notably through specific customs procedures. In some respects these mechanisms are quite efficacious, belying the notion that institutions in Benin are dysfunctional. At the same time, however, the national priority placed on promoting unofficial trade is not a viable long-run strategy for development. The recent downturn in the re-export trade starkly reveals Benin's vulnerability to shocks in Nigeria. Even more so than for other countries of the region, Benin's economy is dominated by the informal sector, which provides a dubious foundation for sustainable long-term development (Benjamin and Mbaye, 2012; Mbaye et al., 2019).

Despite the vulnerability to shocks in Nigeria and the questionable sustainability of informal trade, Benin's heavy dependence on this trade for government revenues and the numerous beneficiaries among both formal and informal operators explain the government's reluctance to crack down on smuggling. Furthermore, even if the government were determined to shut down informal trade with Nigeria, it would be difficult to do so as long as the underlying incentives created by Nigeria's distortions remain. Large price

differences between adjacent countries with porous borders are an invitation to smuggling that ingenious traders are bound to exploit. Thus, rather than focus on eradicating ICBT, the government should pursue policies to diversify Benin's economy to reduce its vulnerability to Nigeria's instability.

In this chapter, we focus on two of the main dimensions of Benin's ICBT with Nigeria: imports of goods subject to heavy protection in Nigeria, particularly used cars and rice, which are then re-exported to Nigeria; and Benin's imports of petroleum products, which are highly subsidised in Nigeria. The remainder of the chapter is organised as follows. Section II provides historical background. Section III discusses the effect of divergent economic policies as a key driver of informal trade between Benin and Nigeria, particularly Nigeria's high import protection and fuel subsidies. Section IV provides evidence on the magnitude of informal trade. Section V describes the institutional processes governing informal trade, particularly the role of customs administration, with illustrations in the cases of used cars, rice, and petroleum products. Section VI analyses the effects of informal trade on Benin's economy, particularly fiscal revenues. Section VII concludes.

## II HISTORICAL ECONOMIC RELATIONS BETWEEN BENIN AND NIGERIA

Benin and Nigeria have deep historical economic ties, reflecting their geographical and cultural proximity. The two countries share several languages and ethnicities. Trade within the region pre-dates the colonial period, was altered by colonial economic and political relations, and further adapted to post-colonial political and social developments, most importantly divergent trade and other economic policies.

Yoruba, Hausa, and Ibo trading networks operated prior to the colonial era, but expanded in response to the arrival of European traders in the seventeenth century (Igué and Soulé, 1992; Hashim and Meagher, 1999). Long-distance caravan trade routes linking coastal West Africa with the Sahara and the interior were based on artisanal and ecological comparative advantages, but even in pre-colonial times trade patterns of taxation and tolls impinged on trading routes. The kingdom of Dahomey, corresponding geographically to a southern part of contemporary Benin, had highly developed institutions that facilitated economic ties with Europe, notably the slave trade centred around the town of Ouidah. English, Portuguese, Dutch, and French ships arrived in Ouidah loaded with tobacco, liquor, guns, and miscellaneous items of cheap junk much prized by the local population, which were exchanged for large numbers of slaves. The slave trade was a major source of revenue for the kings of Abomey, who designated a special representative ('Yovogan' or 'chief of whites') to administer the trading relationships between leading local merchants with European slave traders (Igué and Soulé, 1992).

In the second half of the nineteenth century, as the slave trade collapsed, traders switched from slaves to palm oil, transacting with French trading firms

from Marseille, which created trading posts in Dahomey exporting palm nuts and oil in exchange for tobacco, guns, cloth, and vegetables.

The official colonisation of Dahomey in 1894 by the French altered trading relationships for several reasons. The French colonial government granted a monopoly to French trading companies, spurring the creation of unofficial networks by displaced local businesspeople. The geographical situation of the new colony of Dahomey, sandwiched between German-controlled Togo and English-controlled Nigeria, provided a corridor for French trade with its landlocked colonies, Niger and Upper Volta (now Burkina Faso), creating a precursor to Benin's role as an entrepôt. Furthermore, Dahomey's relatively advanced educational system reinforced its advantage as a commercial hub. The Yoruba group's spread provided a network across the region along the Gulf of Guinea.

The colonial borders between Dahomey and Nigeria were largely retained as national frontiers when the countries gained independence in the 1960s. These borders artificially separated people sharing similar cultural backgrounds, who largely disregarded official borders in their social relations. As Isyaku (2017, pp. 210–13) describes it:

The traditional rulers have always refused to accept this situation [partition ...] The socio-cultural relationship between the two states is further fostered by the fact that Yoruba groups occupying the contiguous localities claimed a common origin from Ile-Ife, spoke [...] dialects of the same language and possessed similar political, social and religious institutions. Economic links, particularly commercial routes and markets, contribute to this cultural uniformity.

In the post-colonial period, kinship groups continued to play a major role in organising informal trade between Benin and Nigeria, notably the Yoruba (Igué and Soulé, 1992; Igué, 2003; Golub and Hansen-Lewis, 2012). Along the northern frontier between the two countries, the Hausa are dominant. Adherence to Islam is a source of solidarity and motivation for both the Hausa and the Yoruba, providing security for transactions, mutual assistance, and credit, all based on trust rather than formal contracts (Sudarkasa, 1985). In recent years, however, there have been numerous clashes between Yoruba and Hausa traders over control of markets (Porter et al., 2010).

Informal trade was boosted by the instability in Nigeria following the Biafra war in 1967, with an influx of Ibo refugee traders into Benin, and Benin supplying goods to sections of Nigeria cut off from supplies. During the war, Benin became a major cocoa exporter, despite non-existent production of this product, as Nigerian cocoa was diverted through Benin.

Starting in 1973, Benin adopted low-tariff policies to facilitate the entrepôt role of Cotonou to take advantage of the oil boom in Nigeria following the first oil shock. Benin also took steps to expand access to credit to importers by opening up the banking system, and deregulated the importation of key products, such as rice, formerly monopolised by state-owned firms. The Marxist government of Benin deployed the nationalised banking system in favour of

the re-export trade. These credits were limited to Beninese nationals, with defaults on these loans contributing to the banking crisis of the late 1980s (Hashim and Meagher, 1999). During the 1980s and 1990s, Benin took several further steps to liberalise its imports. Customs duties were waived on the two main items re-exported to Nigeria at that time: rice and cloth. In 1985, the state monopoly on imports was eliminated. In 1993, all remaining quantitative restrictions on imports were removed. In 1994, a simplified system of customs duties with a maximum rate of 20 per cent was established, with rice and cloth still exempt (IMF, 1996).

The West African Economic and Monetary Union (WAEMU), a group of mostly francophone countries of which Benin is a member (and of which anglophone Nigeria is not), established a common external tariff (CET) in 2001 that lowered import duties for most member countries but raised them for Benin (and Togo), particularly for cloth, rice, and other important re-export goods (Soulé, 2000, Table 7.3). Nevertheless, the WAEMU duties remained well below those in Nigeria. Moreover, Benin has found ways of circumventing WAEMU import taxes by exercising customs valuation with consideration discretion, and most importantly making greater use of special customs regimes for transit and re-exports, through which it imports at very low tax rates. These customs regimes are described in detail in Section V.

Both Benin and Nigeria are members of the larger regional group the Economic Community of West African States (ECOWAS), which encompasses both the francophone and anglophone nations of West Africa. ECOWAS has progressed far less than WAEMU in regional integration. Some cooperative regional efforts have advanced, particularly in the political realm, but Nigeria is large enough that it has seen little need to coordinate with its much smaller neighbours, and it has sometimes obstructed or failed to implement ECOWAS harmonisation efforts (Hoffman and Melly, 2015). After numerous delays, ECOWAS agreed to a CET in 2013. Although Nigeria is among the countries that have adopted the CET in principle, in practice it has not fully implemented this regime, or has availed itself of escape clause provisions that allow higher protection. Thus, a number of Nigerian imports face tariffs that exceed the ECOWAS maximum of 35 per cent, and there remains a list of items facing outright bans, as discussed later.

Nigeria has made repeated threats to eradicate smuggling, but with little lasting effect. The borders have sometimes been closed due to other political tensions between the two countries. From February 1984 to February 1986, Nigeria shut down the border with Benin in an effort to curb smuggling of petroleum products out of Nigeria. During this time, Nigeria closed down all service stations within 10 km of the border with Benin, in a futile attempt to curb smuggling. Heilbrunn (1999) observes that the effects of the border closures were short-lived at best and that the recession in Nigeria in 1985 had far larger effects on lowering ICBT than the ineffectual measures of the Nigerian authorities.

In 1996, President Abacha of Nigeria closed the border in a political dispute with Benin's President Soglo, related to the latter's military cooperation with the USA, which Abacha viewed as a threat. The resulting dislocations in Benin, notably gasoline shortages, contributed to Soglo's loss in the 1996 presidential elections.

In August 2003, the border was closed for a week following a confrontation between the Nigerian and Beninese governments precipitated by the harbouring of a suspected Nigerian criminal in Cotonou.<sup>2</sup> Only when he was turned over to the Nigerian authorities following a meeting between Obasanjo and President Kerekou of Benin in Badagry, Nigeria, was the border re-opened. Following the meeting, the two presidents issued the 'Memorandum of Badagry', which committed the Benin and Nigerian governments to fostering formal trade relations while curtailing smuggling and criminality. In March 2008, Nigeria initiated a crackdown on imports of used cars, holding up car convoys at the usual crossing points such as Kraké and Igolo (Houngbo, 2008). More recently, President Buhari has taken a number of measures to curb smuggling from Benin, notably prohibiting imports of rice and cars through land borders once again.

Notwithstanding these occasional border closings and frequent threats from Nigeria, the re-export trade has always recovered as the enforcement of border controls reverts to its normal laxity. A sharp downturn in informal trade in 2015–2017 for some products, notably used cars, has yet to be fully reversed. As discussed in what follows, this prolonged decline is likely due more to the recession in Nigeria dampening demand than to border closures. Regardless, these episodes reveal Benin's acute vulnerability to economic shocks from Nigeria.

Officials from Benin and Nigeria have recently announced joint efforts to curb smuggling (Goudreau, 2018). Further, the two governments have just opened a joint centre for customs control at the largest official border crossing between the countries – the Seme–Kraké corridor. As commentators have noted, however, most smuggling does not go through official border posts, so the utility of this initiative is questionable (AFP, 2018). More generally, the implementation of anti-smuggling measures is likely to remain ineffectual given the disparate interests of the countries involved, and, more importantly, given the beneficiaries of smuggling within them, as will be described.

### III CAUSES OF INFORMAL TRADE: NIGERIA'S PERVASIVE DISTORTIONS INCENTIVISE SMUGGLING

The most important underlying source of Benin's informal trade is Nigeria's dysfunctional economic policies, which provide incentives for traders to profit

<sup>2</sup> The case involved the assassination of one of then-Nigerian President Obasanjo's nieces in a carjacking in Lagos. The carjacking ring stole cars in Nigeria and took them to Cotonou. The head of the carjacking ring, Tidjani Hamani, a Niger national, was based in Cotonou, where he was released by the Benin judiciary after having been arrested.

from circumventing them. It is beyond the scope of this chapter to analyse in detail the reasons for Nigeria's corruption and mismanagement, but it surely reflects a combination of Nigeria's size, ethnic fractionalisation, and oil wealth. Indeed, Nigeria has been one of the starkest examples of the 'resource curse', whereby natural resources such as oil contribute to inefficiencies and corruption (Venables, 2016). Revenues from natural resources crowd out manufacturing and agriculture. Nigeria has attempted to maintain its industrial and agricultural base through import substitution, but this has largely fostered inefficiency and incentives for evasion. Worse, large resource rents can provide an irresistible political temptation to engage in the notorious wasteful spending and corruption that occur in Nigeria.

In effect, therefore, Nigeria's resource curse and institutional weaknesses have been transmitted to Benin. The distortions in Nigeria fuelled by oil and corruption provide economic rents to smugglers in Benin, so much so that much of Benin's institutions, both formal and informal, have evolved to capture these rents.

The dominance of the informal sector and the artificial nature of national borders in West Africa are also crucial underlying causes of the informalisation of trade. Throughout West Africa, and particularly in Benin, the informal sector represents approximately 50 per cent of GDP and 90 per cent of employment. The ascendancy of the informal sector, including ICBT, is both the cause and effect of the weakness of the formal sector. With the economic crisis and subsequent structural adjustment programmes of the 1980s, government employment dropped sharply in Benin as in other sub-Saharan countries and formal private-sector employment failed to pick up the slack as the business environment remained poor (Golub and Hayat, 2015). The informal sector became the employer of last resort, particularly for young people newly entering the labour market, even those with substantial education (Benjamin and Mbaye, 2012; Mbaye et al., 2019). Many of the informal gasoline transporters and retailers are young people with secondary education who are unable to obtain formal jobs. The booming informal sector in turn contributes to the hostile climate for formal business investment, creating a vicious cycle.

Moreover, contrary to common perceptions, the informal sector is in some respects better organised than the formal sector, with large informal firms often rivalling formal firms in size, and kinship groups linking together informal operators into networks that cross borders and even continents. The Yoruba and the Hausa are particularly important for Benin–Nigeria ICBT, as previously noted.

### **A Import Protection in Nigeria**

Nigeria has long had some of the most restrictive import barriers in the world, including very high tariffs and import prohibitions, while Benin (and Togo) have deliberately maintained low import taxes to foster their roles as entrepôts for Nigeria (Igué and Soulé, 1992). Recent research has confirmed the importance

TABLE 8.1 *Nigeria's import barriers on selected products, import tax rates (per cent) and import bans, 1995–2018*

	1995	2001	2007	2013	2018
Beer	Banned	100	Banned	Banned	Banned
Cloth and apparel	Banned	55	Banned	Banned	45/Forex ban**
Poultry meat	Banned	75	Banned	Banned	Banned
Rice	100	75	50	100	70***
Sugar	10	40	50	60	70
Cigarettes	90	80	50	50	95
Used cars*	Banned	Banned	Banned	Banned	Banned/70
Vegetable oil	Banned	40	Banned	Banned	Banned

Sources: Authors' calculations based on data from Soulé (2004), Nigerian customs data provided by the World Bank, Nigerian import prohibition list [www.customs.gov.ng/ProhibitionList/import.php](http://www.customs.gov.ng/ProhibitionList/import.php), online reports, and World Trade Organization (2017).

\* The maximum age of cars banned from import has varied over time: it was more than eight years old in 1995, and was more than five years old in 2001; it then moved back to more than eight years old in 2007 and is now more than 15 years old. In addition, imports via land borders have been banned since 2016.

\*\* Banned from using the official foreign exchange market.

\*\*\* Rice imports through land borders banned since 2013.

of Nigeria's import barriers in driving unofficial exports from Benin to Nigeria (Golub, 2012; Raballand and Mjekiqi, 2010; Bensassi et al., 2018).

Table 8.1 displays Nigeria's import restrictions on some of the key products of the re-export trade as they have evolved over time. Unlike Benin (and Togo), Nigeria has aggressively promoted domestic manufacturing and agricultural industries through import substitution, unfortunately usually resulting in highly inefficient production, with powerful interest groups favouring continued protection. While Nigeria has liberalised some sectors as part of the ECOWAS harmonisation efforts already noted, including reducing the number of goods that are subject to import bans, progress has often been reversed. For example, in 2015 Nigeria lifted its import ban on textile (cloth and clothing) imports, but then raised the import tariff to 45 per cent in 2016 and placed textiles on a list of goods that were ineligible to use the official foreign exchange market, in effect raising transactions costs via a de facto additional tax on imports to the extent that the unofficial exchange rate tends to be depreciated relative to the official rate.

Import taxes on goods for domestic consumption have generally been lower in Benin than in Nigeria. With the advent of the ECOWAS CET in 2015, these differences have declined for many goods, but for goods for domestic consumption and others subject to special protection in Nigeria large gaps remain. Furthermore, import duties in Benin are largely irrelevant for unofficial trade to Nigeria, as products destined for diversion to Nigeria are mostly imported via special transit and re-export regimes with very low tax rates, rather than for domestic consumption,



where normal duties and value-added taxes apply. In cases where Nigerian protection is particularly elevated, it can still be advantageous to import goods for domestic consumption and re-export to Nigeria, but clearly importing under transit and re-export status is even more attractive. The extent to which imports intended for Nigeria enter under a regime for transit rather than for domestic use varies considerably by product and over time, as we discuss further later.

## **B Macro-economic and Exchange Rate Policies in Nigeria**

Macro-economic policies, particularly exchange rate policy, are another relevant factor driving cross-border trade, with Nigeria having a crawling peg to the US\$ but an inconvertible exchange rate regime, while Benin is a member of the WAEMU Communauté Financière en Afrique (CFA) Franc single currency, formerly pegged to the French Franc and now to the Euro.

Nigeria's economy is highly dependent on oil, and thus subject to shocks from fluctuations in world oil prices. The recent recession in Nigeria in 2015–2017, associated with a sharp downturn in world oil prices, provides a clear example of the spill-over effects of Nigerian macro-economic developments on Benin. The Buhari administration resisted devaluing the Nigerian Naira (NGN) despite severe balance of payments pressures. As a result, a shortage of foreign currency exacerbated the recession in Nigeria. Equally importantly, the black market exchange rate depreciated sharply while the official exchange rate remained fixed, as shown in Figure 8.1. With ICBT largely operating in the parallel foreign exchange market, the purchasing power of Nigerian consumers fell further as the black market exchange rate depreciated precipitously. At the end of 2014, Nigeria's black market exchange rate was at less than a 10 per cent discount under the official exchange rate of about NGN 180 per US\$. As the foreign exchange shortage worsened, in early 2016 the black market rate had depreciated to about NGN 350 per US\$. A 30 per cent official devaluation in June 2016 temporarily eased pressures, but the situation soon deteriorated again after the official exchange rate was repegged at NGN 300 per US\$. By February 2017, the black market exchange rate had tumbled again to about NGN 500 per US\$. Since mid-2017 the black market discount has declined considerably due to the recovery of the price of oil and Nigeria's balance of payments.

The recession in Nigeria and the depreciation of the black market exchange rate were major causes of the sharp downturn in Benin's ICBT in 2016–2017, as described in Section III.C.

## **C Subsidised Fuel Prices**

The main underlying source of the pervasive informal trade in petroleum products is differential official pricing mechanisms between Nigeria and its franco-phone neighbours. Nigeria has long delinked domestic and world prices of fuel and set very low domestic prices, whereas Benin has largely aligned domestic prices to world prices. Official prices of gasoline in Benin have greatly exceeded

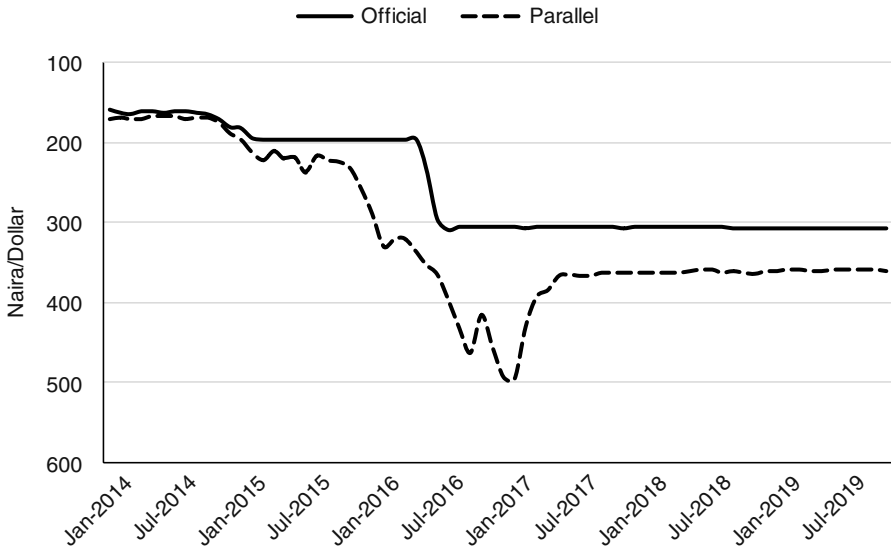


FIGURE 8.1 Nigeria’s official and black market exchange rates (NGN per US\$)

those in Nigeria for the past three decades, with an average margin of US\$0.22/litre for Benin in 1991–2016.<sup>3</sup> Similar differentials exist for other petroleum products, although the gap for diesel is smaller. Consequently, Benin imports almost all its fuel informally.

### D Port Efficiency

Nigeria’s adverse business climate and particularly poorly functioning port and customs also contribute to the attractiveness of Cotonou as an entrepôt. According to the World Bank Doing Business indicators in 2018,<sup>4</sup> Nigeria is ranked among the worst in the world as regards the ease of trading across borders, at 182nd out of 190 countries, despite efforts to improve port functioning. Benin’s ranking is mediocre, at 107th in the world, but far better than Nigeria. Correspondingly, the time to comply with border and documentary procedures is about three times longer in Nigeria and Benin. Various studies have documented the greater efficiency of the port of Cotonou relative to Nigeria (Hoffman and Melly, 2015, 2018; Ezeoha et al., 2019), motivated in part by Benin’s efforts to boost its entrepôt status.

While Benin endeavours to maintain better trade facilitation than Nigeria, that is a low bar: Benin is indeed superior to Nigeria in port functioning, but

<sup>3</sup> World Development Indicators (WDI), <https://databank.worldbank.org/source/world-development-indicators>.

<sup>4</sup> <https://databank.worldbank.org/source/doing-business>.

the port of Cotonou is still far from global best practices. This is even more true for other aspects of the business environment, where Benin is often ranked below Nigeria. Benin's overall ranking in the Doing Business indicators is 153rd, slightly worse than Nigeria's 146th. Benin does particularly poorly on important areas such as electricity provision and contract enforcement.

In short, Benin's trade facilitation institutions function better than Nigeria's, but Benin's overall business climate is poor.

#### IV MAGNITUDE OF ENTREPÔT TRADE BETWEEN BENIN AND NIGERIA

This section provides estimates of the magnitude of ICBT between Benin and Nigeria for Benin's smuggling of imported goods into Nigeria and Benin's informal imports of petroleum products.

Smuggling is of course difficult to measure, but can be estimated indirectly through the magnitude of official imports per capita into Benin compared to Nigeria and other countries (Benjamin et al., 2015). Our previous work showed that imports per capita into Benin of certain products that are heavily protected in Nigeria are far too large to be explained by Benin's domestic consumption. In this section we update our comparisons of imports per capita in Benin, Togo, and Nigeria for some of the key products of the *entrepôt* trade – namely, those that are heavily protected in Nigeria. We confirm that imports into Benin (and also Togo) are much too large to be explained by domestic consumption. Recently, however, Benin's imports of some of these key products have dropped off sharply. Figures 8.2a–d show imports per capita for cars, rice, cotton cloth, and poultry, respectively, for Benin, Togo, and Nigeria.<sup>5</sup>

While there is some domestic Nigerian production of these products, which is, after all, why they are protected, it is typically low relative to domestic consumption, or not large enough to explain the very large differences in import patterns displayed in these figures.

##### A Cars

Nigeria has banned imports of used cars beyond a certain age in an effort to protect its highly inefficient auto industry. While the permissible age of cars has gradually increased, all imports through land borders were banned in 2016. Nigeria also recently implemented an increase in tariffs. Despite this high protection, Nigerian automobile production has steadily declined to very low levels (Proshare, 2013). No other countries in West Africa produce cars. Togo and especially Benin have developed car-import value chains largely to

<sup>5</sup> Imports are from the UN Comtrade database (<https://comtradeplus.un.org>), measured as the US\$ value of world exports to the respective country. Population is from World Bank World Development Indicators online.

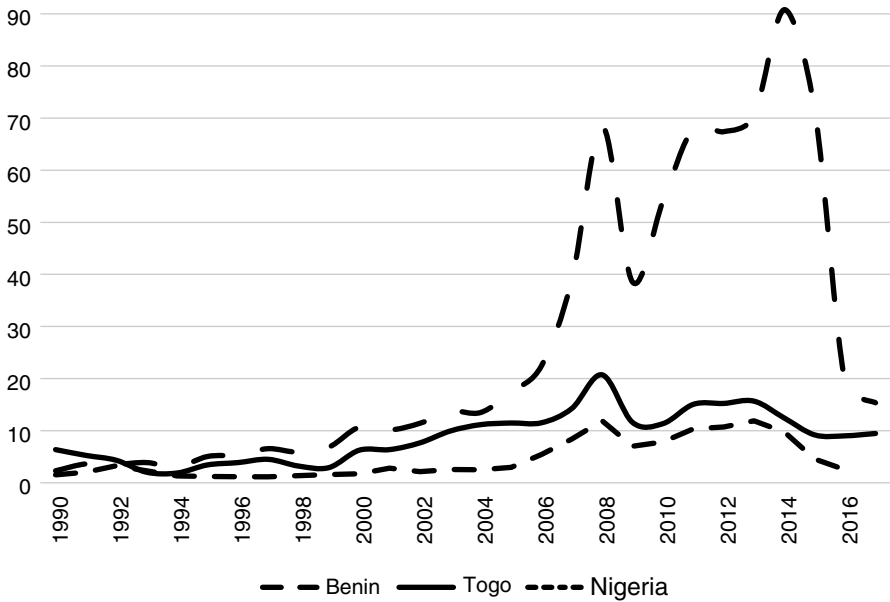


FIGURE 8.2a Imports per capita in US\$ for Benin, Togo, and Nigeria: Cars

supply the Nigerian market. Car imports in Benin grew rapidly to very high levels until 2015, after which they dropped sharply. At their peak, car imports per capita in Benin reached about US\$80 in 2012–2014, about eight times the ECOWAS average level of about US\$10 per person (Figure 8.2a). Starting in 2015, however, car imports into Benin dropped dramatically. Togo's per capita car imports have also been well above Nigeria's and average ECOWAS levels, although far below Benin's, due to Togo's geographical disadvantage relative to Benin in supplying the Nigerian market and the relatively high cost of transshipping cars. Box 8.1 in Section V describes Benin's ICBT in cars in more detail.

## B Cloth

Perhaps no product is of more importance to low-income but fashion-conscious West Africans than cotton cloth. Nigeria developed a highly inefficient and protected textile industry and most firms have either disappeared or operate at very low capacity.<sup>6</sup> Imports of cloth in Benin and Togo far exceed those in Nigeria (Figure 8.2b). Nigerian official imports are almost non-existent. In Benin and Togo, imports have surged since the early 2000s, to over

<sup>6</sup> See 'Nigeria: Reviving the Textile Industry', <https://oxfordbusinessgroup.com/articles-interviews/nigeria-reviving-the-textiles-sector>, 10 March 2013.

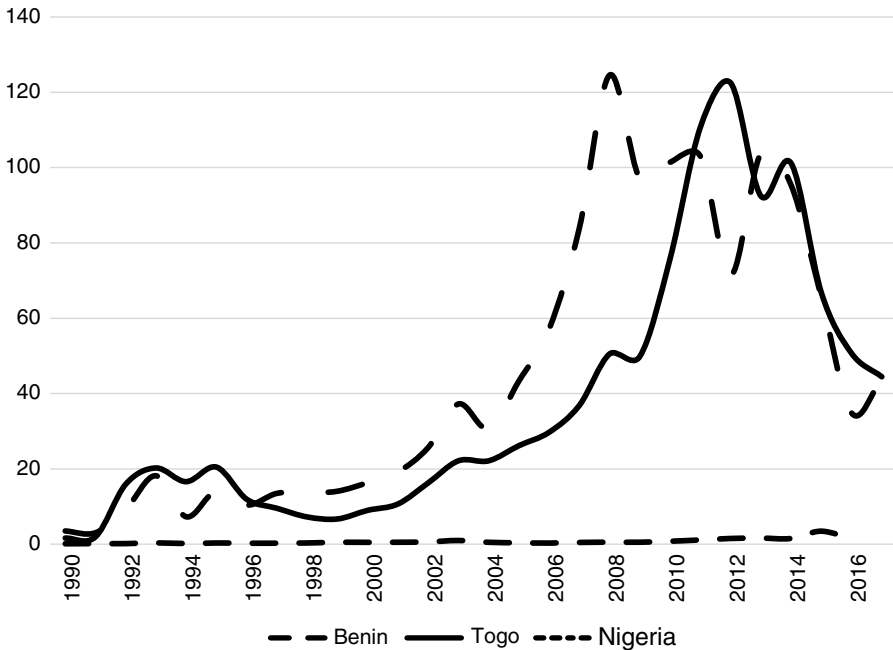


FIGURE 8.2b Imports per capita in US\$ for Benin, Togo, and Nigeria: Cotton cloth

US\$100 per capita in 2008–2014, more than ten times the average ECOWAS levels of about US\$7 per capita. Togo’s relative success in smuggling cloth, compared to cars, reflects the fact that cloth is easier to transport, as well as Togo’s historical role as a regional centre for the textile industry. As in the case of cars, however, cloth imports dropped steeply in 2015–2017.

### C Rice

Nigeria has prioritised the development of domestic rice production using stringent import protection. Nigerian rice production remains far below domestic consumption, with the market substantially supplied by Benin, and to a lesser extent Togo and Cameroon. Rice imports into Benin exploded around 2012, while Togo’s imports rose more modestly (Figure 8.2c). A downturn in Benin’s rice imports occurred in 2015, as in the case of cars and cloth, but unlike those two rice imports recovered sharply in 2016–2017, despite continued efforts by the Nigerian government to stifle smuggling, with a ban on imports of rice through land borders in effect since 2013.

Almost all of Benin’s rice imports are of parboiled rice, the preferred type of rice in Nigeria but not in Benin. This provides additional evidence that the large volume of rice imports in Benin is intended primarily for Nigeria (see, e.g. Adefoko, 2017).

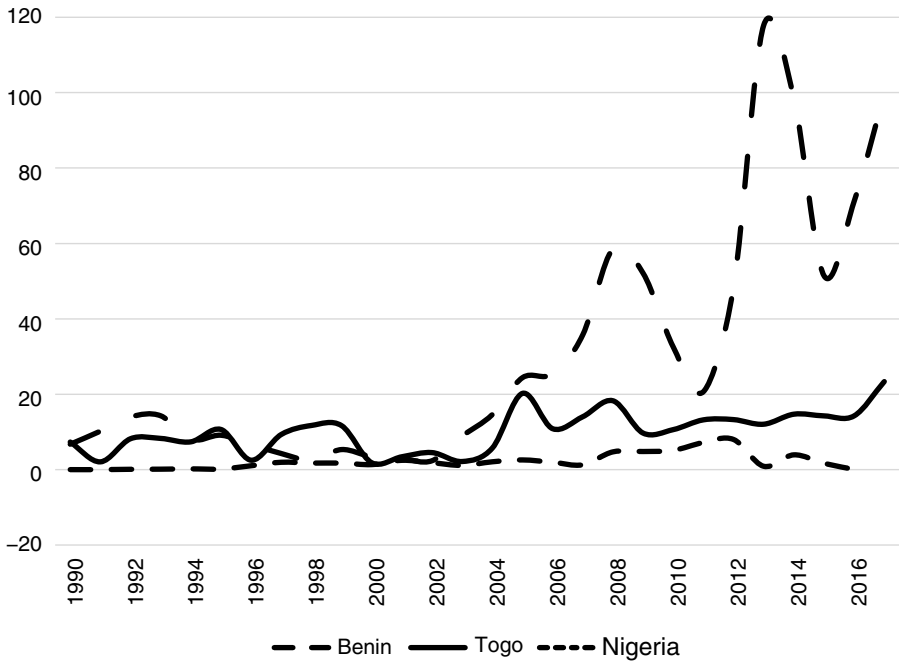


FIGURE 8.2c Imports per capita in US\$ for Benin, Togo, and Nigeria: Rice

#### D Frozen Poultry

Poultry has also been on the list of banned items in Nigeria since the early 2000s. Poultry imports into Benin have surged from a few dollars per person in the late 1990s to over US\$30 per person in 2014 (Figure 8.2d). Nearly all of Benin's imports are intended for Nigeria (Oshiotse, 2002). Probably due to the high cost of transportation and refrigeration, Togo has not imported much frozen poultry, but an uptick from the mid-2000s until 2015 can be seen. Benin's imports have dropped sharply since 2015.

#### E Summary on Entrepôt Imports

Entrepôt imports into Benin are very large but also highly volatile. The sharp downturn in entrepôt trade in 2016–2017 illustrated in Figures 8.2a–8.2d is a case in point. There are two main causes of this recent decline: the recession in Nigeria, with an accompanying sharp depreciation of the Naira, and President Buhari's efforts to close the border to smuggling from Benin. Of these two, there are several reasons why the recession in Nigeria is likely to have been far more significant than the Nigerian government's crackdowns. First, the efforts to curb smuggling have a long history of ineffectiveness. Traders are skilled in evading official detection and, more importantly, there are numerous beneficiaries from

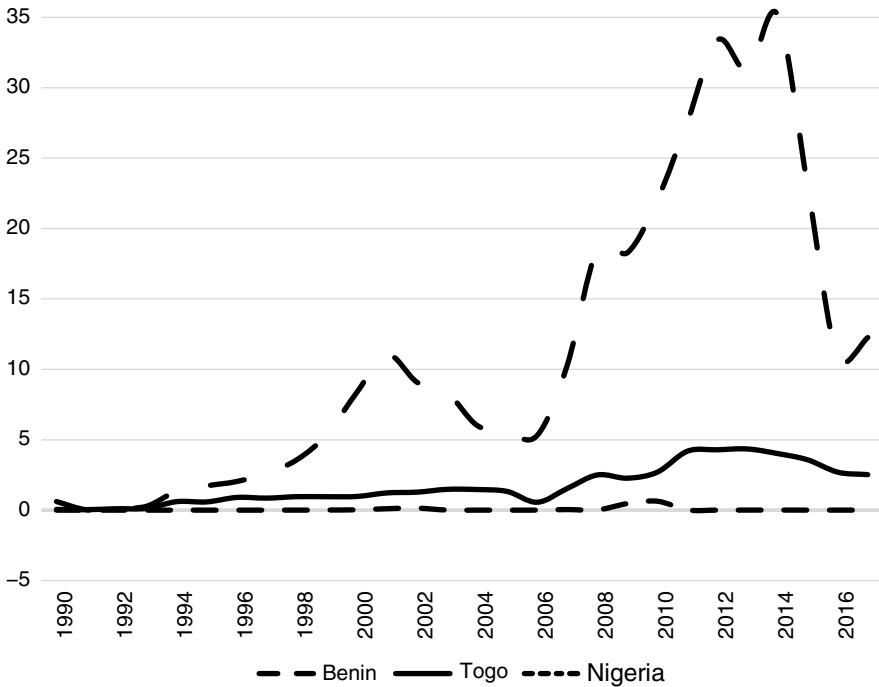


FIGURE 8.2d Imports per capita in US\$ for Benin, Togo, and Nigeria: Poultry

smuggling in Nigeria, including customs officials. Furthermore, Figures 8.2a–8.2d show that imports into Nigeria also declined in 2016–2017, whereas they should have risen if supply from Benin was cut off, given that Nigerian production did not rise during this period for these products. In particular, car production in Nigeria remains minuscule. Also, the fact that rice imports in Benin declined only briefly in 2016, before shooting back up in 2017, is consistent with the fact that rice is a basic necessity, more so than the other goods shown in Figures 8.2a–8.2d. Thus, rice demand is likely to have fallen less as incomes plummeted in Nigeria. All of this suggests that a fall of demand in Nigeria rather than the Buhari administration's hardened policies on smuggling is the primary cause of the decline in Benin's *entrepôt* trade. A sharp increase in Benin's taxation of *entrepôt* imports of cars in 2012–2015 likely also contributed, as discussed later.

The importance of the world oil price in driving Nigeria's economy, and in turn Benin's imports of goods intended for transshipment to Nigeria, is illustrated dramatically in Figure 8.3. The left axis shows the world oil price and the right axis the value of imports of nine products that are subject to import protection in Nigeria (cars, rice, cotton cloth, new clothes, used clothes, poultry, sugar, vegetable oil, and cigarettes) in millions of US\$. Both series are deflated by the US GDP deflator. Changes in the world price of oil are followed with

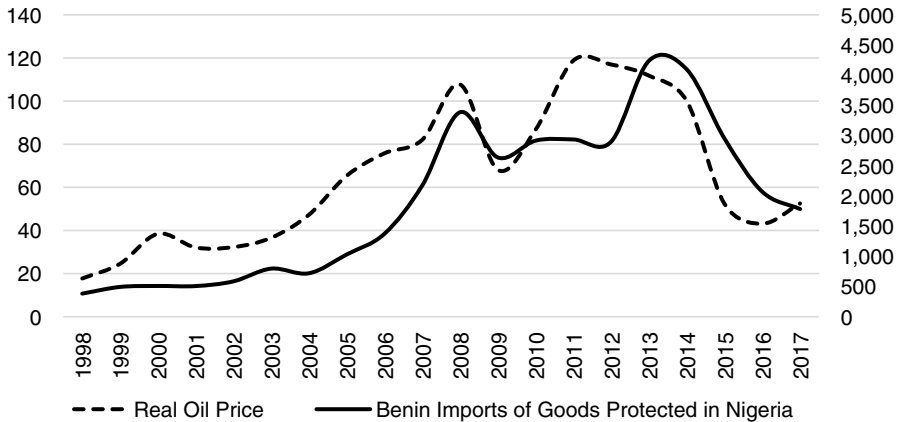


FIGURE 8.3 Benin's imports of selected key products that are subject to protection in Nigeria (right vertical axis, 2015 US\$ millions) and the world price of oil (left vertical axis, 2015 US\$ per barrel)

The products are cars, rice, cotton cloth, new and used clothes, poultry, sugar, vegetable oil, and cigarettes. Benin's imports are measured by rest-of-world exports to Benin of these products, in millions of US\$. The oil price is the average annual Brent crude price in Europe. Both series are deflated by the US GDP deflator to remove common trends due to inflation.

Sources: Authors' calculations using data from United Nations Comtrade database and Saint Louis Federal Reserve Bank database

a short lag by very similar movements in Benin's imports of key products. In 2011–2014, when world oil prices peaked, imports of these nine products alone rose to about US\$4 billion, equivalent to about half of Benin's GDP. About 80 per cent of these imports were likely destined for Nigeria. When the price of oil collapsed in 2015–2017, Benin's imports declined by around 50 per cent. As seen in Figures 8.2a–8.2d, individual products have some idiosyncratic variation but generally followed this general pattern, illustrating their sensitivity to the world oil price due to its importance for the Nigerian economy.

Import taxes and competition with Togo are also factors affecting the volume of entrepôt imports in Benin, as described in more detail in Section VI. In particular, Benin raised transit taxes on imported cars in 2012, leading to a dip in Benin's imports and a rise in Togo's. This explains why Figure 8.3 and Table 8.2 show that Benin's entrepôt imports dropped in 2012 despite the high price of oil at that time.

## F Benin Informal Imports from Nigeria

Petroleum products constitute by far the largest informal import from Nigeria (Bensassi et al., 2018). While precise measures are difficult to obtain for



petroleum product imports into Benin, informal imports are estimated to supply about 80 per cent of Benin's consumption (Mbaye et al., 2019). Box 8.2 in Section V below provides a description of the trade in petroleum products.

Benin also informally imports a variety of manufactured products from Nigeria, although the volumes are low relative to petroleum products (Golub, 2009).

## **G Comparison to Other Estimates**

The overall magnitude of informal trade is difficult to measure precisely, but generalising from these sectors, as well as the evidence on imports by customs regime discussed in Section V below, it is clear that informal trade is much larger than formal trade, perhaps double in size. These estimates are larger than those in most previous literature because, as noted in Golub (2009), previous studies have ignored the role of goods declared in transit regimes. The following paragraph shows that goods declared in transit and re-export regimes are about double the value of goods declared for domestic use.

In 2011 Benin's Institut National de la Statistique et de l'Analyse Economique (INSAE) carried out a large-scale survey of informal trade in Benin over a ten-day period, as described in Bensassi et al. (2018). The INSAE study involved thousands of interviews at unofficial border crossing posts on the Benin–Nigeria border. While the survey had some important limitations, such as only taking place during the daytime and the fact that the veracity of the answers provided by traders can be questioned, the survey provides the only available direct estimates of the composition and magnitude of informal trade. Bensassi et al. (2018) focused only on domestically produced goods, but the INSAE dataset also surveyed trade in *entrepôt* regimes.<sup>7</sup> An examination of the summary INSAE data by product and regime reveals that the key smuggled products identified earlier constitute the bulk of goods reported in *entrepôt* status. That is, cars, rice, cotton cloth, new clothes, used clothes, poultry, sugar, vegetable oil, and cigarettes accounted for about 60 per cent of the goods reported by traders as transit and 90 per cent of the goods reported as re-export. The INSAE magnitudes, however, are well below those estimated indirectly, as the surveys undoubtedly did not cover many traders, particularly those crossing at night when the largest traders generally operate. On the side of exports from Benin to Nigeria, the INSAE data report that over 90 per cent of Benin's informal exports to Nigeria consist of petroleum products. Thus, the INSAE data corroborate the focus of this chapter on a few key *entrepôt* goods subject to high levels of protection in Nigeria and petroleum products, which are heavily subsidised in Nigeria.

It may also be of interest to compare our indicators of unofficial trade with officially reported Benin–Nigeria trade. As already noted, official bilateral trade

<sup>7</sup> We thank Joachim Jarreau for sharing the INSAE data.

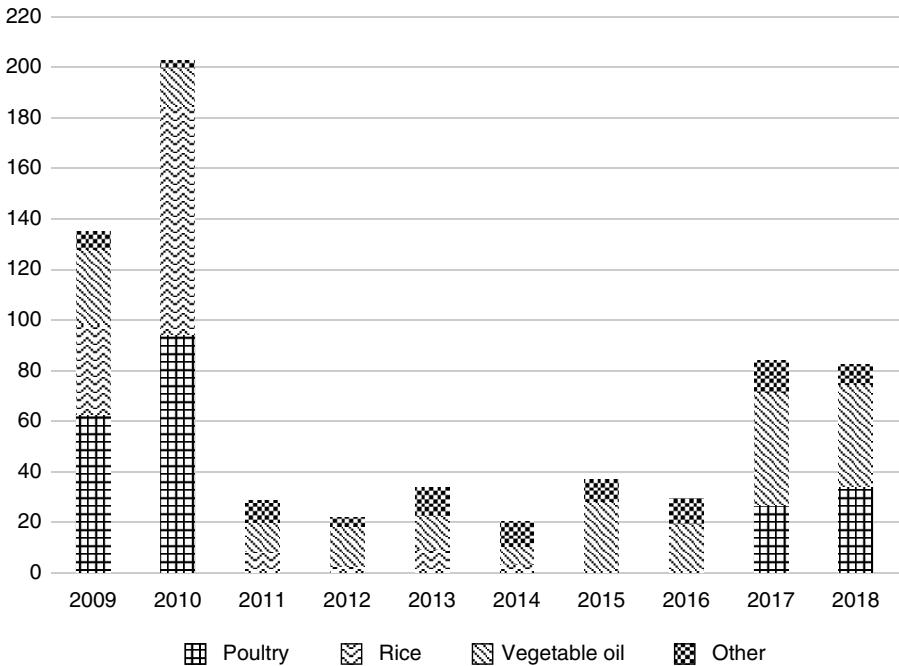


FIGURE 8.4a Official Benin trade with Nigeria, principal products, in US\$ millions: Exports

Source: Authors' calculations using data provided by Benin government

is very low. Figures 8.4a, b show the composition of official Benin exports to and imports from Nigeria, in US\$.

Interestingly, the most important products in official trade are much the same as those that are smuggled, although official trade is much smaller, highly volatile, and three products accounted for almost all of official Beninese exports to Nigeria over 2009–2017: poultry, rice, and vegetable oil (in sharply varying proportions). Whereas total entrepôt trade approached US\$5 billion at its peak, the vast majority of which was destined for Nigeria, official Benin exports to Nigeria peaked at US\$200 million in 2010 and have since been below US\$100 million. In 2009–2010, poultry and rice were the two largest of Benin's official exports, but these two dropped sharply starting in 2011. Recently, vegetable oil has been the largest official Benin export to Nigeria. These fluctuations likely reflect shifting degrees of enforcement of Nigeria's restrictions on informal trade for selected products, with these products sometimes allowed to enter Nigeria officially.

Figure 8.4b shows that reported imports to Benin from Nigeria are even smaller. Petroleum products are usually the largest official import by far, although these official imports are dwarfed by smuggling of gasoline and diesel.

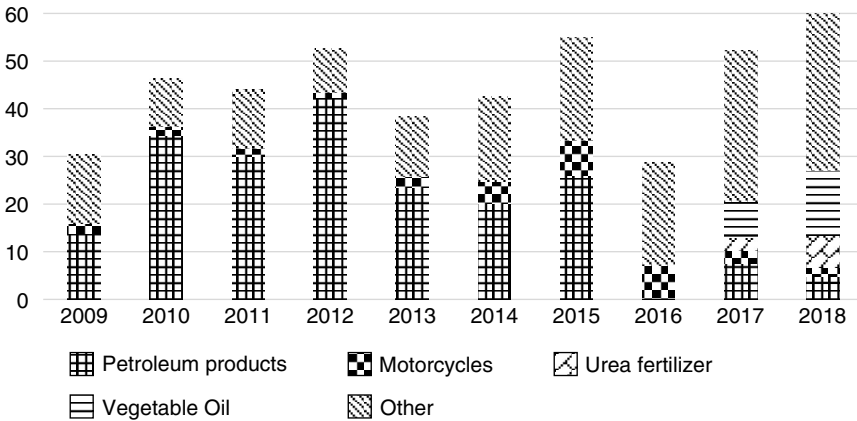


FIGURE 8.4b Official Benin trade with Nigeria, principal products, in US\$ millions: Imports

Source: Authors' calculations using data provided by Benin government

In short, the composition of official trade between Benin and Nigeria seems roughly similar in structure to that of unofficial trade, but it is much smaller and subject to erratic changes in product composition.

## V THE INSTITUTIONAL STRUCTURE OF INFORMAL CROSS-BORDER TRADE IN BENIN: HIGHLY ORGANISED INFORMAL TRADE

This section describes the institutional processes through which goods are transhipped to Nigeria and fuel is smuggled into Benin.

### A Customs Regimes

Goods imported into Benin are rarely ordered by the final consumers of these goods prior to arrival in the port. Instead, large importing companies, both domestic and foreign owned, bring goods into the port of Cotonou to sell to domestic and regional buyers. Only when the goods are purchased are they declared under one of three main customs regimes:

- *mis à la consommation* (for domestic use);
- transit; and
- re-exports.

If declared for domestic use, the purchaser must clear all import taxes, including customs duties, value-added taxes, and several other smaller taxes. The import duty rates are set by the ECOWAS CET. For final consumer goods the total tax rates are about 45 per cent.

There are two main regimes for the transshipment of goods in Benin and Togo: transit and re-exports. The classification of goods into these two categories is complex, with rather minor differences often determining whether transactions are classified as re-exports or transit. These two rubrics include a variety of subcategories of transshipment based on practices that have evolved over time. In any case, the differences between the two regimes are quite small and the main point is that under both of these regimes imports are taxed much more lightly than when they are declared for domestic use, as explained in the following. In practice, the magnitude of transit trade is much higher than re-exports in almost all cases. We will use the term ‘entrepôt imports’ to describe both transit and re-exports. Togo has very similar regimes for imports.

Transshipped goods do not necessarily – or even usually – end up in the stated destination country. Most goods in transit in Benin are declared for Niger, but everyone knows that most of them end up in Nigeria. On-site visits by the authors to car parks in Benin confirmed that the buyers of vehicles are overwhelmingly Nigerian. Numerous international and local press reports also observe smuggling from Benin to Nigeria. As will be discussed, *entrepôt* imports are affected by Benin’s competition with Togo, as well as by events in Nigeria.

Table 8.2 displays Benin’s imports according to the three customs classifications noted earlier – domestic use, transit, and re-exports – over 2002–2017 as a ratio of Benin’s GDP. These data are reported by Benin’s customs, whereas the trade values in Section IV are from the UN Comtrade database as reported exports from Benin’s trade partners. The overall magnitudes of the Beninese data and the UN Comtrade data are similar. The advantage of the Benin customs data is that they disaggregate by customs regime, but they are not available on a consistent basis for as long a time period as the UN Comtrade data. The Benin customs data importantly also include revenues collected, and thus enable a computation of effective import tax rates for each customs regime.

Benin’s *entrepôt* trade (transit and re-exports) is generally much larger and more volatile than imports declared for domestic use. While imports for domestic use are stable at around 20 per cent of GDP, *entrepôt* imports vary from 20 to 60 per cent of GDP.

The composition of imports between domestic use and *entrepôt* trade may be affected by differential taxation of the two regimes. Tax competition with Togo may also play a role, as discussed in Section VI. Statutory taxes on *entrepôt* imports in Benin are generally very low, with the notable exception of used cars. Statutory rates are largely irrelevant, however, as there is substantial discretion in applying tax rates. In particular, tax rates are much lower if goods are labelled for land-locked countries, usually Niger, but in reality the stated destination is almost always modified from Niger to Nigeria once the goods leave the port. Thus, in the analysis we use actually applied tax rates, measured by tax revenues divided by value of imports, rather than statutory tax rates.

Figure 8.5 shows the share of *entrepôt* imports of total Benin imports for the three most important products exported informally from Benin to Nigeria:

TABLE 8.2 *Value of Benin's imports by customs regime (per cent of GDP), 2002–2017*

	Domestic use	Transit	Re-exports	Total imports	Transit and re-exports
2002	21	53	5	79	58
2003	21	20	2	44	22
2004	22	23	0	45	24
2005	19	28	0	47	28
2006	18	41	0	59	41
2007	18	44	1	63	45
2008	21	53	2	75	54
2009	20	58	1	79	59
2010	20	70	1	91	71
2011	16	50	1	67	51
2012	16	28	1	45	29
2013	20	39	3	62	41
2014	26	41	15	83	57
2015	22	33	3	58	36
2016	21	24	1	46	25
2017	23	31	1	54	32

Source: Authors' calculations based on Benin customs data (imports) and World Bank World Development Indicators (GDP)

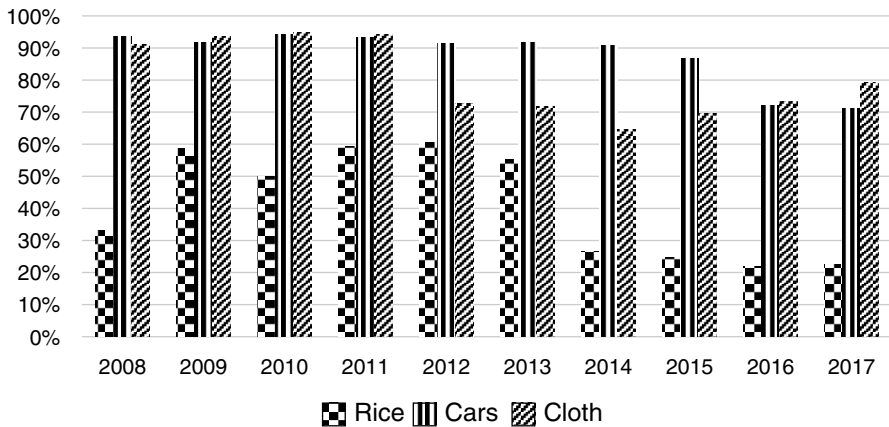


FIGURE 8.5 Share of Benin's key imports declared in entrepôt regimes (transit and re-export): Cars, rice, and cloth (per cent of total imports of respective products)

Source: Authors' calculations using Benin customs data

cars, cotton cloth, and rice. It shows that for cars, and until recently cloth, imports in entrepôt status constituted about 90 per cent of total declared imports, or, equivalently, imports declared for domestic use were only 10 per cent of total imports. The entrepôt share for cars and cloth dropped in

2016–2017 to around 70 per cent, likely due to the general reduction of informal trade to Nigeria, most of which is declared in transit or re-export. To the extent that domestic consumption in Benin did not fall as much, the share of imports for domestic use rose. The share of imports of rice declared in *entrepôt* regimes was lower than for cars and cloth, at about 50 per cent from 2009 to 2013, and then dropped quite sharply in 2014–2017 to about 25 per cent. This was likely due to a reduction in taxes on rice imports for domestic use, from 33 per cent prior to 2014 to 14 per cent in 2014–2017. Thus, for rice it became less advantageous to use transit status relative to importing through the regular channel for distribution in Nigeria, and a sizeable share of imports of rice was shifted from the transit regime to import for domestic use.

## **B Social Organisation of Informal Trade**

Although goods are sometimes imported legally by formal firms, distribution is dominated by informal or semi-formal operators, both foreign and domestic, once the goods are sold and exit the port storage depots. Smuggling is largely controlled by sophisticated and well-organised networks, with many small operators involved on the margins. The trust and connections provided by these informal networks, often ethnic or religious in nature, facilitate market transactions spanning continents, and enable the provision of credit and transfers of funds.

In many cases, importers and distributors are large informal firms, as described in Benjamin and Mbaye (2012) and Mbaye et al. (2019). These firms have a large volume of business, yet in other respects operate in much the same way as smaller informal firms do; that is, they are controlled by a single businessperson, have falsified accounts, and do not pay regular business income taxes. Their financing is sometimes through banks, but more typically from own or family savings and retained earnings. The fate of the firms is inextricably linked to that of the owner, who often relies on political connections to maintain his status as a large businessman operating outside of the legal and regulatory system.

For bulk items, such as rice, wheat, and sugar, importers purchase directly from international brokers, with whom they are in regular contact. A few major importers dominate the rice market, with *Difezi et fils* controlling more than half of sales.<sup>8</sup> Likewise, *Cajaf Common*, owned by Sébastien Ajavon, is the dominant importer of frozen chicken ultimately destined for Nigeria. Lebanese business networks dominate the used car trade.

Importers of second-hand goods, such as used cars, often travel abroad or have foreign correspondents who provide information about sourcing

<sup>8</sup> <http://beninsite.net/2018/07/03/commerce-de-reexportation-vers-nigeria-nid-de-fraudes-fiscales/>, 3 July 2018.

opportunities. Overall, traders display remarkable flexibility in adapting to changing market opportunities (Golub, 2009, 2012).

ICBT has developed a sophisticated infrastructure and is often organised much more efficiently than public services. Goods can cross the border by land or water. By land, there are numerous and ever-changing tracks used by traders along the long borders. A complex network of canals is also used, with new canals being dug when customs agents patrol existing routes. Specialised warehouses for various goods, such as rice, are located along the Benin–Nigeria border, built and operated by brokers or private traders. A network of markets is also dotted on both sides of the Benin–Nigeria border, with sister markets on either side of the frontier.<sup>9</sup>

Complex relationships between traders and government officials alternate between cooperation and conflict in both Nigeria and Benin. Importers have elaborate ruses for evading import taxes. Nigerian prohibitions on imports through land borders are evaded quite easily considering that the number of unofficial crossing points far exceeds official border posts. Bans simply lead to declining traffic at official posts, in favour of unofficial posts, mainly in the northern part of the frontier or through Niger. Further, poorly paid customs officials often collude with traders to get around government efforts to curb smuggling. Traders refer to the bribes they pay as ‘sacrifice’. A Nigerian trader with the pseudonym Delani vividly described the process of rice smuggling:

‘I work within a group of about seven [smugglers]. The least any of us handles is 1,000 bags. When people say rice importation has been banned though the land border, people like us just laugh. We have a leader. How we operate is that each person shops for the rice he has been contracted to supply. Any week we have a large shipment, we gather everything together. We load them on some trailers. Sometimes it may be 5,000 bags [...] Then our leader approaches our contacts in customs to arrange how the cargo gets through the border. We pay the customs officials NGN 1,000 on each bag of rice and we are issued a time, date, and route we could pass through that is not being monitored. Usually, we cross the border around 11 PM’.

(Oluwagbemi, 2017)

Even if officials were to implement orders to crack down on smuggling, smugglers are frequently more heavily equipped and armed than customs and police officials. The situation is vividly illustrated by an incident where an anti-smuggling officer in Nigeria was shot dead by an army officer of the same nationality escorting a convoy of smuggled cars into the country (Sesan, 2017).

Boxes 8.1 and 8.2 provide a more detailed description of Benin’s trade in used cars and petroleum products, respectively.<sup>10</sup>

<sup>9</sup> Based on Golub (2009, 2012); Mbaye et al. (2019); and on-site field research carried out in 2018.

<sup>10</sup> This discussion of the used car market is based on Perret (2002), Golub (2012), and Mbaye et al. (2019), and on field research carried out by the authors in Benin on several occasions since 2008.

**Box 8.1 Trade in Used Cars**

Used cars have been by far the most important of Benin's entrepôt imports in terms of employment, income, and customs revenue since about 2000. Imports of vehicles in transit status rose steeply from 50,000 in 1996 to 200,000 in 2000, and to 250,000 in 2002 and 2003. After a dip in 2004–2005 to about 150,000, they then increased steadily to nearly 350,000 in 2014.<sup>11</sup> Cars imported for domestic use are of the order of 20,000; that is, less than 10 per cent of cars imported in transit status. However, car imports declared for transit plunged in 2016–2017, falling below 100,000, still far above domestic consumption but down to levels not seen since before 2000.

The used car trade is one of Benin's major industries. Huge car parks can be seen on the outskirts of Cotonou. The business is estimated to employ 10,000–15,000 people directly, in importing, selling, storing, driving, and so on, and several thousand more indirectly (Golub, 2009). The value-added generated by the distribution and handling of used cars has been estimated at about 10 per cent of Benin's GDP, roughly the same as cotton.

Cars are imported into Benin through a process of elaborate subterfuge. The vast majority of cars imported in transit status are declared as having Niger as their destination, but it is common knowledge that at least 90 per cent end up in Nigeria. For example, in 2014, of the approximately 332,000 cars imported in transit status, 326,000 were declared for Niger – obviously bearing no resemblance to actual shipments to Niger, where annual car purchases are almost certainly below 10,000. There is a well-established set of procedures for obtaining documents from customs authorising diversion of the cars to Nigeria.

Used car imports follow a complicated and well-organised circuit. Importers with connections in developed countries locate, purchase, and arrange for the transportation of the cars. Some of the importers are affiliated with international shipping companies, such as Grimaldi, that own their own boats. Others rent the boats. Freight forwarders (*transitaires*) handle all the paperwork and authorisations. Other intermediaries play a role in matching buyers and sellers of cars. After the cars clear the port, they are stored in car parks in Cotonou, before being driven to their destination by companies specialising in the delivery of cars to the border, under escort from customs and with police permission. The cars are driven at night in convoys of about 100 cars. They cross the border to Nigeria after paying bribes to both Beninese and Nigerian customs inspectors. The bribe is routine and the amount is largely set by precedent, according to the *transitaires* interviewed. The cars then receive valid licence plates in Nigeria. In short,

<sup>11</sup> For details see the working paper version at <https://edi.opml.co.uk/resource/benin-the-economic-relationship-with-nigeria/>



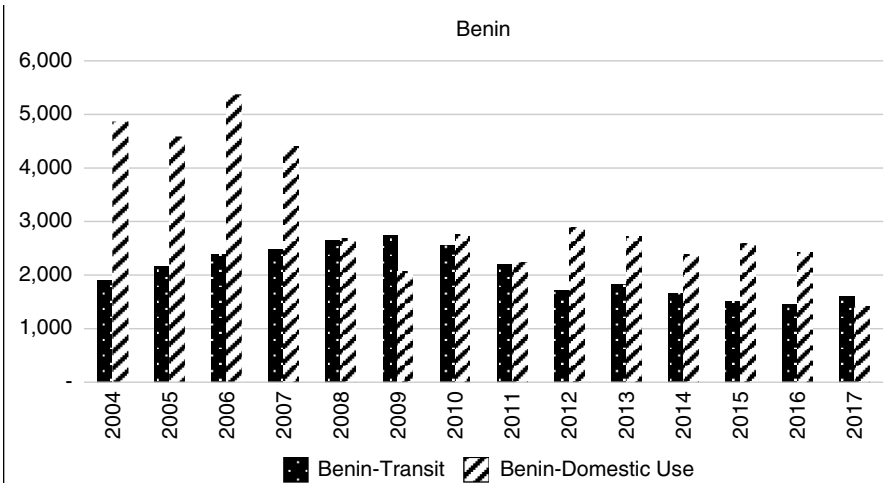


FIGURE 8.6a Average valuations of cars imported under regimes for transit and domestic use, in US\$: Benin

Source: Authors' calculations based on Port of Cotonou and Customs data

government officials – from the highest to the lowest levels – on both sides of the border facilitate and benefit from this trade.

Customs also apply considerable discretion in the valuation of imported cars, which alters the effective tax rate. A lower valuation may reduce the amount of *ad valorem* taxes collected. Figure 8.6 shows average customs valuations of cars declared for transit and for domestic consumption in Benin and Togo, measured in US\$.<sup>12</sup> Presumably, cars imported in the two regimes are similar in quality, since the per capita incomes and demand for cars do not differ much between Nigeria and Benin. In 2004–2007 cars imported for domestic use in Benin were assigned much higher values than cars in transit, a system that ceased from 2008 to 2011 and then resumed to a lesser extent in 2012. In Togo, on the other hand, customs valuations are higher for cars imported in transit than for domestic consumption. Customs officials in both countries are likely responding to domestic political pressure from consumers, other government branches, and smugglers.

Togo competes intensely with Benin for access to the Nigerian market. Togo charges lower fees for a speedier service in handling car imports, in an attempt to offset Benin's geographical advantage.

The ample supply of ageing vehicles in developed countries and low incomes in West Africa provide a natural basis for trade in used cars.

<sup>12</sup> CFA Francs are converted into US\$ at a constant exchange rate of CFA Franc 500 per US\$, to avoid valuation effects.

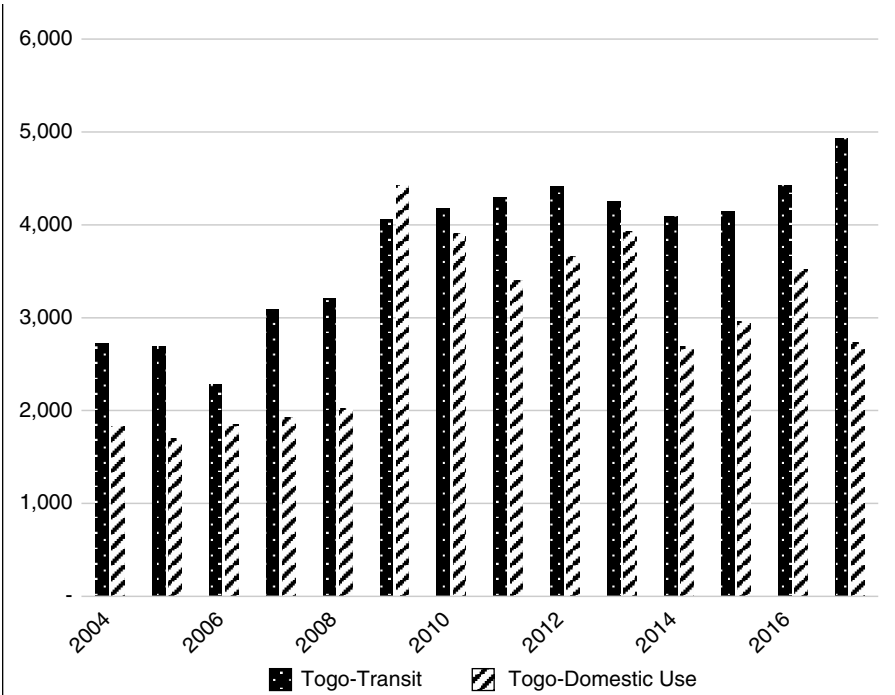


FIGURE 8.6b Average valuations of cars imported under regimes for transit and domestic use, in US\$: Togo  
 Source: Authors' calculation based on Port of Cotonou and Customs data

Toyota, Mercedes, and Peugeot cars predominated in the early 2000s, but other Japanese and European companies are increasingly prevalent. An accompanying market in spare parts has also flourished.

Nigeria's ineffective attempts to protect its own struggling car industry have diverted this trade to the parallel market. At the end of the 1970s Nigeria assembled 100,000 cars, but the car industry has been moribund in the country for many years. In 1994, Nigeria banned imports of vehicles more than eight years old. In 2002, the law was further tightened to a ban of all cars more than five years old. Since then the permissible age has gradually increased. In 2013, steep tariffs were implemented as Nigeria unveiled another attempt to revive the auto industry with the Nigerian Automotive Industry Development Plan. Vehicle production increased moderately at first, but has fallen back to very low levels in the last few years, declining even more rapidly than the rest of the manufacturing sector (Economist Intelligence Unit, 2017).

Nigeria has repeatedly banned imports of cars by land routes. These bans, however, have until recently proved impervious to the porous border between the two countries, the strong demand for cheap vehicles, and the ambiguous attitudes of the authorities in Nigeria. The recent sharp downturn in Benin's imports is likely more due to the recession in Nigeria than to the effectiveness of the import ban. Regardless, the collapse of car distribution in Benin has had severe effects on income and employment. A recent article describes the change vividly: 'Residents say drivers used to pass by in huge convoys, speeding towards the border, beeping their horns in celebration. Bars that sprang up to cater to visiting clients have closed and dozens of Lebanese, who dominate the import business in West Africa, have departed' (Sasse and Carsten, 2017).

### **Box 8.2 Petroleum Product Imports from Nigeria**

Smuggling of oil products into Benin began around 1980 and increased dramatically in 2000. Like the *entrepôt* trade from Benin to Nigeria, smuggling of petroleum products into Benin reflects differential policies combined with the ease of slipping goods across the border and the complicity of the two countries' officials, including at the highest levels of the military. In this case, however, the main factors are the large subsidies in Nigeria, along with the alignment of domestic to world prices in Benin, which together result in much lower consumer prices in Nigeria compared to Benin (Morillon and Afouda, 2005; Mbaye et al., 2019). In recent years Nigeria has partially deregulated petrol prices, but they remain well below Benin's, although to a lesser extent for diesel than for gasoline.

The black market price in Benin is determined by a mark-up on the Nigerian official price and has little connection to Benin's official price. In 2016, our field research revealed a persistent although variable differential between the official and black market price.

The share of gasoline supplied by informal imports from Nigeria rose from about 10 per cent in 1998 and 1999 to about 50 per cent in 2000, and to 83 per cent in 2001 and 2002, only tapering off slightly in 2003–2004 to 72 per cent (Morillon and Afouda, 2005). Despite some increases in Nigerian gasoline prices, the share of smuggled gasoline was estimated at about 80 per cent of Benin's domestic consumption in 2013 (Mbaye et al., 2019).

The dominance of the informal market in Benin is reinforced by the lack of official gas stations, and the lack of stations in turn reflects the dominance of the informal market, with the zones bordering Nigeria in particular witnessing a decline in the number of operating service stations. In contrast, there is a very dense network of service stations in Nigeria, which readily supply the informal traders who smuggle the gasoline into Benin.

The distribution network in Nigeria includes large wholesalers who have storage depots along the border that hold up to 1,000 litres of gasoline. These wholesalers have close political ties to high-level officials in Nigeria. Wholesalers sell to various intermediary distributors of various sizes, who sneak the gasoline through the border by pirogue, cars whose gas tanks have been expanded, in small quantities on scooters, or on foot.

The net effect of this massive trade in petroleum products on Benin's economy is complex. It entails a large loss of fiscal revenues, but is also a source of employment and income for traders and distributors, accounting for about 1–2 per cent of GDP and 15,000–40,000 jobs, depending on the method of estimation (Golub, 2009).

## VI THE EFFECTS OF INFORMAL TRADE ON BENIN

The effects of ICBT on Benin are mixed (Galtier and Tassou, 1998). Golub (2009) estimated that ICBT generates about 20 per cent of Benin's GDP, and a somewhat smaller but still large part of employment, most of it in the handling of used cars and the distribution of petroleum products. The effects on fiscal revenue are particularly important. On the negative side, informal trade contributes to an institutional environment that favours informality, and that thus may impede the development of a modern formal private sector. There are also allegations of an association of informal trading with more insidious forms of illegal trade in arms and narcotics, but we do not have access to information about its extent.

### A Effects on National Income and Employment

The contribution to national income from informal trade derives from the value-added in the handling and distribution of *entrepôt* trade and petroleum products, including tax revenues. There are no official measures of the value-added of smuggling, but rough estimates can be derived from the previous analysis. Together, our calculations suggest that the handling and distribution of *entrepôt* trade and petroleum product imports account for approximately 20 per cent of Benin's GDP. Of these two, *entrepôt* trade is by far more significant.

For this purpose, we can consider three main categories of *entrepôt* trade:

- Cars imported in transit status. Cars require much more domestic handling in Benin than other goods, as described in Box 8.1. Cars are also subject to relatively high transit taxation of about 20 per cent, as described in the following. We thus assume that the share of value-added in car handling, shipping, and taxation is 70 per cent of imported value.
- Other goods imported in transit status, such as rice, cloth, and frozen poultry. These goods imported in transit status face minimal transit taxation and

relatively little domestic handling, so we assume that domestic value-added is only 20 per cent of imported value.

- Goods imported for official use but in fact transshipped to Nigeria, notably rice and frozen poultry. These goods imported in regimes for domestic use face import taxes averaging around 45 per cent (30 per cent for rice), but relatively little domestic handling, so we assume that value-added is 50 per cent of imported value.

We assume further based on the trade data that (1) total imports intended for transshipping to Nigeria are 50 per cent of Benin's GDP; and (2) the share of cars, goods falsely declared for domestic consumption, and other goods in *entrepôt* status constitutes, respectively, 20, 20, and 60 per cent of informal trade with Nigeria. Under these assumptions, the contribution of value-added in *entrepôt* status amounts to 18 per cent of GDP.

The effects of imports of petroleum products on Benin's GDP are even more difficult to estimate but are much smaller. The most detailed study is Morillon and Afouda (2005). Their estimates of the gross margins of distributors suggest that the value-added in informal trade of petroleum products amounts to about 2 per cent of GDP. The extent to which traders' incomes are a net addition to GDP is questionable insofar as the informal distribution of petroleum products displaces official distribution and, in the process, results in loss of government revenues. As Morillon and Afouda (2005) rightly observe, however, the informal import of petroleum products involves a terms of trade gain, since Benin can import gasoline at prices below world levels. Nigeria's subsidised petroleum products are in effect a transfer to Benin. Morillon and Afouda's (2005) calculations suggest that this trade gain is around 1 per cent of Benin's GDP.

There are likewise no official measures of employment in informal trade. Perret (2002) estimates that direct employment in the used car trade in 2001 was about 15,000, with indirect employment creation of around 100,000. Morillon and Afouda (2005) estimate that employment in smuggled petroleum products ranged from about 20,000 to 40,000, mostly traders and sellers, in the early 2000s. At the peak of the re-export trade around 2014, employment was likely much higher. The decline in *entrepôt* trade since 2015 has had significant negative effects on employment, particularly in the car distribution sector.

While ICBT with Nigeria accounts for a sizeable share of national income and employment, the longer-term effects on economic growth and diversification could be negative. ICBT attracts entrepreneurial talent into illegal or semi-legal informal activities. Furthermore, the implication of government officials at all levels in informal activities makes reform much more difficult. Nevertheless, ICBT does not necessarily preclude investment in sectors where Benin has strong potential comparative advantage, such as horticulture and agro-processing. There is abundant under-employed labour in Benin and improved opportunities in formal industry would likely attract many of the small-scale traders who work in informal trade as a last resort.

## B Effects on Government Revenues

Benin's system of import taxation has revolved around maximising the income from entrepôt trade, by taxing goods when they enter Benin at a rate well below that in Nigeria, or taking advantage of Nigeria's import prohibitions. However, avoidance of indirect taxes on smuggled petroleum products from Nigeria mitigates this revenue gain from entrepôt trade.

Benin has a high dependence on import tax revenues, which account for about half of tax revenues, far above the average share of about 10 per cent of international trade taxes in tax revenues in low-income countries (Coady, 2019). In 2015–2017 there was a substantial drop in the tax revenue-to-GDP ratio from 14.5 to 12.6 per cent, which was mostly due to reduced revenues from international trade taxes. This drop in international trade taxes was in turn due to a sharp decline in revenues from entrepôt trade (Table 8.3).

Table 8.3 shows the effective tax rates in Benin and Togo on entrepôt imports. These are calculated from customs data provided by the governments in both countries as the value of revenues from taxing imports in the transit and re-export regimes divided by the value of entrepôt trade. Table 8.3 presents information for cars as well as aggregate trade. A number of interesting features appear from these data.

First, the tax rates on Benin's imports of cars in transit status are much higher than the rates for other goods. The effective tax rates on goods imported in transit status other than cars are well below 1 per cent, whereas the rates on cars are in double digits. Second, Benin sharply raised the effective tax rate on cars imported in transit from about 13 per cent in 2008–2010 to above 30 per cent in 2012–2015. With the recession in Nigeria lowering demand, Benin rolled back the effective transit tax rate on cars to 23.6 per cent in 2017. Third, Togo's effective tax rates on entrepôt trade are very low for both cars and other goods, at well below 1 per cent. Undoubtedly, this reflects Togo's efforts to remain competitive despite its geographical disadvantage in smuggling goods, particularly cars, into Nigeria. Togo, like Benin, lowered transit taxes on cars in 2016–2017, but starting from a much lower level of only 0.8 per cent.

Table 8.3 also presents the contribution of entrepôt trade regimes to tax revenues in the two countries. Not surprisingly in view of the effective tax rate differences, Benin collects much more revenue than Togo. Furthermore, and also related to the high rate of taxation on cars, cars account for more than two-thirds of Benin's revenue from entrepôt trade. At its peak in 2012–2015, entrepôt trade regimes contributed 41 per cent of customs revenue, with cars alone accounting for 25 per cent. With the sharp downturn in trade with Nigeria, the share of entrepôt trade in revenue collection dropped dramatically, falling in 2017 to 11 per cent for all trade and 6 per cent for cars. Togo, on the other hand, receives very little revenue from entrepôt trade due to its low tax rates. However, Togo did experience an increase of this ratio from 0.3 per cent in 2008–2011 to 3 per cent in 2012–2015, due both to a slight increase in its effective tax rates and more importantly to a surge in entrepôt trade likely

TABLE 8.3 *Entrepôt trade tax rates and revenues in Togo and Benin, 2008–2017*

	2008–2010	2011	2012–2015	2016	2017
Effective tax rates on transit and re-exports (%)					
Benin – Cars	12.90	16.40	33.60	29.70	23.60
Benin – All goods	3.40	4.40	6.90	3.60	2.10
Togo – Cars	0.80	0.80	0.50	0.40	0.40
Togo – All goods	0.40	0.10	0.50	0.50	0.50
Share of import tax revenue due to transit and re-exports (%)					
Benin – Cars	15.80	21.90	25.10	11.50	6.30
Benin – All goods	25.80	38.70	41.10	17.50	11.30
Togo – All goods	0.30	0.30	3.00	2.20	2.40

*Source:* Authors' calculations based on Benin and Togo customs data.

incentivised by trade diverted to Togo due to Benin's higher tax rates. Like Benin, Togo's revenues fell in 2016 and 2017 because of the recession in Nigeria.

The estimates in Table 8.3 do not include revenues from goods imported under the regime for domestic consumption. Some of these goods, particularly for rice and a few other key products, are likely intended for Nigeria, although the proportion is difficult to ascertain precisely. Since goods imported for domestic consumption face higher import taxes than those in *entrepôt* status, such imports have a disproportionately higher effect on government revenues, although they constitute a relatively small part of smuggling (we assumed it constituted 20 per cent of *entrepôt* trade in the calculation of value-added). Including these goods labelled for domestic use but intended for Nigeria raises the share of import tax revenue from informal exports to Nigeria to about half of total import tax revenue; that is, 3–4 per cent of Benin's GDP prior to the recent downturn.

Against this, Benin's loss of fiscal revenue due to smuggling of petroleum products from Nigeria was estimated by Morillon and Afouda (2005) at about 1 per cent of GDP. A recent government estimate reported in the press put these losses at US\$37.5 million, or also about 1 per cent of GDP (Energies Media, 2018). This suggests that the net contribution of fiscal revenues from informal trade with Nigeria was equivalent to about 2–3 per cent of GDP in 2012–2015, before the recent recession in Nigeria.

Figure 8.7 looks more closely at the effects of tax competition between Benin and Togo over the period 2002–2017. The line shows the differential in the average effective tax rate on *entrepôt* trade between Benin and Togo (right axis). The two bars show Benin and Togo's *entrepôt* trade-to-GDP ratios, respectively (left axis). Until 2015, a correlation between the tax differential and *entrepôt* trade is discernible, with Benin's trade falling and Togo's rising when the tax differential rises. In particular, Benin raised its taxes in 2003 and again in 2012, and Benin's *entrepôt* trade fell while Togo's rose. After 2014

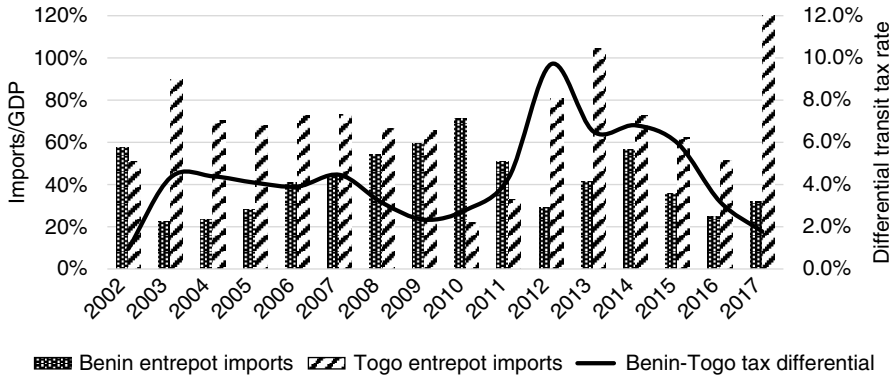


FIGURE 8.7 Entrepôt tax rate differential (Benin minus Togo, in per cent) and entrepôt trade in Benin and Togo (per cent of GDP)

Source: Authors' calculations based on Benin and Togo customs data.

the correlation breaks down due to demand-side shocks coming from Nigeria, causing Benin's trade to fall despite a declining tax rate. Over the period 2002–2014 the correlation coefficient of the tax differential with the entrepôt-to-GDP ratio is  $-0.44$  for Benin and  $0.52$  for Togo, confirming the visual impression.

In summary, informal entrepôt trade constitutes a large part of national income and fiscal revenues, but they are subject to high variability due to competition from Togo and shocks in Nigeria.

VII SUMMARY AND POLICY CONCLUSIONS

Much of Benin's economy is under the spell of the policies and institutions of its giant neighbour Nigeria. Nigeria's power as the largest economy on the African continent is unfortunately distorted by the resource curse of dependency on oil in a setting of weak institutions. A rather unhealthy, even parasitic, relationship has developed between Benin and Nigeria. Resource rents in Nigeria are ultimately transmitted to Benin through smuggling rents.

Benin has developed a sophisticated institutional structure to support its role as a smuggling hub for Nigeria. The resulting entrepôt trade has become one of Benin's largest industries. This trade can be quite lucrative, both for the participants and for Benin's government, which collects substantial revenues from it. Used cars are by far the most important industry in terms of national income and fiscal revenue, accounting for about two-thirds of aggregate import tax revenue from entrepôt trade. Customs administration in particular is configured to enable smuggling. The Benin tax authorities balance the priority to raise additional revenues against fostering the growth of this trade.

These benefits of ICBT to Benin, however, are very fragile, dependent as they are on the vagaries of economic policy in Nigeria. The repeated closures of the border are ominous demonstrations of Nigeria's ability to shut down the re-export trade if it chooses to do so. Likewise, if Nigeria ever did really



harmonise its trade policies within ECOWAS, the *raison d'être* of this trade would largely disappear. Perhaps of greater immediate concern is Benin's vulnerability to macro-economic shocks emanating from Nigeria. The recent sharp drop in most *entrepôt* imports in Benin is due primarily to the recession in Nigeria rather than border closures. The severe shortage of foreign exchange in Nigeria in 2015–2017, combined with a fixed official parity, led to large depreciation of the Naira on the black market. This black market depreciation has exacerbated the downturn, as Nigerian consumers must pay higher prices in Naira for goods invoiced in foreign currencies.

At a broader level, a case can be made that the flourishing of informal trade has retarded Benin's development. The large fiscal benefits of re-exporting have reduced the government's impetus to promote productive economic activities. The lure of the rents in Nigeria's distorted markets exacerbates a culture of corruption and tax evasion that is not conducive to a productive economy. It is doubtful that a development strategy based on smuggling and fraud is a viable long-run path to emerging market status.

In principle, it would be desirable for Benin to coordinate macro-economic and trade policies with Nigeria, to avoid creating incentives for Benin to circumvent discrepancies in prices between countries. It is highly unrealistic, however, to expect Nigeria to coordinate its policies with Benin. Benin is far too small to exert any substantial influence on Nigeria's policies and Benin has limited autonomy insofar as it is tightly integrated into WAEMU. Nigeria is unlikely to abandon the protection of influential industries any time soon. For Nigeria, domestic interest groups and perceived national interest are going to trump Benin's interests. Thus, the numerous announcements of separate or joint efforts to combat smuggling by the two governments, such as those discussed in Section II, have had no discernible long-run effects on informal trade. The incentives to take advantage of large pricing differences due to Nigeria's high import barriers and subsidies are very powerful inducements to both traders and border officials to engage in or enable smuggling. The only sustainable solution is for Nigeria to realise that it is not in its interest to pursue policies of relying on import protection to boost inefficient domestic industries and subsidising gasoline use.

Benin can work within ECOWAS to gradually promote harmonisation of policies, but Nigeria is unlikely to cede a great deal of sovereignty to ECOWAS either. ECOWAS does have agreements to combat child trafficking and other illegal activities, but has no programmes to stop smuggling in legal goods, as far as we know. For example, Nigeria has retained an import prohibition list for which there are no provisions in ECOWAS. The Buhari government's refusal to join the Africa Continental Free Trade Area (ACFTA) further reveals Nigeria's intention to continue to protect domestic industries. Benin is also one of the three remaining countries that have yet to sign ACFTA (Eritrea is the third) (Wilson and Munchi, 2019).

Instead, Benin should focus on improving its own institutions and productive capabilities. In some respects, Benin's combination of formal and informal

institutions supporting *entrepôt* trade is quite sophisticated and effective in its objective of promoting Benin as an informal trade hub. The problem is that a development policy oriented towards informality and smuggling is unsustainable. The challenge for Benin is therefore to channel its evident energy and creativity in a more viable direction. Benin is well placed to continue to serve as a regional trading and service centre for legal trade and services, benefiting from its proximity to Nigeria and links to the land-locked countries to the north. Moreover, if Benin moves away from smuggling towards formal trade, avenues for cooperation with Nigeria could open up.

Rather than focus on eradicating smuggling, which it is largely impossible to do under current Nigerian policies, Benin should take measures that improve the business environment for legal businesses. The 2005 Benin Diagnostic Trade Integration Study (DTIS; World Bank, 2005) argued that Benin could emulate Hong Kong.<sup>13</sup> Hong Kong transitioned from being an *entrepôt* for illegal trade to China in the 1950s into a diversified manufacturing and service economy (Chau, 1997). Hong Kong developed world-class institutions, particularly trade facilitation (port and customs), a reliable legal system and property rights, and efficient infrastructure. Hong Kong managed to maintain the efficiency and probity of its own public services even as it served as an *entrepôt* for illicit trade. In Benin, by contrast, the institutional underpinnings of a market economy, such as the legal system and infrastructure, are better than Nigeria's but generally still poor.

The sharp downturn in *entrepôt* trade in 2016–2017 (see Figure 8.2a–d), due to the recession in Nigeria and Nigeria's efforts to close the border to smuggling from Benin, should be a wake-up call to Benin to initiate fundamental reforms. The 1951 United Nations embargo on China was a major impetus to Hong Kong's shift from an *entrepôt* economy to a producer of manufactured and service exports for developed countries.<sup>14</sup> At the same time, if Nigeria is able to rein in corruption and tap its own massive potential it could then benefit Benin, just as Hong Kong re-invented itself as a financial and organisational service centre for Chinese manufactured exports with China's opening to the world economy in the 1980s.

Benin is much less developed than Hong Kong, but the precedent set by Hong Kong in transitioning from illicit to formal trade is still relevant as providing a general plan. In particular, Benin needs to follow Hong Kong's example in two ways: (1) reinvent itself as a legal commercial centre serving the region; and (2) develop competitive domestic industries. In the case of Hong Kong, export diversification involved shifting into labour-intensive manufacturing; Benin

<sup>13</sup> Stephen Golub was the lead consultant and author of the 2005 Benin DTIS.

<sup>14</sup> As Chau (1997) describes, Hong Kong's traders were able to adapt their entrepreneurial skills to manufacturing remarkably easily, contrary to the view, which is often voiced in Benin, that trading and production are antithetical. Also, Hong Kong benefited from the movement of entrepreneurs from China, just as Benin can take advantage of the influx of Nigerian businesspeople.

has a comparative advantage in tropical produce and horticulture. At present, Benin's trade facilitation institutions and business climate are sufficiently superior to Nigeria's to circumvent Nigeria's trade barriers, but inadequate for serving as a regional service centre for legal trade and facilitating foreign and domestic investment. The mediocre quality of public services in Benin extends to the port and customs administration, which are critical for a country with ambitions to serve as a trading centre.

The two Benin DTIS (World Bank, 2005, 2015) provide detailed recommendations for improvements in trade facilitation and other institutions that could contribute to Benin's becoming a hub for formal trade with Nigeria and other countries in the region. These include modernisation of customs, using more information technology and formal management procedures that improve accountability and transparency; improved port logistics; and linked rail and road infrastructure investments. Some progress in this regard has been made. The Millennium Challenge Corporation's programme for improving the port of Cotonou was found to have considerable success in raising operational efficiency, lowering costs, and reducing petty corruption (Millennium Challenge Corporation, 2017). While past reforms of customs have largely failed, more recently progress has been made in the adoption of a new customs code and modern international practices, such as the SAFE Framework of Standards of the World Customs Organization,<sup>15</sup> the revised Kyoto Convention, and the Agreement on the Facilitation of World Trade Organization (WTO) Trade (World Bank, 2018).

More broadly, Benin needs to upgrade its institutions to boost investment in productive activities, as discussed throughout this book. A positive agenda for encouraging investment is more promising than cracking down on informal trade with Nigeria. The latter largely depends on Nigeria adopting more sensible policies, while the former is much more within Benin's own control. In terms of the availability of resources, there is no need to eradicate informal trade with Nigeria for Benin to expand formal production of goods and services. There are plenty of under-employed people who will gladly switch to better-paying and less hazardous formal-sector jobs if these were to be created. The binding constraint is the adverse business climate that deters foreign and domestic investments in productive activities. Improvements in the business climate in turn require better governance. The question then is whether the pervasiveness of informality precludes reforms to the business climate. There is obvious cause for concern in this regard. Despite some significant improvements in trade facilitation, little progress has been made in improving governance and reducing corruption. There are numerous interest groups that benefit from and perpetuate Benin's high level of corruption who will oppose efforts to create a more inclusive and transparent business climate. It remains to be

<sup>15</sup> [www.wcoomd.org/-/media/wco/public/global/pdf/topics/facilitation/instruments-and-tools/tools/safe-package/safe-framework-of-standards.pdf](http://www.wcoomd.org/-/media/wco/public/global/pdf/topics/facilitation/instruments-and-tools/tools/safe-package/safe-framework-of-standards.pdf).

seen if President Talon has the vision and leadership skills to catalyse reforms of the business environment that support formal investment. His background as a successful entrepreneur in the cotton sector is promising. An important symbolic step would be for Benin to join ACFTA.

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