Country Economic Memorandum: In search of new drivers of inclusive growth

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### Key messages

1. **Botswana aspires to become a high-income economy and eradicate extreme poverty by 2036, but ...**
   - It has shifted from a top to a mid-range performer over the past decade – the growth rate declined to an average of 3% per year over the last decade, down from 5.1% in the 2000s.
   - Close to half of its people lives with less than $6.85 per day by 2022, extremely high for an upper middle-income country.
   - The public sector-led growth model built on diamond rents shows signs of exhaustion, while the economy has become more vulnerable to financial, climate and health shocks.

2. **Botswana can meet its aspirations and avoid getting caught in a middle-income country trap with a greater emphasis on creating the conditions for productivity-led inclusive growth.**
   - The country needs to generate productivity gains of about 2% per year, while investing more and above all better in both physical and human capital.

3. **Boosting Botswana’s productivity requires special attention to five determinants**
   - Encouraging dynamic firm creation and growth and technology adoption/innovation
   - Developing skills in the labor force
   - Improving access to financial services
   - Enhancing connectivity to enlarge markets
   - Upgrading public sector performance
**Why this diagnostic?**

This Report intends to be an input into the government’s strategic vision and policymaking to help move Botswana closer to its ambitious objective of becoming a high-income economy by 2036 by:

i. Carrying out diagnostics on past economic performance and potential growth trajectories going forward to uncover binding constraints and realistic opportunities.

ii. Using a conceptual approach based on well established methodologies (Box 1) and benchmarking analysis using a set of aspiring countries (Box 2).

iii. Emphasizing policy objectives for productivity growth, innovation and inclusion.

iv. Drawing from the policy experience of countries that faced similar challenges, including some that graduated or are close to graduating from upper middle- to high-income status.

This report does not cover key aspects that are addressed in parallel studies (e.g., climate change impacts and actions in the CCDR) or require greater attention in future research (sector specific development strategies, the financing of capital investments or the political economy of reforms).
Box (1): The underlying conceptual approach of this report

This report is anchored on three complementary methodologies:

1. The analysis is guided by several conceptual approaches to assess economic growth performance: i) growth decomposition models (Solow and Shapley) to assess the role of accumulation of factors (capital and labor) and efficiency gains (productivity growth), ii) evaluating the process of economic transformation to gain understanding of the reallocation of resources away from agriculture as the country urbanizes (Romer, Henderson), and within sectors (Lewis, Kuznets), iii) the role of natural resources (diamonds) (Sala-i-Martin); and iv) the role of institutions (Acemoglu, Rodrik).


3. Employing case studies comprising countries that have been able to avoid the middle-income trap in recent years to illustrate how such gains can be jump started in Botswana after taking into consideration the country’s political economy context and needs.
Box (2): Benchmarking selection

- Four countries were selected to inspire Botswana’s government in their quest to meet their targets. They achieved rapid and sustained growth episodes in recent years, mainly through productivity gains and, for some of them, diversification away from natural resources. All have close to zero extreme poverty ($2.15/day international poverty line) and relatively low inequality. Two are small economies (Chile and Mauritius), while one is geographically isolated (Mauritius). Korea and Malaysia are two of the greatest development stories in modern times.

- Botswana is ranked 92nd in terms of GNI per capita ($7,430) and distant by $6,495 from the high-income threshold in 2022. Its GNI per capita growth averaged 1.4% over the past 10 years (2013 to 2022).

Aspiring countries (based on 2022 data)

- Chile ranks 66th in terms of GNI per capita ($15,360) and reached HIC status in 2012. Its GNI per capita growth averaged 2.9% in the 10 years preceding graduation.

- Korea ranks 33rd in terms of GNI per capita ($36,190) and reached HIC status in 1995-97 and 2002. Its GNI per capita growth averaged 9.0% in the 10 years preceding graduation.

- Malaysia ranks 74th in terms of GNI per capita ($11,830) and is distant by $2,065 from the HIC threshold. Its GNI per capita growth averaged 2.4% over the past 7 years.

- Mauritius ranks 78th in terms of GNI per capita ($10,360) and is distant by $3,085 from the HIC threshold, while its GNI per capita growth averaged 2.4% over the past 10 years.
1. Why should Botswana search for new drivers of inclusive growth?

2. What were the drivers of growth until the slowdown in economic performance in the late 2000s?

3. Is the traditional model of growth suitable to sustain let alone accelerate growth and shared prosperity?

4. How to jumpstart these drivers?

5. Concluding remarks
1. Why should Botswana search for new drivers of inclusive growth?
Is Botswana’s growth and its effect on poverty running out of steam?

GDP growth is on a downward trend

- Up to the late 2000s, Botswana was one of the best performers in the world with a GDP growth rate averaging 7.1% (1980-2008) and fast reduction in extreme poverty ($2.15 per day), achieving one of the lowest poverty rates in Sub-Saharan Africa (17.7% in 2009).

- It was the only country from the region selected by the Growth Commission as a success story.

- Yet, Botswana’s GDP growth has systematically underperformed other middle-income countries since 2010 (it averaged 3%), except in 2015.

- Botswana’s poverty reduction slowed down too. Extreme poverty fell by only 2.3 percentage points between 2009 and 2015, while inequality remains among the highest in the world.

Note: The poverty rate is based on the international poverty line which is set at $2.15 per day using 2017 purchasing power parities (PPP). The Gini index measures the extent to which the distribution of income among individuals or households deviates from a perfectly equal distribution. Source: World Development Indicators.
Botswana will need a significant and sustained boost to achieve its goal of reaching high-income country status by 2036.

• The government has set **ambitious targets for 2036:**
  • Joining the club of HICs ($13,846 in 2022) and
  • Eradicating extreme poverty ($2.15 per day) and reducing significantly poverty ($6.85 per day).

• Yet, at the pace of growth of the last decade, the country **will not reach the above targets:**
  • GDP per capita will be $9,103, far from the target
  • The poverty rate (at $6.85 per day) will be over 40%.

• **Reinvigorating the development model** is therefore required to achieve faster and more inclusive growth.

High-income status may be difficult to reach by 2036 without faster and more stable growth

And poverty ($6.85 line) will remain prevalent by 2036

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Note: $6.85 (2017 PPP) per day per capita is the upper middle income poverty line. Note: Source: World Bank Long-Term Growth Model
2. What were the drivers of growth until the slowdown in economic performance in the late 2000s?
Botswana growth success story in a nutshell

- Botswana's growth story has been considered one of the greatest successes in economic development, at least up to the global financial crisis in the late 2000s.

- The country transitioned from low- to upper-middle-income status by:
  - Growing its income per capita fivefold between the mid-1980s and 2009, with low volatility.
  - Reducing extreme poverty from 41.8% in 1985 to 17.7% in 2009.

- This success has been explained largely by **four main drivers** of inclusive growth that reinforced each other:
  1. A **factor accumulation story** as the country increased its physical and human capital through significant investments.
  2. A **structural transformation story** as economic activities (and workers) moved from low to higher productivity sectors, while rapid urbanization helped generate albeit still modest agglomeration effects.
  3. A **diamond resource story** with massive fiscal revenues and foreign currency earnings, efficiently used to finance public investments and manage external economic shocks.
  4. An **institutional story** with strong governance and transparency recorded that helped avoid the well-known “curse of natural resources”.
Botswana’s four mutually-reinforcing traditional drivers of inclusive growth at work

- High domestic investment rate (>30% of GDP) fueled by the public sector
- Human capital accumulation and use of labor resulting from demographic, education, and employment dividends.
- Boom in production with a peak in late 2010s.
- Major source of revenue for the government (50%), main foreign currency earner (85%) and one third of GDP.
- Faster institutional development than in most middle-income countries, mainly because of political stability and an early commitment to a meritocratic civil service.

- Economic activities and workers shifted from subsistence agriculture to higher productivity activities.
- Rapid urbanization from 8% to 50% between 1970 and 2008.
2.1 A factor accumulation story

Solow growth decomposition analysis highlights the key contribution of factor accumulation from 1980 to 2009

- In line with economic theory and evidence from East Asia, Botswana was able to substantially increase its stocks of human and physical capital to leverage high GDP growth rates in its first phase of development.

- The accumulation of physical capital and labor accounted for all GDP per capita growth since the early 1990s.

- Productivity growth was a contributor in the 1980s but became negative in the 1990s and 2000s.

Note: The colors show the contribution of each factor and productivity to the change in GDP in each period. Source: Penn World Table; World Bank CEM Country Scan.
With a domestic investment rate over 30 percent of GDP, Botswana almost systematically outperformed other middle-income countries until the late 2000s.

Public investment was the driving force, with a rate only comparable to the one observed in a set of fast-growing economies in East Asia.

Public investment was highly correlated with the availability of revenues from extractives.

... While human capital accumulation and labor use were driven by
demographic, education, and employment dividends

Human Development Index (HDI) increased until mid-2010s.

The age dependency ratio fell by 60 percentage points
(1970-2009)

Universal primary education enrollment achieved in the 1980s
and significant gains observed at the secondary level

Structural unemployment declined by 5.4 percentage points
between 1996 and 2009.

Sources: UNDP – Human Development Report, World Development Indicators, Statistics Botswana.
2.2 Structural transformation away from agriculture ...

The radical transformation of the economy (1982-2012)
- 1982: 62% of the labor force was employed in agriculture, which contributed to 10.3% of GDP.
- 2012: 75.5% of the labor force was employed in industries and services, which contributed to 97.7% of GDP.

Source: Statistics Botswana, World Development Indicators, International Labour Organization.
Note: the series are not strictly comparable over time due to changes in definition, but they capture the actual trends.

Higher relative earnings in industries and services encourages reallocation of labor away from agriculture.
• Associated with the structural change of the economy, Botswana urbanized fast, from 8% in 1970 to almost 60% in 2008.

• By 2009, on average, the median earning in urban areas was 45% higher than in rural areas (without adjusting for spatial differences in living costs), contributing to higher standards of living in the former (rural poverty was 24.4% in 2009 compared with 15% in urban areas).

• The gap in earnings between urban and rural areas has remained constant in relative terms, which speaks to the limited dynamism of cities to foster productivity growth.

• This period saw a strong decline in rural poverty, from 45.2 to 24.4% between 2003 and 2009 (whereas urban poverty fell from 18 to 15%), while inequality declined from 64.7 to 60.5.

Sources: World Development Indicators, United Nations World Population Prospects.
2.3 A natural extraction (diamonds) story

- Shortly after independence (1966), diamonds were discovered, making Botswana the main world supplier. Production peaked in the late 2000s, almost equivalent to 1/3 of the country’s GDP. The diamond sector became quickly the major foreign currency earner and its rents funded almost half of the government revenue.

- Pula Fund – a stabilization fund, was created in 1993 to manage the fluctuations linked to mineral revenues. It has been used to follow a countercyclical policy, especially when the country has been hit by external shocks.

- Diamond rents also finance high participation of the public sector in the economy, including competitive and contestable sectors that could be served without public participation, such as real estate and wholesale trade. Total SOE assets amounted to 32 percent of GDP in 2021.

2.4 An institutional story

- Post-independence, Botswana managed to build **strong institutional foundations** to support the effective functioning of its society. The country's performance in global institutional quality indicators was better than the average in aspirational countries in a wide range of domains ranging from voice to political stability and to control of corruption.

- Yet, the country was lagging in terms of government effectiveness, regulations and rule of the law.

Source: World Governance Indicators. Higher estimates means better. Non weighted score average of the four selected aspirational countries.
3. Is the traditional model of growth suitable to sustain, let alone accelerate growth and shared prosperity?
The traditional growth model is reaching its limits

- Gradual exhaustion of the traditional drivers
- Higher vulnerability of the economy to shocks
- Decreasing effectiveness of policymaking

Botswana’s economic performance has become less stellar over the past decade:
- Slowdown in progress of poverty alleviation with an estimated 14% of the population still living in extreme poverty in 2022.
- Such slowdown is not uncommon as the path to attaining high-income status is steep (Box 3), but it has been exacerbated by persistently high inequalities in Botswana (Box 4).
Box (3): The steep path to attaining high-income status

- Both economic theory and history demonstrate that episodes of rapid and inclusive growth are difficult to sustain over long periods of time. In 2008, the Growth Commission identified only a small set of such episodes in a few countries – with most of them located in East Asia.

- The road from middle to high income appears is steeper than the one from low to middle income. Only 19 countries defined as upper middle-income countries in 1987 reached the status of a high-income country by 2022, including five East Asian countries (Hong Kong SAR, China; Korea; Japan; Singapore; and Taiwan, China). The aspiration and challenge for Botswana is to become one of these graduates.

- A shift from factor accumulation to technology/innovation driven economic growth appears to be the key factor in determining a country’s ability to avoid the middle-income trap (Kharas and Gill, 2015). About 80 percent of labor productivity growth in low-income countries comes from the reallocation of labor, while this contribution is only 32 percent in upper middle-income countries, suggesting the higher importance of intra-sector gains (World Bank 2018).
Box (4): Rapid inclusive growth has been challenged by persistent high inequality

- Botswana is amongst the most unequal countries in the world. By 2015, its Gini coefficient was 10 to 20 percentage points higher than that of its aspirational peers.

- Evidence suggests that inequality is not unusual in the early stages of development since physical capital returns are higher than human capital. Yet, for middle-income countries, inequality reduces economic growth due to credit constraints and the greater importance of human capital for labor income and innovation (Kuznets (1955), Galor (2009)).

- In Botswana, in line with the above arguments, differences in skills and abilities as well as disparities in higher education (particularly post-secondary and tertiary) are the main contributors to inequality (29% and 24%, respectively). Similarly, uneven labor market outcomes (participation, sector of employment and occupation type) explain another 36% of overall inequality.

Botswana’s inequality level is higher than among aspirational peers (Gini index)

Differences in employment between poor and non poor

Note: The bar colors show employment shares by sector for each year. The data is segmented by poor and non-poor households. Source: World Bank calculations using 2002/03 Household Income and Expenditure Survey (HIES), 2009/10 Botswana Core Welfare Indicators Survey (BCWIS), and 2015/16 Botswana Multi Topic Household Survey (BMTHS).
3.1 The gradual exhaustion of the traditional drivers, …

The diminishing returns of the accumulation story:

- **Physical capital**
  - More investment is required to achieve the same level of economic growth as in the earlier periods, highlighting inefficiencies in the economy - the Incremental Capital Output Ratio (ICOR) doubled between 1981-2000 and 2001-2021.
  - Decline in current general government investment from over 30% of GDP in 1972 to 7% of GDP in 2019 as the revenue from diamonds shrank relative to GDP.

- **Human capital**
  - Labor productivity gains averaged around 1.9% per year between 2011 and 2019, which is 2-3 percentage points lower than in aspiring countries.
  - Stagnating education and health outcomes (i.e., secondary enrollment decline by 0.9% between 2014 and 2019 while life expectancy was reduced by 4 years during 2016-2021)
  - Unemployment has been on the rise from 16.2% in 2009 to 25.4% in 2022.

The slower pace of structural transformation:

- **Sectors**
  - Many of the gains from moving away from lower-productivity agriculture were realized during the 1980s and 1990s.
  - Industrial output and employment have started to decline in sectors where the value added per worker has traditionally been the highest.
  - Value added per worker in services is lower than in industry and heterogenous due to the well-known large disparity between formal/modern and informal services.

- **Urbanization**
  - Urbanization is slowing down with a decline in the annual urbanization rate in recent years.
  - Agglomeration effects remain largely unrealized - Gaborone, the largest city, has only 240,000 people, and a population density of 1,400 people/km², which is 7 times lower than in, for example, Kuala Lumpur.
The diamond story is not forever

• The decline in domestic production from 30+ million carats (2004-2008) to an average of 22 million (2010-2022) comes as the country is facing increasing competition from other countries (Russia, Canada) and artificial diamonds.

• While reserves of diamonds are still substantial, they are projected to be exhausted by 2050.

• Extraction costs are rising, requiring substantial investments in equipment and technology.

• Despite efforts to augment labor value added in the mining sector, it remains a low labor-intensive sector. As of today, mining workers represent 1.7% of total paid workers, while the sector accounts for almost 22% of GDP.

The institutional story has lost momentum

• Since 2010, there has been a modest decline in governance indicators, except for a marginal improvement in regulations (see next slide for explanation of the methodology).

Source: World Governance Indicators
The Worldwide Governance Indicators (WGI) aggregate data from more than 30 think tanks, international organizations, non-governmental organizations, and private firms across the world. The data reflect the diverse views on governance of many stakeholders, including tens of thousands of survey respondents and experts. These data sources are rescaled and combined to create six aggregate indicators, representing broad dimensions of governance for over 200 countries and territories. The scores range from -2.5 (weak) to 2.5 (strong) governance performance. The six indicators are:

(i) **Voice and Accountability** captures perceptions of the extent to which a country's citizens can participate in selecting their government, as well as freedom of expression, freedom of association, and free media.

(ii) **Political Stability and Absence of Violence/Terrorism**: measures perceptions of the likelihood of political instability and/or politically motivated violence, including terrorism.

(ii) **Government Effectiveness**: captures perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies.

(iv) **Regulatory Quality**: captures perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development.

(v) **Rule of Law**: captures perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence.

(vi) **Control of Corruption**: captures perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests.

Business risks related to weak competition policies

- Vested interests/cronyism
- Discrimination against foreign companies
- Unfair competitive practices
- Price controls

Share of countries where there is some public participation in a sector or subsector

Note: A higher score typically indicates a higher perceived level of business risk related to competition policy. Source: Author’s elaboration based on data from the Economist Intelligence Unit (EIU) Risk Tracker, August 2021.

Percentage of other countries setting up price controls in the same sectors as Botswana

Source: WBG staff based on OECD and OECD-WBG PMR indicators (2018 methodology). Price controls include fixed prices, maximum prices, or margin controls set in the Control of Goods (Trading Margins) Regulations.
3.2 Higher vulnerability to shocks

GDP growth has become more volatile since 2009

Volatility (1980-2021): 1.01
Volatility (1995-2008): 0.57
Volatility (2009-2021): 2.41

The cost of economic volatility:

- One standard deviation increase in GDP volatility can cut around 1.3 percentage points of the growth rate (Hnatkovska and Loayza (2004)).
- Disproportionate negative impacts on the poor who have less resources to cope with shocks – i.e., the poorest villages are more affected by droughts.

- **Open economy shocks**: Botswana is a small economy that has been increasingly exposed to global economic shocks. Such vulnerability has been exacerbated by the low diversification of the external sector and the country’s decline in its dominant position in diamonds. The export value of diamonds exports fluctuated from a max: US$7.3 b (2014) to a min: US$3.8 b. (2020).

- **Health shocks**: exposure to HIV/AIDS and COVID has negatively impacted economic performance, especially through a deterioration of several human capital indicators. After increasing by 16 years from 2003 to 2015, life expectancy declined by 4 years between 2016 and 2021.

- **Climate shocks**: While Botswana appears to be moderately vulnerable to climate events by global standards, the country is experiencing higher temperatures (+1.5 C since 1970) and lower and erratic rainfalls. A major drought occurred in 2018/19. Given the scarcity of water in the country, small variations might have large consequences on economic activities and people (especially in rural areas – see forthcoming Poverty Assessment).

Source: World Development Indicators, Statistics Botswana
Over the last decade, Botswana’s rankings have stagnated in several international indicators:

- **WEF competitiveness**: lost 25 positions since 2010.
- **Corruption index**: lost 2 positions since 2010.

**Value for money remains low** in critical sectors (education, health, infrastructure, etc.) by international standards.

Botswana is underperforming in social sectors relative to spending, 2021

Limited adjustment of economic development policy objectives to new realities:

- **Domestic**: New demand from emerging (urban) middle class.
- **Global**: Digital technology revolution, changes in the regional structure of GVCs, geopolitical rebalancing, climate change.

Slow implementation of reforms:

- Economic reforms become harder to implement along the development process. They require greater political consensus and more technical capabilities.
- Weak incentives to change the status quo due to vested interests of the elite and the absence of agents of change (Acemoglu, Johnson, and Robinson, 2001).
4. Which drivers will help Botswana become a high-income economy while sharing the benefits more broadly?
For Botswana to avoid the famous “middle-income trap”, the following questions merit further attention:

What do economic theory and empirical evidence tell us about avoiding this trap?

What will it take for Botswana to reach high-income status by 2036?

Which drivers are expected to make the biggest difference?
What do economic theory and empirical evidence tell us about avoiding the middle-income trap?

A common feature of middle-income countries that have successfully transited to high-income status has been their increased reliance on the efficient use of resources rather than relying heavily on simply accumulating them over time.

**ECONOMIC THEORY**

“Productivity isn’t everything but, in the long run, it’s almost everything.”

-(P. Krugman).

**EMPIRICAL EVIDENCE**

Korea had in 1986 the per capita income observed in Botswana today, but it doubled it in only 10 years and increased fivefold in 20 years. Investments in physical and human capital were increasingly accompanied by efficiency gains, as the contribution of TFP to growth increased from 16 percent in the 1970s to 43 percent in the 1980s and to 56 percent in the 2000s.
Box (6): Forward looking analysis: brief overview of the Long-term Growth Model tool

The LTGM tool (WB) was used to project Botswana’s long-term growth and poverty under different scenarios. Following the Solow-Swan growth model, the LTGM building blocks of growth are: i) savings, ii) investment, and iii) productivity. The model also analyzes human capital, demographics, the external sector (external debt, FDI, the Current Account Balance (CAB)) and labor force participation by gender.

The tool can be used to:

• Assess the implications of growth (and changes in inequality) on poverty in Botswana
• Project GDP per capita growth and poverty under different scenarios.
• Quantify how much factor accumulation and TFP gains are needed for Botswana to become a HIC by 2036
• Benchmark Botswana with countries that managed to join the HIC club.

Further details can be found at: https://www.worldbank.org/en/research/brief/LTGM
4.3 What will it take for Botswana to reach high-income status by 2036?

Botswana is projected to miss its GDP and poverty targets by 2036 under a business-as-usual scenario or by only relying on the accumulation of factors as the key driver of growth.

**Scenario 1: Business as Usual (BAU)**

- The gap in income per capita with the HIC threshold will be close to $5,000 while the poverty rate ($6.85 per day) will remain high at around 50% by 2036.

**Scenario 2: BAU + factor accumulation**

- Even with a stronger effort to invest in physical and human capital, the HIC target will not be met even if some reduction in poverty will be achieved by 2036.
- This scenario assumes that capital investment increases from 29% to 40% of GDP between 2022 and 2036, human capital grows by 1 percentage point (as recorded over the last 20 years) and the labor participation rate grows by 1 percentage point (from 73.2 percent). The Gini index is assumed to decline from 53.3 to 40.

Source: World Bank Long-Term Growth Model
Higher and sustained productivity growth is imperative for Botswana, ...

- For Botswana to match the transformational pace of successful countries, it must urgently move toward productivity-led growth.

- Even with higher factor accumulation, Botswana will need to increase its productivity to 2% by 2036 to become HIC – well above past and current levels.

- Such productivity growth was only attained by Korea during the 1980s and early 1990s. Other successful countries (Mauritius or Malaysia) achieved about 1 percent of productivity growth per year in the decade before becoming HIC.

Source: World Bank Long-Term Growth Model
Botswana’s negative Total Factor Productivity (TFP) contribution to per capita output growth over the past decade (2011-19) is in stark contrast with the pace of aspiring countries during their fast-growth episodes.

... especially because the country has failed to generate productivity gains in its recent history
Labor productivity improvements are lagging

Aggregate decomposition of per capita Value Added

Source: World Bank CEM Country Scan, World Development Indicators. Note*. Years show the period before graduation to high income for the aspirational peers except for Korea. Data is available from 1991 onward.

Percentage contribution to annual labor productivity growth

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Box (7): Productivity decomposition

The Solow Decomposition

The approach follows a standard production function represented in the formula below, where at time $t$, $Y$ is gross domestic product (GDP), $A$ is the total factor productivity, $K$ is the capital stock, and $hL$ is effective labor used in production, decomposed as $h$ being the adjustment for labor quality and $L$ being the number of workers. $\beta$ is the labor share.

$$ Y_t = A_t K_t^{1-\beta} (hL_t)^\beta \quad (1) $$

Equation (2) is obtained by taking the natural logarithm of both sides of Equation 1. It expresses the log-linear form of the production function.

$$ \ln(Y_t) = \ln(A_t) + (1 - \beta)\ln(K_t) + \beta \ln(h_t) + \beta \ln(L_t) \quad (2) $$

From equation (2), total factor productivity $A_t$ can be expressed as:

$$ \ln(A_t) = \ln(Y_t) - (1 - \beta)\ln(K_t) - \beta \ln(h_t) - \beta \ln(L_t) \quad (3) $$

Total factor productivity is a function of output/GDP, physical capital, human capital (quality) and the quantity of labor. It is interpreted as the efficiency with which inputs are used in the production process or technological progress that contributes to output growth.

However, the variable $A_t$, which is often referred as the Solow Residual, captures all the changes in output which are not explained by the factors of production (physical capital and labor), including but not only technical change.


The Shapley Decomposition

This approach decomposes, the output per capita into three basic drivers: (i) the contribution of labor productivity; (ii) employment growth; and (iii) the size of the labor force.

$$ Y = \frac{Y}{E} = A \frac{E}{N} \quad (p) $$

where $Y$ stands for total output, $N$ for total population, $A$ for total working-age population, $E$ for total employment, $Y/E$ for output per worker (average labor productivity), hereafter denoted with $p$.

The productivity driver ($\Delta p$) can be further decomposed by distinguishing between: (i) productivity growth within individual sectors; (ii) changes to productivity in terms of the reallocation of labor across sectors (static reallocation effect); and (iii) the joint effect of changes to the relative contribution of different sectors to employment and sectoral productivity growth (dynamic reallocation effect).

$$ \Delta p = \sum_{t=1}^{n} \left( p_i^T - p_i^0 \right) \frac{s_{i,t=0} + s_{i,t=T}}{2} + \sum_{t=1}^{n} \left( s_i^T - s_i^0 \right) \left( p_{i,t=0} + p_{i,t=T} \right) \frac{2}{2} + \sum_{t=1}^{n} \left( p_{i,t=0} - p_{i,t=T} \right) \left( s_i^T - s_i^0 \right) \frac{2}{2} $$

where the superscript $t=0$ and $t=T$ represent initial and final period, respectively, $p_i$ represents output per worker in sector $i$, $s_i$ stands for the share of sector $i$ in total employment and $n$ is the total number of economic sectors. The $\Delta$ operator denotes the change in productivity or employment shares between $T=t$ and $T=0$.

The contribution of labor productivity is the combination of three effects. The "within" effect is the weighted sum of productivity growth within individual sectors, where the weights are the averages of the employment shares of each sector in the two-time periods. The "within" effect is positive (negative) when the weighted change in productivity is positive (negative). The second term measures the portion of aggregate productivity changes explained by labor reallocation across sectors, which is positive if changes in employment shares are positively correlated with productivity levels. The third term represents the joint effect of changes employment shares and sectoral productivity growth. It is positive (negative) if workers are relocating to sectors that are experiencing positive (negative) productivity growth. In other words, the second term indicates whether workers moved to above-average productivity level sectors (static reallocation effect) while the third term shows whether productivity growth is higher in sectors that expanded in terms of employment shares (dynamic reallocation effects).
To better understand how Botswana can generate productivity growth, this study uses the analytical framework developed by Kim and Loayza (2019) (Box 5):

- The key determinants of productivity growth are: i) innovation, ii) education, iii) market efficiency, iv) infrastructure and v) institutions.

- These determinants are empirically proxied by several indicators, which are aggregated into five indexes.

Following this framework, Botswana is benchmarked against comparators to identify areas with the largest gaps and where policy should focus on.
Box (8): The Loayza-Kim (2019) analytical framework

Based on an extensive literature review, Kim and Loayza (2019) identify five main and interrelated determinants of economic productivity, which explain about 40% of the variation in productivity across countries.

- **Innovation**, to create and adopt new technologies, which is captured by the following indicators: Public and private expenditure on R&D as a percentage of GDP as an indicator of the effort to create new technologies; and the number of patent applications by residents and nonresidents and the number of scientific and technical journal articles as indicators of the outcome of R&D activities.

- **Education**, to spread these new technologies throughout the economy and to develop the capacity of the workforce to assimilate them. They choose the following indicators: Government expenditure on education as a percentage of GDP as an indicator of public investment in foundational human capital; the shares of the population aged 25 and over with completed secondary education and with completed tertiary education as indicators of educational attainment among workers; and a standardized international test score – a single average of scores in math, science, and reading on the Programme for International Student Assessment (PISA) – as an indicator of educational quality.

- **Market efficiency**, to promote the effective and flexible allocation of resources across sectors and firms, which is measured by the World Bank Doing Business scores as an indicator of output market efficiency, which measure the regulatory environment in terms of ease for firms to start a business, trade across borders, register property, get credit, and the like, the International Monetary Fund (IMF) Financial Development Index as an indicator of financial market efficiency, which measures the level of financial development by including the size and liquidity of financial markets, ease for individuals and firms to access financial services, and the ability of financial institutions to provide services at low costs with sustainable revenues, and a composite index, using factor analysis, consisting of minimum wage (% of value added per worker), severance pay for redundancy dismissals (weeks of salary), and the share of women in wage employment in the nonagricultural sector from World Bank databases.

- **Infrastructure**, to support and facilitate the economic activity of households, businesses, and markets. For a subcomponent index for infrastructure (Infra), we select fixed-telephone and mobile subscriptions (per 100 people); the length of paved roads (km per 100 people) (International Road Federation 2017a, 2017b); electricity production (kw per 100 people); and access to an improved water source and improved sanitation facilities (% of the population).

- **Institutions**, to defend property rights, and to safeguard basic civil rights. The World Bank Worldwide Governance Indicators include measures of voice and accountability (citizens’ participation in selecting their government and freedom of expression); control of corruption (the extent to which public power is exercised for personal gain); government effectiveness (the quality of public services and policy formulation and implementation); political stability (the absence of politically motivated conflict); regulatory and quality and the rule of law.

Key results of the benchmarking against aspiring countries show critical gaps

Areas with the largest gaps are innovation, education and infrastructure
(Score of each determinant index)

<table>
<thead>
<tr>
<th></th>
<th>Innovation</th>
<th>Education</th>
<th>Market Efficiency</th>
<th>Infrastructure</th>
<th>Institutions</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Botswana</td>
<td>7</td>
<td>43</td>
<td>60</td>
<td>47</td>
<td>70</td>
<td>227</td>
</tr>
<tr>
<td>Chile</td>
<td>13</td>
<td>50</td>
<td>68</td>
<td>55</td>
<td>82</td>
<td>268</td>
</tr>
<tr>
<td>Korea</td>
<td>98</td>
<td>99</td>
<td>87</td>
<td>73</td>
<td>73</td>
<td>430</td>
</tr>
<tr>
<td>Malaysia</td>
<td>24</td>
<td>50</td>
<td>82</td>
<td>58</td>
<td>67</td>
<td>281</td>
</tr>
<tr>
<td>Mauritius</td>
<td>5</td>
<td>40</td>
<td>70</td>
<td>55</td>
<td>75</td>
<td>245</td>
</tr>
</tbody>
</table>

Notes:
Red = score below 50; orange = score between 50 and 80; green = score above 80
Values shown correspond to the index for each of the five categories.

Source: Long-Term Growth Model; Annex A provides more details on these scores

Unpacking the gaps within each determinant category:

- **Innovation index**: Botswana is well below the levels of comparators. Investment in R&D as a share of GDP is 0.39%, below Malaysia (0.85%) and Korea (4.29%). Other indicators such as patent developments and the number of scientific and technical journals published also lag behind all aspiring countries.

- **Education index**: Although Botswana spends more on education (10% of GDP) relative to Chile (3.7% of GDP), Mauritius (4.98%) and Malaysia (5.59%), post-primary education completion rates are lower. Only 35.7% of the labor force (over 25) has completed their secondary or tertiary education against 46% in Malaysia, 47% in Mauritius, 52% in Chile, and 78% in Korea.

- **Market efficiency index**: Botswana’s financial market index is far from the value reported by other countries. By contrast, its labor market appears to function relatively well with less stringent regulation and a higher proportion of women as part of the employed labor force.

- **Infrastructure index**: Whilst Botswana lags behind aspiring countries, its index is not far from the one reported by Chile, Mauritius, and even Malaysia. It fares better than comparators on communication and roads but remains behind in terms of electricity production and access to improved sanitation. The low population and economic density are also a serious obstacle to creating agglomeration effects.

- **Institutions index**: While Botswana fares relatively well by international standards, it systematically lags in terms of government effectiveness. The quality of the regulatory environment is also below those observed in aspiring countries.
Which productivity drivers will require the most attention?

Boosting Botswana’s productivity drive requires special attention to the following determinants:

1. Promoting **dynamic firm creation and growth** and **adoption of technologies**
2. Developing **skills** in the labor force to better respond to the demand from firms and to increase labor earnings through productivity gains.
3. Improving **access to financial services**, especially for small and medium firms.
4. Enhancing connectivity to enlarge markets through trade, transport and digitalization.
5. Upgrading **public sector performance**.
Igniting these drivers can also contribute to enhancing economic inclusion and increasing upward mobility

- For Botswana to achieve its target of faster and shared growth, the productivity drivers must not only accelerate economic growth but also enhance economic inclusion.

- Enabling these drivers should help the poor and vulnerable groups climb the income ladder by:
  
  o Fostering a more dynamic private sector, especially micro and small enterprises, which is a pre-condition for more robust growth and job creation. Without many more jobs accessible to the broad population, poverty and inequality will remain entrenched.

  o Ensuring that the poor can participate in the growth process through equitable human capital development policy (even coverage and quality of service delivery across groups of people and places) to meet the demand for skills and improved access to financial services.

  o Reducing spatial inequalities between rural and urban areas and boosting the economic density of cities.

In sharp contrast to aspiring countries, Botswana has failed to reduce poverty and generate upward mobility across income groups through the expansion of the middle class.
While productivity is almost everything, it is not everything ...

This report provides a sense of direction for future policies as opposed to being prescriptive.

- The use of three analytical filters helps identify the most important drivers of productivity growth and a series of associated specific policy objectives. However, while necessary, the focus on these drivers and its underlying policy reform agenda is not a sufficient condition.

It is key to recognize two main aspects not covered by this analysis:

- Choice of productivity determinants based on a large sample of countries, yet they do not necessarily capture all aspects of a specific country context (e.g. Botswana’s high spatial dispersion of physical and human resources limits economies of scale in service delivery and market development).

- Other factors beyond productivity also matter for robust and inclusive growth (number and types of jobs, regional context, macro-fiscal policies, climate change, political economy, etc.)
5. How to jump start these drivers?
5.1 The policy challenge

Boosting productivity growth should be the anchor of policymaking in Botswana to trigger the virtuous circle by which an initial improvement in determinants/drivers leads to higher productivity, which in turn leads to better determinants/drivers. As emphasized earlier, Botswana needs to do it inclusively given its high level of inequality.

The recent economic literature has emphasized two basic principles that could be applied by Botswana in its quest toward productivity-led growth:

• **Pursue catalyst reforms or ideas that create short-term gains for the largest possible number of people:** This can gather political alliances for reform, including among the elite, and reduce resistance to change. Along those lines, Botswana can get inspired by successful countries that have been able to jump-start the reform process by implementing ideas that do not necessarily require a lot of financial resources. A selected number of case studies are presented here using the World Bank’s comparative advantage to get involved in over 150 countries around the world.

• **Prioritize to build momentum:** Recent economic theory and experience, including from fast-growing countries, show that starting with a strong and focused program on a few selected sectors or policy areas creates momentum in favor of reforms to account for the limited absorptive capabilities in the government and local economy.
Kickstarting the agenda: a framework for action

**KEY DRIVERS IDENTIFIED**

- Encouraging dynamic firm creation and growth and technology adoption/innovation
- Developing skills in the labor force
- Improving access to financial services
- Enhancing connectivity to enlarge markets
- Upgrading public sector performance

**GUIDING POLICY PRINCIPLES**

- Catalyst reforms
- Prioritization

**ACTIONS/CRITERIA**

- Get inspired by successful practices in other middle-income countries
- Focus on firm and job creation
- Exploit existing and potential comparative advantages
- Match potential global demand with the country's assets and advantages
## A menu of catalyst reforms

<table>
<thead>
<tr>
<th>Drivers</th>
<th>Good practices / Catalyst ideas</th>
<th>Countries</th>
</tr>
</thead>
</table>
| 1. Dynamic firm creation and growth and technology adoption/innovation | • Enhancing FDI spillovers to domestic firms  
• Supporting small firms in terms of product accreditation and certification to reach export markets  
• Reducing regulatory entry barriers including through digitalization and formalization  
• Developing an industrial complex to reduce transport and logistical costs and generate linkages  
• Opening transport services and lifting restrictions to trade in services  
• Boosting female employment in labor-intensive activities | Costa Rica, Vietnam  
Peru  
Ecuador, Moldova  
Morocco  
Philippines  
Bangladesh |
| 2. Improved skills in the labor force | • Using independent employment service providers  
• Promoting partnerships with companies through Workplace-based Learning (WBL) programs  
• Skill development by reaching informal firms | South Africa  
Germany  
India, Nigeria |
| 3. Better access to financial services | • Promoting digital finance in underserved areas  
• Trusting open finance  
• Providing portfolio guarantee for loans to SMES  
• Diversifying access to Finance for MSMEs – early-stage finance, asset-based financing  
• Establishing an infrastructure Credit Guarantee to leverage private funding sources | Egypt  
Brazil  
Burkina Faso, Madagascar  
Sweden  
Nigeria |
| 4. Enhancing connectivity to enlarge markets | • Creating spatial planning platforms in urban areas  
• Developing integrated spatial, urban mobility and aviation development through urban opportunity zones.  
• Reforming trade soft infrastructure (behind the borders reforms) | Asian cities  
USA  
India |
| 5. Upgrading public sector performance | • Re-aligning the government structure toward priorities  
• Creating a e-portal to accelerate administrative procedures | Canada  
Vietnam |
**Challenge:** With only 7 firms per 1,000 inhabitants, Botswana lags in firm dynamism and technology adoption.

**Constraints:**

- SMEs (84% of all firms) face administrative hurdles and FDI is limited by restrictive financial and trade policies and cumbersome administrative procedures.
- Incumbent firms (including SOEs) are often protected by anti-competitive practices, creating barriers to entry and competition and reducing incentives to innovate.
- Firms face infrastructure bottlenecks (energy, transport and logistics, water, digital).

**Solutions:**

1. **Foster an environment that enhances the creation and growth of innovative small businesses**
   - Eliminate redundant administrative procedures such as permits and licenses through a “guillotine” approach.
   - Deepen digitalization of key government-to-business processes (registration, insolvency, import/export, land acquisition and use, construction, and tax compliance).
   - Create programs to facilitate high-growth potential startups with access to risk capital, business training and mentorship, and skills.

2. **Attract FDI and create linkages with local firms**
   - Encourage technology transfer through appropriate tax incentives and intellectual property rights.
   - Facilitate the entry of skilled workers, while promoting the transfer of competencies to local workers.
   - Promote partnerships between foreign and local firms to develop efficient supply chains through programs enhancing quality controls, adoption of standards, etc.

3. **Encourage competition and market contestability**
   - Update the competition framework to (i) spell out more strongly the competitive neutrality principles; (ii) enforce competition regulation evenly across all firms, including SOEs; and (iii) strengthen the power and capability of the competition agency to review and abolish regulations that create barriers to entry or competition (e.g., FDI caps in competitive sectors).
Facilitate the entry and growth of small, young, and dynamic firms as those are generally more prone to use new technologies than existing ones.

**Ecuador:** In 2020, the government introduced a new simplified registration for small firms, available on a digital platform. Three years later, about 45,000 firms were registered, or almost 2/3 of the total.

**Moldova:** About 131 permits/licenses were configured in e-Permits and made available for online application. Time spent by businesses to meet regulatory requirements was reduced from 10.7% in 2014 to 6.2% in 2020 or an equivalent savings of US$13.5 million per year.

**Peru:** Strengthening the phytosanitary regulations and supervision system was critical in opening foreign markets for Peruvian products. As a result, 157 new agricultural products have been exported in more than 20 countries.

**Bangladesh:** The specialization of labor-intensive exports processing zones, with looser labor regulations, led to the creation of million of jobs, mainly taken by women. Female employment expanded by 4.4% per year between 2003 and 2013 –twice the national rate.

Attract “strategic” FDI and develop synergies with local firms to transfer technologies and competencies.

**Costa Rica:** A single “superstar” investor (Intel) triggered the country’s insertion into global value chains, Within three years of Intel’s arrival, the country tripled its stock of FDI to $1.3 billion, with the emergence of backward linkages and domestic value addition among local industries.

**Vietnam:** The government partnered with eight leading MNEs in the automotive, electronics, energy, and household appliance sectors to develop forty-five local suppliers between 2018 and 2021. Not only these local firms delivered better quality inputs but they also discovered new clients.

**Morocco:** The creation of the Tangiers economic zone, together with tax incentives and regional promotion policies, has catalyzed FDI inflows and linkages with local firms.

**Philippines:** New industrial zones with quality infrastructure and tax incentives for firms investing in the information technology (IT) and business process outsourcing (BPO) sectors led to a boom in revenue (up to US$30 billion in 2021) and in employment (1.5 million workers).
Challenge: Limited availability of skilled workers. Botswana spends relatively more on human capital, but outcomes are much lower than UMICs. Technical and vocational training is under-resourced and Social Protection systems have large room for efficiency gains.

Constraints:
• Limited measurement of human capital outcomes (education and health)
• Existing skills and youth employment programs are fragmented, preventing coordination and impact at scale
• Insufficient coordination between public and private education and training providers
• Learning deficits start early and accumulate, leading to large dropouts after Form 3

Solutions:
1. Improved value for money of public investments in education and skills by:
   • Strengthening foundations of learning (Early Childhood Development, early grade reading and math).
   • Enhancing coordination of skills development and youth employment programs.
   • Moving towards results-based financing of training providers (based on employment outcomes while relying on stronger measurement).
   • Enhancing further education and training at artisan and technician levels - particularly for school drop-outs.

2. Stronger cooperation with the private sector by:
   • Strengthening Workplace Based Learning (WBL) programs in SMEs and in the informal sector.
   • Open training programs with private providers focused on skills for the future (digital, green skills, STEM related fields, medical work; as well as entrepreneurship and soft skills).
Catalyst ideas

Developing smart partnerships to enhance workplace-based learning (WBL)

**South Africa**: To provide quality-training to unemployed youth, the government partnered with the Youth Employment Service (YES) - a private sector-driven not-for-profit company with experience in job placements. Since 2018, YES has worked with 1,500 sponsoring companies and 70,000 youth (58% of them female). About R3.95 billion has been injected in the economy.

**Germany**: To promote WBL programs, the government partnered with the private sector through different delivery models. Such flexibility resulted in significant benefits for youth in the form of smoother transitions from school to work and lower youth unemployment rates. It was also beneficial for enterprises, providing a good return on investment, saving recruitment costs, better match between the profiles of workers and company-specific skills requirements, and increased staff loyalty or reputational gains for the company.

Scaling up pilot programs in high-demand for targeted beneficiaries

**Philippines**: The Cebu Education Development Foundation provides high quality tertiary IT education, early IT skills development, and ensures job prospects for IT graduates. The IT-BPO sector employed nearly 1.5 million workers in 2022 and is projected to expand the number of jobs to almost 2.5 million by 2028. BPO jobs are also well paid: the average salary in the BPO sector is about three times higher than the country’s GDP per capita.

**Nigeria**: The Innovation Development and Effectiveness in the Acquisition of Skills (IDEAS) Project introduces improved and structured apprenticeship training in selected trade informal clusters in close cooperation with local trade associations.

**India**: The Industry Apprenticeship Initiative (IAI) Grant Scheme was launched in 2019 with the aim to provide training to specific clusters. It delivers grant funding to selected industry clusters to implement demand-driven, quality apprenticeship programs in a dual training mode provided by members of the cluster.
**Challenge:** Despite progress, Botswana still lags in financial inclusion and digital finance. The allocation of credit to MSMEs remains insufficient – only 8% obtained a banking credit in 2019.

**Constraints:**

- **Supply side:** (i) weak incentives to finance SMEs; (ii) lack of competition from non-banks due to restricted capacity and resources; and (iii) crowding out by weakly targeted and subsidized lending from state-owned financial institutions.
- **Demand side:** (i) high informality of SMEs, (ii) low levels of financial literacy; (iii) unreliable financial management and reporting by MSMEs; and (iv) dominance of cash as a preferred means of payment.

**Solutions:**

1) **Improve Digital Financial Services**
   - Foster digital and inclusive finance by (i) adopting the financial inclusion roadmap, (ii) developing fast payment services through a payment switch, (iii) enhancing payments interoperability and (iv) introducing digital ID.

2) **Enhance SME credit**
   - Implement targeted reforms to foster competition in the SME credit market by (i) streamlining the development of finance institutions, (ii) improving the efficiency of SME lending by introducing market-based credit enhancement products (such as credit guarantees schemes, or wholesale facilities) to banks and non-banks, and (iii) supporting the regulatory environment for new, innovative credit products.

3) **Strengthen Credit Infrastructure**
   - Strengthen credit infrastructure, by enforcing the reporting of both positive and negative data from credit providers, in line with the Credit Information Act.
## Catalyst ideas

<table>
<thead>
<tr>
<th>Developing specific programs targeting SMEs and the informal sector by increasing digital financial services and early-stage finance</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Egypt:</strong> To enhance inclusive finance in underserved areas, a three-pillar program was implemented with local banks by (i) setting up a financial literacy and marketing campaign; (2) designing effective financial products (prepaid card); (3) developing financial incentives (cash and reward points). As a result, 146K prepaid cards were issued to women and 97K pre-paid cards issued to men. Further, 122 new merchants were onboarded; leading to a 13% increase in POS transactions and 49% increase in ATM transactions.</td>
</tr>
<tr>
<td><strong>Brazil:</strong> By implementing open finance, a multilateral and open data-sharing regime, product innovation was encouraged through better consumer data and enabling payment initiation. Less than two years after its launch, Brazil’s open finance ecosystem reported over 27 million customers with 41 million accounts participating as of September 2023.</td>
</tr>
<tr>
<td><strong>Burkina Faso:</strong> To facilitate access to Finance for MSMEs, a portfolio partial credit guarantee with a (50-50) risk sharing facility was established for: (i) MSME; (ii) agriculture; (iii) women; and (iv) crisis. The scheme is managed by a guarantee fund licensed by the Central Bank. There are currently nine PFIs participating.</td>
</tr>
<tr>
<td><strong>Sweden:</strong> By combining (1) policies, regulation and tax reforms; (2) ecosystem development; and (3) financial instruments tailoring, early financing available for SMEs reached a total transaction value of SEK 1,03 trillion (USD 100 billion) between 2007 and 2022. The number of companies invested in during this period amounted to 6,714.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Leveraging funding sources through innovative instruments, including channeling risk capital to crowd in private sector financing</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Nigeria:</strong> The Infrastructure Credit Guarantee Company Ltd. (InfraCredit) is a private company established in 2017 to attract institutional investors by reducing the risk associated with local-currency corporate and project bonds. As of December 31, 2021, eight projects had reached financial completion for the equivalent of N60.3 billion (equivalent to US$159.4 million).</td>
</tr>
<tr>
<td><strong>Pakistan:</strong> GuarantCo and InfraCo Asia are replicating the InfraCredit experience in Pakistan. In November 2020, GuarantCo launched a private credit guarantee institution (InfraZamin Pakistan) to provide credit enhancements to tap into local currency pools of liquidity-held Infrastructure Credit Guarantee.</td>
</tr>
</tbody>
</table>
DRIVER 4
Enhancing connectivity to enlarge markets

**Challenge:** Landlocked with low population and economic density, Botswana needs to enlarge its markets and reduce cost to access them to realize economies of scale and positive agglomeration effects.

**Constraints:**
- Insufficient upgrading and maintenance of connective physical and digital infrastructure.
- Gaps in soft infrastructure (e.g., trade facilitation policies) hinder movement of goods, services, people, and capital and the ensuing efficiency gains.

**Solutions:**

1. **Trade facilitation and policy**
   - Implementing AfCFTA and other existing trade commitments to help develop value chains with high export potential.
   - Improve border agency cooperation, governance, and transparency of trade regulations, and implement the trade national single window and the authorized economic operator program.
   - Removal of import bans (especially food) to lessen price escalations, which affect mostly the poor, and shortages in the market, which affect trade in other sectors such as tourism.

2. **Transport connectivity**
   - Build the Trans-Kalahari Railways (which will offer an alternative to the South African corridor) by sharing risks with private investors.
   - Adopt the national aviation policy framework that proposes a clear path to reforming the aviation industry and developing regional networks in partnership with the private sector.

3. **Digitalization**
   - Continue to enhance digital inclusion by connecting rural, remote, and urban underserved areas through the SmartBots connectivity initiative, the Universal Service Fund, and related reforms to promote competition.
   - Open digital regional market integration by i) improving and harmonizing regulations for cross-border connectivity, data flows, and digital payments and ii) working with regional bodies such as SADC on a single digital market agenda.
Box (9): Import bans often do more harm than good

- Botswana is adopting import restrictions in some sectors, including in food and other agricultural products, under the notion that import bans stimulate the local economy. Such policy is also adopted on the premise that it increases (food) security as the country will become less dependent on imports.

- However, international evidence suggests that the costs of import bans often exceed the above potential benefits: 1) limits the availability of products (at least in the short term), leading to higher prices; 2) inflationary pressures tend to affect the poor disproportionately; 3) encourages misallocation by diverting resources from efficient sectors to the protected ones; 4) limit the flow of technology and knowledge, hindering innovation; and 5) encourages retaliation from key trade partners.

- Based on the above, Botswana's policymakers should carefully evaluate the costs and benefits associated with the adoption of import bans. The country, especially the poor, stands to lose more than what it can get out of the import bans. In agriculture, for instance:
  - Due to the existence of very few local producers, the availability (and quality) of the products banned (e.g. tomatoes, carrots, potatoes, etc.) has fallen on the domestic market in the short-term.
  - **Lower availability led to food price inflation**: while stable in the 2 years preceding the bans, the prices of potatoes increased by almost 40% in the two years following the import restrictions. Prices of onions increased even faster. In contrast, the prices of bananas (not subject to the bans) increased only by about 1% during the same period.
  - Higher prices hurt the most poor consumers (who don’t have the financial resources to pay), while the gains of selling more expensive products only benefit a few producers.

- In the longer term, the authorities should consider that agricultural productivity is higher in South Africa (water resources, economies of scale, market access, technology, etc.) than in Botswana, suggesting that it would be better off importing agricultural products from its neighbor and enabling existing and potential comparative advantages in other sectors (e.g. green energy, base minerals, eco-tourism, etc.)
Using new technologies to improve urban planning and facilitate the information flows

**Asian cities.** The development of Spatial Planning Platforms (SPP) has improved data acquisition, interoperability, and the integration of various data systems, laying the groundwork for smarter urban planning and management. Such platforms have led to (i) improved urban planning (Dhaka in Bangladesh or Can Tho in Vietnam); (ii) improved infrastructure asset management (Yunnan in China); and (iii) increased resilience to climate change (Columbo in Sri Lanka).

**USA:** To attract capital, create jobs, and lift residents out of poverty in poor urban communities, Opportunity Zones (OZ) were created in 2018 to offer investors three specific incentives for cashing out of their investments and putting capital gains to work supporting the economic development of low-income communities. In two years, OZ investment reached 3,800 communities for a total of $48 billion raised from roughly 21,000 individual and 4,000 corporate investors.

**India:** The deregulation of the transport sector (airlines, maritime and roads) has reduced costs and plays a large role in facilitating both internal and external trade by removing restrictions on foreign ownership of ships and facilitating entry of private investors (trucks, containers, etc.). Logistical services were further facilitated by the removal of “octroi” duties on inter-state movement of goods.

Developing specific initiatives to link poor urban communities to markets

Removing regulatory obstacles that prevent trade with external partners

Catalyst ideas
Challenge: While institutions are relatively strong, the government effectiveness has been weak and declining. Such weakness is visible in the implementation gap of government programs.

Constraints:
- Misalignment in the organizational structure and vision of the state.
- Ineffective coordination across government agencies hampers timely decision-making.
- Shortcomings in technical capacity and use of evidence dent the definition of problems and efficient implementation of solutions.
- Weak incentive mechanisms to foster accountability and transparency.

Solutions:
1. **Strengthening strategic planning and coordination capabilities** to underpin formulation of policy (e.g. certain industrial policies, climate change, etc.)
2. Investing in data, digital platforms, M&E systems and citizen feedback loops to **ensure proper use of evidence in the formulation and implementation of public policies** with the goal of promoting efficiency.
3. Mainstreaming open contracting and e-procurement systems that will help **promote better value for money by increasing transparency**, esp. around large infrastructure contracts.
Catalyst ideas

Re-organizing the government to align it with key objectives

**Vietnam:** The government was bold in reforming its institutions—by strengthening the Ministry of Trade—when it accelerated trade liberalization in the mid-1990s. It was merged with the Ministry of Industry to form the Ministry of Industry and Trade in 2007. Creating this institutional anchor explains well the country’s success to date as the country is today one of the most open economies in the world, with unprecedented export growth over the past two decades.

**Canada:** A comprehensive review was launched in 1994 to identify what to preserve and not what to cut in government programs. This review, under the responsibility of the Prime Minister and with the involvement of Ministers, led to a reduction of 10% in program spending with, however, significant variations between programs. Public employment was also reduced, partly through a transfer to the private sector, by about 50,000 employees.

Introducing new technologies to facilitate inter-government relationships and the timely exchange of information

**Vietnam:** The e-portal platform was created in 2019. It allowed the online processing of administrative procedures by households and businesses. As of early 2023, approximately 30% of all procedures are online, with the objective to reach 50% by end of 2023.

**Mexico:** The use of filters in IT systems to detect the risk of corruption, including in agencies.

**USA:** To fight corruption, the U.S. Securities and Exchange Commission (SEC) uses machine learning to identify patterns in the text of SEC filings. These patterns can be compared to past examination outcomes to find risks in investment manager filings. As a result, staff have become five times more effective than random selection. For investment advisors, the SEC uses machine-learning algorithms to predict the presence of idiosyncratic risks for each advisor.
While there is no silver bullet to systematically select priority areas or sectors, three guiding criteria are proposed based on economic theory and empirical evidence:

1. **Labor-intensive and tradable sectors** which are most likely to create productive jobs and foster innovation;

2. **Globally competitive sectors** as an export-led strategy appears as an imperative to increase market size for a small and undiversified economy like Botswana; and

3. **Sectors with high expected regional and global demand** to position Botswana and capitalize on emerging market trends.
First criteria: Labor-intensive and tradable sectors

A central objective for policy makers in Botswana is to create the maximum number of jobs given the exceptionally high structural unemployment rate and limited economic inclusion. Two stylized facts from economic literature and evidence can guide this objective:

1. **Sectors with the highest employment or employment potential should be prioritized.** The rationale is that this will maximize the impact on people, leading to a much-needed stronger inclusion. Indirect jobs can also be created through forward and backward linkages. (IFC Jobs Study, “Assessing Private Sector Contributions to Job Creation and Poverty Reduction,” January 2013).

2. **Sectors with the highest content of tradability should also be prioritized as the labor productivity gains are often 2-3 times bigger than in non-tradables** (IMF, The Level of Productivity in Traded and Non-Traded Sectors for a Large Panel of Countries, WP/15/48).
## Ranking of labor-intensive and tradable sectors, 2022

Top-5 per column in green, top 3 aggregate in blue lines

<table>
<thead>
<tr>
<th>Sectors</th>
<th>Employment (L)</th>
<th>Labor intensity (L/Y)</th>
<th>Potential Job Multiplier*</th>
<th>Tradability (X/Y)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public administration</td>
<td>131,650</td>
<td>0.7</td>
<td>-</td>
<td>0</td>
</tr>
<tr>
<td>Commerce</td>
<td>125,506</td>
<td>0.6</td>
<td>1.7</td>
<td>0</td>
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<tr>
<td>Agriculture</td>
<td>67,839</td>
<td>0.3</td>
<td>2.3</td>
<td>3.4</td>
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<tr>
<td>Education</td>
<td>57,902</td>
<td>0.3</td>
<td>1.9</td>
<td>0</td>
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<tr>
<td>Manufacturing</td>
<td>50,803</td>
<td>0.3</td>
<td>6.1</td>
<td>3.0</td>
</tr>
<tr>
<td>Construction</td>
<td>50,041</td>
<td>0.3</td>
<td>2.3</td>
<td>0</td>
</tr>
<tr>
<td>Administrative support</td>
<td>44,212</td>
<td>0.2</td>
<td>1.3</td>
<td>0</td>
</tr>
<tr>
<td>Domestic employee</td>
<td>31,156</td>
<td>0.2</td>
<td>2.2</td>
<td>0</td>
</tr>
<tr>
<td>Hotel and restaurants</td>
<td>30,955</td>
<td>0.2</td>
<td>1.6</td>
<td>0</td>
</tr>
<tr>
<td>Health</td>
<td>30,703</td>
<td>0.2</td>
<td>2.1</td>
<td>0</td>
</tr>
<tr>
<td>Transport</td>
<td>20,023</td>
<td>0.1</td>
<td>2.8</td>
<td>2.0</td>
</tr>
<tr>
<td>Science and research</td>
<td>16,679</td>
<td>0.1</td>
<td>4.1</td>
<td>0</td>
</tr>
<tr>
<td>Mining</td>
<td>12,723</td>
<td>0.1</td>
<td>3.9</td>
<td>15.6</td>
</tr>
<tr>
<td>Finance</td>
<td>10,378</td>
<td>0.1</td>
<td>3.6</td>
<td>0</td>
</tr>
<tr>
<td>Communication</td>
<td>7,508</td>
<td>0.0</td>
<td>5.7</td>
<td>0</td>
</tr>
<tr>
<td>Water</td>
<td>5,166</td>
<td>0.0</td>
<td>9.5</td>
<td>0</td>
</tr>
</tbody>
</table>

All data for Botswana except (*), which corresponds to the U.S. economy, based on updated employment multipliers by the Economic Policy Institute, 2019. The job multiplier includes supplier and induced jobs created by one additional job in the sector.
Second criteria: Globally competitive sectors

A combination of three analytical, well-established approaches has been used to select specific industries and products where Botswana is or can expect to be competitive in international markets.

• The first approach attempts to identify products where Botswana has already a revealed comparative advantage, building on the “safe” strategy that it makes sense to “push what is already working”. This is the classical methodology, developed by B. Balassa 40 years ago.

• The second approach takes the view that a country should push products that are in proximity of what it is already doing well. This is the ‘product space approach’ developed by R. Hausmann and his associates.

• The third approach is to get inspired by countries that have been able to escape the middle-income trap. This is the growth identification approach developed by the former WB Chief Economist Justin Lin.
**Ranking of Botswana’s globally competitive sectors**

**Revealed comparative advantage in minerals (diamonds) and agriculture (livestock)**

*TOP-10 products*

<table>
<thead>
<tr>
<th>Category</th>
<th>Multiplier</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stone/Glass</td>
<td>18.99</td>
</tr>
<tr>
<td>Animals</td>
<td>0.97</td>
</tr>
<tr>
<td>Minerals</td>
<td>0.52</td>
</tr>
<tr>
<td>Ore/Metals</td>
<td>0.37</td>
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<tr>
<td>Chemicals</td>
<td>0.14</td>
</tr>
<tr>
<td>Plastic/Rubber</td>
<td>0.13</td>
</tr>
<tr>
<td>Textile/Clothing</td>
<td>0.10</td>
</tr>
<tr>
<td>Vegetables</td>
<td>0.09</td>
</tr>
<tr>
<td>Machines</td>
<td>0.08</td>
</tr>
<tr>
<td>Metals</td>
<td>0.07</td>
</tr>
<tr>
<td>Food</td>
<td>0.06</td>
</tr>
<tr>
<td>Fuels</td>
<td>0.04</td>
</tr>
<tr>
<td>Wood</td>
<td>0.04</td>
</tr>
<tr>
<td>Transport</td>
<td>0.04</td>
</tr>
<tr>
<td>Hide/Skin</td>
<td>0.02</td>
</tr>
<tr>
<td>Footwear</td>
<td>0.02</td>
</tr>
</tbody>
</table>

Source: World Integrated Trade Solution, MIT.

**Product space indicates nearby opportunities in metals (tools, tubes, automobile parts)**

*TOP-10 products*

- Appliances for thermostatically controlled valves (8481 HS92)
- Knives and blades for machines (8208 HS92)
- Screws and similar articles of iron or steel (7318 HS92)
- Interchangeable tools for hand tools (8207 HS92)
- Parts and accessories for metal working machines (8466 HS92)
- Equipment for temperature change of materials (8419 HS92)
- Transmission shafts (8483 HS92)
- Tube or pipe fittings of iron or steel (7307 HS92)
- Machinery parts, not containing electrical features, n.e.c. (8485 HS92)
- Parts of motor vehicles (8708 HS92)

**Identification approach suggests that aspiring countries have more actively penetrated export markets and expanded their exports of services than Botswana**

**Index of export penetration 1/**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Botswana</td>
<td>1.3</td>
<td>1.6</td>
<td>2.6</td>
</tr>
<tr>
<td>Mauritius</td>
<td>1.7</td>
<td>2.6</td>
<td>8.3</td>
</tr>
<tr>
<td>Chile</td>
<td>2.6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Korea</td>
<td></td>
<td>9.5</td>
<td></td>
</tr>
<tr>
<td>Malaysia</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: 1/ Number of countries to which the reporter export a product divided by the number of countries importing this product that year.
With few existing advantages and nearby opportunities, growth can be pursued by making longer “jumps” into strategic areas with future diversification potential.

The greatest potential for Botswana, based on its existing assets, are in 1) renewable energy (solar and wind), 2) base minerals (uranium, nickel, copper, cobalt and manganese); and 3) eco-tourism. These sectors are projected with fast-increasing global demand.

Digital services is another sector that could receive greater attention. It is not only expected to be in high demand globally, but it has also been used by other small countries to move forward due to its strong potential to create jobs and diversify their economy.

Botswana is rich in minerals that are critical for renewable energy technologies.
Where future global demand could match Botswana’s assets and potential

Clean power and transports will require more new minerals

Eco or sustainable tourism

Demand for new minerals will explode

Digital services in a connected world

Source: The World Bank
Example in priority sector 1: Livestock – labor intensive and globally competitive

Livestock contributes over 60% of agricultural value-added. Botswana has access to demanding markets. Livestock is an important source of income and jobs, particularly for the rural communities.

**Challenge:** Botswana’s beef sector competitiveness, productivity and growth stagnated, despite the existence of comparative advantages and presence in large international markets.

**Constraints**
- High cattle mortality (livestock numbers fell from 2.6 million to 1 million in the last decade) due to diseases and increased vulnerability to climate shocks.
- Persistence of smallholder communal system hinders investments and economies of scale in cattle value-chain development.
- Policy and institutional challenges in business environment – BMC monopoly reduces sector competitiveness and efficiency.

**Proposed Solutions**

1. **Sector Reforms:**
   - Advance the competitiveness agenda by: i) signing the Meat Industry Regulatory Authority (MIRA) bill, and ii) developing regulations and a capacity building plan for MIRA’s operationalization.

2. **Sector investments**
   - Develop an investment plan for the Beef Cluster Strategy, the government’s strategic framework for the sector, to:
     - Increase productivity through investing in improved R&D for better breeds and promoting sustainable rangeland management.
     - Enhance marketing through re-branding and diversification of beef export markets
     - Promoting policy and institutional coordination between ministries, private sector industry stakeholders and producers.
Example in Priority Sector 2: Renewable energy (RE) – tapping on global demand and supporting job creation

Botswana owns strong competitive advantages from its outstanding solar and wind resources, vast areas of land available, and a stable investment framework to attract private operators.

What will Botswana gain with RE?
- Improve energy security while providing a green baseload through dispatchable solar.
- Protect export-oriented businesses (such as diamonds) in a context where importing countries are setting up carbon taxes.
- Help export electricity to neighboring countries generating revenues by leveraging the complementarity of the resources (e.g., with hydro) and regional trade opportunities.
- Create jobs, foster skills development and support local development.

To enhance further investments, the government needs to provide:
- Address planning and procurement gaps by developing a comprehensive RE roadmap managed by a dedicated delivery unit (as in Namibia) to ensure timely implementation and maximize the socio-economic benefits from RE.
- A bankable framework underpinned by clear regulations (supporting solar IPP projects, corporate power purchase agreements and local financing).
- Adequate transmission infrastructure to enable export of electricity (such as the BOSA line to South Africa).

Results of modelling show that targeted action plan in RE will:
- Increase local content by 10%.
- Job creation by 25%.
- An additional 2,500MW of solar PV to supply regional demand would triple job creation and boost the local share of the RE projects in comparison to Vision 2036.
Key results of the prioritization exercise

• Combination of three criteria suggests a selection of sectors/products on which Botswana could focus:
  • Manufacturing, agriculture (Job creation)
  • Diamonds and livestock (revealed advantage) but also some metals products (product space) and (digital) services (identification framework)
  • New minerals, eco-tourism, renewable energy (potential global demand)

• This list is indicative of direction but not conclusive since the art of policymaking is to adjust to new opportunities.

• Sectoral studies are needed to further examine the validity of these directions. In that context, the CCDR will provide detailed responses to three basic questions: (i) to what extent Botswana can become an exporter of renewable energy; (ii) can Botswana integrate into new value chains associated with the global demand of new minerals; and (iii) how can Botswana manage the negative impact of rising temperature and more volatile rainfalls on its economy?
6. Concluding Remarks
A platform to guide policies for future growth, jobs, and inclusion based on three filters

<table>
<thead>
<tr>
<th>Filter 1: Productivity Analysis</th>
<th>Filter 2: Good practices / Catalyst ideas</th>
<th>Filter 3: Prioritization criteria</th>
</tr>
</thead>
</table>
| Dynamic firms                   | • Facilitating the entry and growth of small, young, dynamic firms as those are generally more prone to use new technologies.  
• Attracting FDI and developing synergies with local firms to transfer technologies and competencies. | |
| Skills                          | • Developing smart partnerships with the private sector to enhance workplace-based learning (WBL).  
• Scaling up successful pilot programs in high demand for targeted beneficiaries. | Labor-intensive tradable sectors |
| Finance                         | • Improve DFS by developing fast payment services through the payment switch and adopting the financial inclusion roadmap.  
• Implement targeted reforms to foster competition in the SME credit market | Globally competitive sectors |
| Connectivity                    | • Using new technologies to improve urban planning, facilitate the information flows  
• Developing specific initiatives to link poor urban communities to markets (physical and digital).  
• Removing regulatory obstacles that prevent trade with external partners. | Sectors with high-projected global demand |
| Governance efficiency           | • Re-organizing the government to align it with key objectives  
• Introducing new technologies to facilitate inter-government relationships and the timely exchange of information to ensure transparency. | |
Several areas merit further attention (with ongoing and forthcoming work by the World Bank in parentheses):

- While using better-existing resources is crucial, there is still a need to selectively invest more resources into capital accumulation, especially in infrastructure, raising the challenge of funding both from the public and private sectors (ongoing work on energy and water provision).

- Greater attention should be given to the mechanisms of public delivery --- Botswana will need to step up the value for money in infrastructure (energy, water) and services (education, health) as outcomes are far below what could be expected from the amount of resources allocated to these sectors (forthcoming PER on social sectors).

- To the extent Botswana is a small country, further integration to regional and local markets through appropriate trade policies is a priority (forthcoming study on regional integration for SACU countries and ongoing TA project on regional trade facilitation).

- Further granularity is needed at the sectoral levels since designing and implementing relevant policies requires a good understanding of domestic and international markets and players (forthcoming study on regional value chains in Eastern and Southern Africa, ongoing work on livestock, and recent FSAP).

- Economic growth is to a large extent the ability to accumulate more wealth, but increasingly it is also about the preservation of existing wealth as the result of more severe climate shocks and sustainability challenges (forthcoming CCDR).

- The political economy of reforms has to be better understood, including the potential resistance of vested interest groups and the agents of change that can catalyze the speed of implementation.
References (1)

- IFC Jobs Study (2013), Assessing Private Sector Contributions to Job Creation and Poverty Reduction.
References (2)


- World Bank (2022), *Botswana Digital Economy Diagnostic*, https://doi.org/10.1596/37786


- World Integrated Trade Solution, *Calculate Revealed Comparative Advantage using UNSD COMTRADE data*. 

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ANNEX A
Empirical identification of drivers of productivity
### A dashboard for benchmarking


<table>
<thead>
<tr>
<th>TFP determinants</th>
<th>Botswana</th>
<th>Chile</th>
<th>Mauritius</th>
<th>Malaysia</th>
<th>Korea</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Innovation</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>R&amp;D expenditure, public and private (% of GDP)</td>
<td>0.39</td>
<td>0.49</td>
<td>0.27</td>
<td>0.85</td>
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<tr>
<td>Number of patents (/100 people)</td>
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<td>0.04</td>
<td>0</td>
<td>0.06</td>
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<td>Number of scientific and technical journals published (/100 people)</td>
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<td>0.03</td>
<td>0.01</td>
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<td><strong>Education</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Government expenditure on education (% of GDP)</td>
<td>10.3</td>
<td>3.7</td>
<td>4.98</td>
<td>5.59</td>
<td>4.31</td>
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<tr>
<td>Secondary completion rate (% of relevant population)</td>
<td>32.98</td>
<td>43.76</td>
<td>44.42</td>
<td>38.99</td>
<td>35.69</td>
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<tr>
<td>Tertiary completion rate (% of population aged 25 and above)</td>
<td>2.78</td>
<td>8.2</td>
<td>2.64</td>
<td>7.34</td>
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<td><strong>Market efficiency</strong></td>
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<tr>
<td><strong>Financial market:</strong></td>
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<tr>
<td>IMF Financial Development Index</td>
<td>0.22</td>
<td>0.54</td>
<td>0.43</td>
<td>0.68</td>
<td>0.84</td>
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<tr>
<td><strong>Labor market:</strong></td>
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<td></td>
</tr>
<tr>
<td>Minimum wage (ratio to value added per worker)</td>
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<td>0.22</td>
<td>0.23</td>
<td>0.24</td>
<td>0.29</td>
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<tr>
<td>Women in wage employment in the nonagricultural sector (% of total nonagricultural employment)</td>
<td>45.73</td>
<td>36.15</td>
<td>38.09</td>
<td>40.05</td>
<td>43.67</td>
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<tr>
<td><strong>Infrastructure</strong></td>
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<td></td>
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<tr>
<td>Mobile subscription (per 100 persons)</td>
<td>167.3</td>
<td>133.24</td>
<td>132.25</td>
<td>148.83</td>
<td>115.71</td>
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<td>Electricity production (kw per 100 persons)</td>
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<td>431552</td>
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<td>Paved road (km per 100 persons)</td>
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<td>0.16</td>
<td>0.48</td>
<td>0.19</td>
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<td>Access to improved sanitation facilities (% of population)</td>
<td>63.3</td>
<td>99</td>
<td>93.2</td>
<td>96</td>
<td>100</td>
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<tr>
<td>Access to improved water source (% of population)</td>
<td>96.2</td>
<td>99</td>
<td>99.9</td>
<td>98.2</td>
<td>99.68</td>
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<td><strong>Institutions</strong></td>
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<td>Voice and accountability</td>
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<td>0.94</td>
<td>-0.32</td>
<td>0.67</td>
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<td>Control of corruption</td>
<td>0.8</td>
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<td>0.45</td>
<td>0.48</td>
<td>0.49</td>
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<tr>
<td>Government effectiveness</td>
<td>0.36</td>
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<td>1.04</td>
<td>1.14</td>
<td>1.18</td>
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<td>Political stability</td>
<td>1.01</td>
<td>0.46</td>
<td>0.68</td>
<td>0.24</td>
<td>0.09</td>
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<tr>
<td>Regulatory quality</td>
<td>0.58</td>
<td>1.5</td>
<td>1.12</td>
<td>0.84</td>
<td>1.11</td>
</tr>
<tr>
<td>Rule of law</td>
<td>0.63</td>
<td>1.42</td>
<td>0.9</td>
<td>0.64</td>
<td>0.98</td>
</tr>
</tbody>
</table>

Source: World Bank Long-term Growth Model
Some of Botswana’s drivers of productivity are far away from those in aspiring countries

Botswana’s Performance on key determinants of productivity vs comparators

Comparators Heatmap on key determinants of productivity

Values shown correspond to the index for each of the five categories, which are calculated by weighting the components in each index, (Score of each determinant index)

Source: World Bank Long-term Growth Model, World Development Indicators.
ANNEX B
Country case studies
FDI Spillovers – Costa Rica
Attracting an anchor investment for structural changes

Context
In November 1996, Intel announced a monumental decision to establish a microprocessor assembly and testing factory in Costa Rica—positioning the firm as the largest foreign investor in the country at the time. Intel’s engagement in Costa Rica evolved over the project’s life to move up the value chain from assembly and testing to higher value-added operations to include Global Shared Services Centers, an Engineering Development Center for both pre-and post-silicon development, and a mega laboratory for testing new microprocessors. As part of its attraction and post-investment strategy, the Costa Rican Government worked resourcefully and with a novel sense of urgency to enhance the country’s technical education, incentives law, regulation, and infrastructure to attract this “anchor investment” and maximize its linkages and spillovers.

Government Interventions
Targeted proactive investment promotion and high-level Government support. In the 1990s, the Costa Rican government, in collaboration with its Investment Promotion Agency, CINDE, engaged in highly targeted investment promotion—courting large electronics corporations in the United States. Deliberately vying to make its way on Intel’s list of investment location options, the Government and CINDE demonstrated agility in showing how the country’s investment landscape would adapt to meet Intel’s stringent requirements. For example, recognizing Intel’s concerns about potential interruptions in production, the government committed to infrastructure upgrades supported directly by the President of Costa Rica at that time, including modernizing the national airport, vital for expediting shipments.

Skills upgrading. Intel required a highly skilled labor pool for its complex operations. The government worked with Intel’s HR specialists to co-design vocational training programs. Additionally important reforms were initiated in the existing educational curricula, backed by the Ministry of Education, to meet Intel’s requirements.

Supplier Networks. CINDE’s role went beyond promotion efforts targeting Intel; they also worked to attract supporting industries and suppliers, to eventually transform the FDI landscape through a vibrant electronics cluster.

- Local Suppliers. In the late 1990s, Costa Rican officials, inspired by visits to Asian countries with robust Local Industry Upgrade (LIU) programs, launched Costa Rica PROVEE, a program to develop local suppliers. Spearheaded by organizations like CINDE, the Chamber of Industry, and PROCOMER (Costa Rica’s trade promotion agency), along with private sector companies like Baxter Healthcare, this initiative aimed to deepen the economic impact of foreign investment through the multiplier effect and anchor foreign investors via strong local supplier relationships. Intel worked with local companies to help raise their quality and cost competitiveness to meet global standards, for example, in cardboard packaging.

- Global Suppliers. A direct consequence of Intel’s investment was the establishment of satellite offices for several global suppliers beginning in 1999—providing building blocks for the budding electronics support industry. Most of these firms, under contract to provide easily accessible technical support for manufacturing and testing equipment sold to Intel, opened a small service center or located an engineer at the Intel facility. These included Photarctics, NTX, Tiros, RV5, DEK and Pycom, among others.

When approaching suppliers, Cinde faced a “chicken or egg” dilemma: investors wanted existing suppliers, but suppliers needed a guaranteed market. Finding that suppliers already catered to existing investors in different sectors, such as electronics and medical devices, for items like clean rooms and packaging, they identified these overlapping supplier relationships to target decision-makers in these firms and establish a local supplier base.

Impact
Costa Rica’s effort to attract and support Intel shows how even a single “superstar” investor can lead the way in triggering structural transformation of the national export profile. It was a turning point of the country’s insertion into global value chains, as well as the development of an export-oriented sector producing high-technology and sophisticated manufacturing and value-added services. Providing an important demonstration effect, within three years of Intel’s arrival, the country tripled its stock of FDI to $1.3 billion. Its effects on the local economy were far-reaching.

Backward linkages. Initially Intel was sourcing its key inputs for assembly and testing of microprocessors internationally. But as it shifted toward higher value activities, the percentage of Intel’s domestic purchases jumped from 26% in 2013 to 69% in 2016. By 2016, services accounted for all local purchases, as Intel moved assembly and testing to Asia. The company began sourcing more specialized local services, particularly in IT and R&D, increasing from 5% in 2013 to 17% in 2016. (See Tables 1 and 2).

Domestic Value Addition. Intel’s climb up the value chain not only increased average salaries of its worker but also provided a valued domestic value addition. For each dollar that Intel produced and exported, 18 cents stayed in the country (in the form of payments for production factors and inputs produced by Costa Rican companies) in 2013, compared to 44 cents in 2016.

Business Culture, Standards and Knowledge Sharing. Exposure to Intel’s world-class business environment helped raise the performance standards of its workforce and suppliers. Following Intel’s practices, the National Insurance Institute (INS) created the first national Job Safety and Health Standard. There is also data indicating that the arrival of Intel and other multinationals in Costa Rica supported a more skilled labor force and fostered labor mobility from multinationals to local firms.

References
Market implementation and forward-looking vision of local enterprises to facilitate supplier linkages with FDI and promote access to foreign markets. Nevertheless, the Ministry of Industry and Trade (MoIT), has implemented policies to upgrade the capabilities and technology of domestic suppliers to meet the demands of multinational enterprises, which include quality, price, and delivery amongst others. Once they have demonstrated they can fulfill these and other requirements, they are linked to multinationals for future supply opportunities.

Impact

The pilot Supplier Development Program proved successful in improving the performance of participating firms in various ways: boosting suppliers’ performance benchmark by 20%, indicating a significant improvement in their technical and managerial capabilities. The program also achieved notable impacts on suppliers’ networking and collaboration opportunities, with a 30% increase in the likelihood of establishing new connections and exchanging information. As a result, there was a 10% increase in the number of MNE clients, which was essential in enhancing the suppliers’ market access and growth potential. Moreover, the SDP firms were found to be more resilient during the COVID-19 pandemic, experiencing shorter closures and less demand fall. Approximately 50% of the SDP participants became formal suppliers of MNE buyers, resulting in 38 new contracts worth USD 13.3 million. The program also led to the enhancement of public support programs, with the introduction of a new coordination mechanism that focuses on market orientation and facilitating collaboration between suppliers and buyers. The program’s success has led to its replication with a new cohort of 50 firms, further promoting local economic development and contributing to sustainable growth.

Despite its achievements, the pilot also highlights that public support for the development of GVC supplier programs requires scale. The pilot supported 45 enterprises and aims to reach 100 firms annually in the scale-up phase, which represents only a small percentage of the estimated 800,000 SMEs. Public support programs at a much larger scale are needed to tangibly increase the value added of domestic production in GVCs. Not surprisingly, the expansion of the suppliers’ base is slow. Foreign investors emphasize the dearth of domestic suppliers that can meet the required quality, quantities, delivery times, and prices. They also highlight the need for policies to assist local firms.

The pilot Supplier Development Program offers useful lessons for similar initiatives in other countries:

- Alignment between government’s FDI policy and linkage strategies: FDI linkages must address multiple constraints. A clear government vision and coherent approach, especially in FDI policy and linkage strategies, is critical to provide an enabling environment for sustainable and effective supplier development programs.

- Strong commitment from involved parties and capable lead agency: The effectiveness of FDI linkage programs depend on key conditions such as strong government buy-in, committed investor and motivated/capable local private sector partners, each playing an important role to achieve intended impacts.

- Strong team on the ground and local presence: Gaining the trust of clients in government and the private sector is critical, and in Vietnam, was a major reason why the program was able to continue to deliver on several activities during the worst of the pandemic.

- Market-driven: A market-driven approach is paramount and is best incorporated in linkage programs by consulting with and involving FDI firms at all stages of the process. A detailed understanding of binding constraints and demand-supply gaps is crucial to design the SDP. An SDP Advisory Group with the active participation of MNEs in Vietnam provided inputs and guidance for the SDP design and implementation.

- Intensive and targeted efforts: Supplier upgrading requires long-term and intensive efforts and resources from all actors—suppliers, government, and buyers—which would be beyond normal resources expected for a traditional SME support project. Targeted support guarantees that, with limited resources, support reaches those suppliers which have the most potential to establish linkages with MNEs.

- Well-developed ecosystem to support supplier upgrading initiatives: Development of local networks of mentors and industry consultants is critical for supplier development. The project put significant efforts in building up capacity of local consultants, peer them with international consultants for hands-on coaching and on-the-job training. In that way, local consultants were able to provide effective coaching to pilot participants.
Support Farms – Peru
Improving quality to access new markets

Context
Peru experienced an impressive boom in high value-added agricultural exports that resulted in remarkable gains in productivity, competitiveness, and employment. Over the past two decades, Peru has experienced a boom in agricultural exports, led by seasonal exports to the northern hemisphere of high-value fresh fruits and vegetables which grew at an annual rate of 22.5 percent since 2000 and reached an export value of US$ 6.7 billion in 2021. Peru is the world’s largest exporter of blueberries, grapes, and asparagus and the third exporter of avocados. This boom has contributed to reducing poverty in rural areas, which declined from 80 percent in 2004 to 36 percent in 2018, and even more in some areas that saw larger expansion of agricultural exports. The agricultural exporting sector provides 0.8 million formal agricultural jobs, up from 0.5 million in 2004, and supports indirectly another 0.7 million jobs, with high productivity and incomes.

Government Interventions
Private sector investment and innovation underpinned by public policy reforms and investments in public goods facilitated the agricultural export boom. Several issues needed to be addressed for Peru to truly exploit its comparative advantage in agriculture, given its broad but variable climatic conditions. First, tariff liberalization and regulatory reforms to increase competition, domestically increased agricultural productivity while an aggressive strategy of pursuing free trade agreements (FTAs) greatly expanded agricultural markets. Second, strengthening the phytosanitary regulations and supervision system was critical in opening markets for Peruvian products. Third, public investment in large-scale irrigation projects expanded the agricultural frontier into land previously considered from the desert and allowed farmers to achieve scale by leasing large tracks of land. Fourth, an Agriculture Promotion Law provided a favorable and flexible labor and tax regime for agricultural exporters by relaxing labor requirements on the minimum length of contracts, reducing benefits, and simplifying dismissal procedures. Fifth, private sector investment in agricultural research led to the adaptation of non-native species (e.g. blueberries) and varieties more suitable for local soil and climate conditions (e.g. Hass avocado) while investments in cold chain infrastructure and new cooling technologies expanded opportunities to increase exports of fresh produce.

Overcoming phytosanitary barriers allowed Peru to reap the benefits from FTAs once supply conditions were addressed. Phytosanitary barriers are more important than tariffs for agricultural products as imports of fresh fruits and vegetables are not authorized in most countries until a process of phytosanitary risk assessment is conducted and potential mitigation measures including whether the commodity must be inspected, treated, or certified to be imported safely into the country without the risk of pest introduction. Peru’s experience highlights the key role of strong support organizations like the National Agrarian Health Service (SENASA), which certifies producers’ compliance with sanitary and phytosanitary requirements, and the Trade Promotion Agency (PROMPERU), which promotes exports and assists with compliance of private standards, and the importance of private sector engagement from the beginning of the reform process.

Strengthening the phytosanitary regulations and supervision system (SENASA) was critical in opening foreign markets for Peruvian exports. Regulatory changes put SENASA clearly at the head of the SPS system in the country while a concerted effort to provide it with adequate financial and human resources allow it to play a key role in the development of the boom by acting on two fronts. The first, internally, through work with local producers to establish a pest surveillance system and introducing effective phytosanitary processes and protocols, such as fruit fly control, that allow opening foreign markets for key export products. SENASA also reinforced MSTQ standards and supported specialized infrastructure and services in the sector. The second, at an external level, through negotiation with counterparts in importing countries for the opening of markets and the provision of services linked to export (e.g., certifications of production sites, packing plants, shipping, etc.).

PROMPERU’s role as a dedicated agency in charge of export promotion and capacity building to comply with private standards also played a pivotal role. PROMPERU’s role to promote Peru’s products, inform on new trends and requirements in international markets and provide support to firms to comply with private standards contributed to the expansion of new export markets and export volumes. The role of PROMPERU has more importance in the phytosanitary sector.

FTAs. Peru has signed 23 FTAs that cover 72 percent of world GDP and 90 percent of world trade. The landmark FTA with the US (2009) was followed by agreements with other important economies like China (2010), South Korea (2011), Japan (2012), and the EU (2013). Average tariffs for agricultural products dropped from 13 percent in 2004 to 2 percent in 2019.

Impact/Lessons
Institutional reforms are needed to fully reap the benefits from trade openness and trade agreements. Despite the myriad FTAs signed by Peru in the last decades, the agricultural export boom would have not materialized without the strengthening SENASA and PROMPERU. Both agencies then used the coordination mechanisms embedded in FTAs to stage frequent bilateral meetings with importing countries agencies to proactively solve market access issues.

Substantial investment and institutional strengthening pay off in terms of exports. Over the last two decades, SENASA has implemented several public investment projects for a total amount of US$ 435 million aimed at improving its own infrastructure and equipment, training personnel, strengthening quarantine and surveillance systems. As a result, SENASA managed to introduce 157 agricultural products in more than 20 countries during this period.

Continuous work to improve market access and monitor and adapt to new buyer requirements is needed to keep exports growing. SENASA’s work does not end once market access for a product is achieved but continues to improve the conditions under which entry is allowed in order to reduce costs and increase the competitiveness exports. Likewise, PROMPERU is constantly monitoring foreign markets and revamped its export support services to respond to new buyer requirements.

Early engagement of the private sector in the reform process and market access negotiations is key. Most innovations and technology transfers that increased agricultural export supply and diversified the export basket resulted from the work of sectoral associations, sometimes in collaboration with public entities. Producer associations also worked closely with SENASA from the start to design and comply with the phytosanitary protocols required by imported countries.
Reduce entry barriers – Ecuador
Encourage informal firms through simplification and simplification

Context
Ecuador was facing serious productivity and competitiveness challenges at the outset of the Covid pandemic. Growth in Ecuador in the early 2000s, during the oil boom, was driven by public sector activity. Notwithstanding its benefits, the growth model was unsustainable and constrained private sector dynamism. Total factor productivity stagnated, and labor productivity also grew at a slower rate than wages. The high costs of labor in non-tradeable services combined with weak productivity growth resulted in a noticeable erosion in Ecuador’s competitiveness. The country’s real exchange rate, a measure of competitiveness, appreciated more than that of other countries that benefitted from the commodity boom, and remained appreciated after oil prices dropped.

Private sector firms in Ecuador are overwhelmingly young and small, and they struggle to grow over time. Most firms (over 90 percent) are microenterprises, 7 percent are small, and the remaining 2 percent are either medium or large firms. More than 18 percent of firms in 2015 were new entrants, and nearly 40 percent were less than five years old. Informality in Ecuador remains high compared to other countries. Unregistered firms accounted for 37 percent of total employment in Ecuador in 2011. Overall, Ecuador’s performance on most of the available informality indicators has remained worse than the average in the LAC region since the mid-2000s.

Ecuador’s regulatory environment has been a burden to the private sector during the last decade. In 2019, it took 48.5 days for an entrepreneur in Ecuador to start a business, almost twice the regional average, five times the average for OECD high-income economies and significantly more than in countries like Chile (4 days) and Colombia (10 days). The cost to start a business as a percentage of per capita income reached 33 percent in 2019, higher than the average for Latin America and the Caribbean. Barriers to entry, exit and growth disproportionately affect young and small firms, which represent the bulk of Ecuador’s private sector.

Government Interventions
In 2020 the government developed and implemented a comprehensive reform which aimed to lower barriers to entry and encourage formal registration of firms, particularly SMEs. One of the main measures was the introduction of a new type of company modality (“Simplified corporation form” or SAS). The SAS is a simplified, cost-free type of company that allows one or more individuals to start a business with maximum contractual flexibility. After noting the considerable initial demand for creating these companies, in September 2020, the Superintendence of Corporations of Ecuador enabled an Electronic Creation System specifically for the SAS. The benefits of the Ecuadorian SAS include:

- simplified registration process
- both physical and electronic registration
- the possibility of a single shareholder
- no minimum capital requirement to be incorporated
- full-fledged limited liability
- indefinite duration
- optional use of intermediaries to incorporate a company

With the creation of the SAS, Ecuador joined a regional trend of introducing simpler, more flexible corporate rules in regulatory frameworks, with the objective of stimulating the formal creation of new companies, especially micro and small enterprises, and of promoting the formalization of existing businesses. Other countries with similar reforms include Colombia, Chile, Mexico, and Argentina, and more recently, Uruguay, Paraguay, and Peru.

Impact
The new simplified corporation (SAS) form has become the most popular legal form for entrepreneurs since implementation began in May 2020. As of September 2023, more than 43,000 S.A.S. have been registered in the country, representing 71% of total companies registered since 2020. Almost 65% of the SAS have registered online.

As of 2022, 29% of SAS have a woman as their legal representative, and 41% have at least one female shareholder. Meanwhile, more than 600 SAS have succeeded in accessing loans from banks with a current portfolio of US$136 million. The new SASs have also begun to participate in public procurement bidding processes. In addition, the Internal Revenue Service (IR) has collected around $218 million in taxes from SAS alone.

According to surveys conducted by the Ecuadorian government in 2022, the Simplified Stock Company (SAS) form is popular among entrepreneurs, with 65% of respondents citing the possibility to formalize without needing a notary as the main advantage. The reduced registration time was the main reason for 17% of respondents, while 12% indicated that the main reason for choosing the model was not having to go in person to the commercial registry. Additionally, 6% said that the absence of a minimum capital requirement was the reason they chose to formalize under SAS.

The introduction of the SAS has been supported by information and training provided to the private sector. Examples include the development of performance measurement reports and private sector satisfaction surveys; manuals for external users and analysts of the institution; online training courses; and an ongoing communication campaign to publicize the SAS, explaining its scope and benefits with a view to encouraging entrepreneurs to take advantage of the scheme.

Company registration in Ecuador 2015-2023

Source: Government of Ecuador

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Reduce entry barriers — Moldova
Developing a simplified licenses regimes under a digital platform

**Context**

Between 2000 and 2021, per capita GDP of Moldova expanded at an average annual pace of almost 5 percent, helping the country reach about 15 percent of the EU average per capita GDP from about 3 percent in the early 2000s. Despite strong past growth, the productivity of Moldovan workers remains low compared with their regional peers. Faster convergence is held back by slow labor productivity growth in manufacturing and services. Stagnant private sector productivity growth has been caused in good part by market inefficiencies and slow structural transformation. Policies aiming to boost productivity and job creation need to make markets more contestable and accessible, for example, by reducing barriers to firms’ entry, exit, and growth, and ensuring a level playing field.

Around 2013, an assessment of Moldovan firm performance from panel data provides some indications that the poor business environment was having a negative impact on sales and productivity. Firm entry was lagging as Moldova had low new business density (new business registrations per capita), compared to its peers. The business environment was characterized by regulatory uncertainty and high transaction costs: (a) firms faced multiple and overlapping regulatory requirements at the national and local levels involving licenses, permits, and authorizations; (b) there were over 400 permits, licenses, and authorizations; (c) indirect costs, such as waiting times for obtaining permits, reached more than 60 days per firm; (d) yet 92 percent of centrally- and locally-issued permits and licenses did not comply with the regulatory principles required by legislation; (e) moreover, business inspections created additional hurdles – around 15 separate inspections were carried out at each business each year and a majority of firms reported that the process was unfair and that they were not treated equally.

**Government Interventions**

Aiming to improve business entry and competitiveness, the Government of Moldova conducted a regulatory simplification reform of its licensing and permits regime. A stocktaking of all licenses and regulatory requirements was done and redundancies in regulations were identified. Further, by utilizing the principle of risk-based regulations, the number of business licenses was reduced by 65 percent (from 416 to 152).

A digital platform for issuing business permits and licenses was launched. 131 permits/services were configured in e-Permits and are available for online application while 78 services are fully digital. User functions of the portal include online application, processing, digital ID, and digital payments. Based on system reports, on average, it takes seven days to process an application and issue a permit, as compared to 30-60 days before. The e-permit system is integrated in Government services, linked to the Government’s e-Payment system and commercial banks have mobile applications connected to MPay to enable a fully contactless process for the private sector. e-Permits was introduced just before the pandemic allowing business continuity despite Covid-19 related restrictions.

**Impact**

The reform helped improved business perceptions related to the investment climate based on business surveys conducted by the Government of Moldova. The degree in which the state was perceived to intervene in business activity decreased from roughly 11 percent in 2014 to 6.2 percent in 2020, the lowest value in the past 15 years. Only 11 percent of respondents reported having difficulties in obtaining licenses in 2020. The significant decrease relative to the 21 percent reported in 2019 is expected to be linked to the implementation of the e-permit system, which began implementing in 2018 and exhibited a fast acceleration in its utilization during the COVID-19 pandemic.

The proportion of time that management at businesses spent meeting regulatory requirements was reduced from 10.7 percent in 2014 to 6.2 percent in 2020. By decreasing the time that managers spend dealing with business permits and other regulations, the reform helped reduce the cost of doing business in Moldova by approximately US$13.5 million per year.
Connect to markets – Morocco
Enhancing agglomeration effects within the Tangier-Med industrial cluster

Context
Since 2003, under the royal initiative, the Tangier region has benefited from massive investments with considerable repercussions in terms of industrial development and foreign investment. The catalyst of this dynamic is the Port of Tangier Med which became the largest port of maritime transport in Africa, with the extension of Tangier Med II. Tangier Med is a connectivity node on the main route of world trade. It is connected to Asia, Europe and North America. Tanger Med is also a major link between Africa and Europe, a link that plays a key role in integrating Morocco into European value chains, and potentially beyond.

The proactive scheme and policy have also focused on the hinterland of Tanger Med with a network of free zones, logistics zones and industrial zones, and connectivity infrastructure. This approach is being replicated a little further east with the project of Nadir West Med. The dynamic has resulted in groundbreaking investments (Renault for example), with significant spill-over effects (e.g., automotive ecosystem) in the region and beyond.

The administrative region of Tangier-Tétouan-Al Hoceima represents 10% of the Moroccan population and 10% of the GDP. The region accounts also for 20% of exports and 30% of FDI, illustrating the dynamics of growth. However, the benefits of these dynamics are spatially concentrated in the region (not benefiting the Rif and the country as a whole). How to create more opportunities in more places may be the focus of a new TMSA-WBG partnership.

Government Interventions
Tanger Med consists primarily of two activities under Tanger Med Special Agency (TMSA) (i) the port of Tanger Med itself and (ii) a cluster of industrial and logistics zones (under Tanger Med Zones, TMZ). The initiative was launched by the King of Morocco in 2003 with the port starting operations in 2008.

TMSA is an autonomous agency, entirely state-owned through non-general budget vehicles like “fonds Hassan II” and the “Caisse de Dépôts et Gestion (CDG)”. Tanger Med owns the land and infrastructure. At the port, TMSA is both the landlord and the port authority. Port terminal operations have been conceded (PPP) to World class operators, interested in investing in a transshipment hub. Overall TMSA initial investment has been about 4 billion USD.

The port of Tanger Med has three main activities:
- The transshipment port which has two sites (TM 1 and TM2). When TM2 will be fully operational the total capacity of TangerMed will reach 8.5 MTEU, making TangerMed the biggest container port in Africa and the Mediterranean.
- Export (import) of cars in specialized ships.
- Ro-Ro Ferry to primarily Algeciras (26 connections per day), mixing private vehicles and export/import trailers.

Tanger Med handles 8.5 million TEU, over 450,000 cars (mostly exports and about 300,000 trailers (Ro-Ro).

The network of zones handled by the Tanger Med Zones (TMZ) subsidiary of TMSA includes:
- Tanger free zone next to the city and the airport, which existed prior to TM
- Renault and automotive city
- Logistics zone next to the port
- Two industrial parks in Tetouan province targeting local firms and SMEs

Operators include Eurogate (Rotterdam), APM (Maersk) and a consortium involving CMACGM and the historical Moroccan handling company Maris Maroc.

Impact
TMSA essentially met its objective, port investments were delivered in time and easily commercialized to global investors. Tanger Med currently hosts over 1000 firms for about 100,000 direct jobs, including a major anchor investment in the automotive sector (Renault decided in 2008). Other manufacturing sectors include aerospace, energy (e.g. wind turbines), and light manufacturing activities (textile) which tend to migrate to other parts of Morocco, given the lack of space and rising wages in Tanger. Building on this dynamic, Morocco is seeing other major investments in the Northern part of the country. PSA (Stellantis) has started another automotive cluster at Kenitra (In Between Rabat and Tangers). A replica of the TangerMed port/zone is being completed at Nadir (NadorWestMed), in the East.

The transfer of the Ferry-Ro-Ro to TM improved radically the connection with Spain for Moroccan exports (most of them cross the strait of Gibraltar). The container activity in TM is primarily oriented towards transshipment. The TangerMed has become the de facto global shipping hub for West Africa leading to more frequencies between Morocco and the South. However, the active connection through the disputed Western Saharan corridor also contributes to supply chain linkages with West Africa.

The administrative region of Tangier-Tétouan-Al Hoceima represents 10% of the Moroccan population and 10% of the GDP but now it accounts for 20% of exports and 30% of FDI, illustrating the dynamics of growth. The impact of TMSA beyond its immediate hinterland and direct jobs are not fully understood. For instance, how skills diffusion benefits other provinces, what is the un tapped potential for supply chain integration with areas where land is more available than Tangiers (a constraint now) and salaries lower. The spillovers in the Eastern provinces (aka Rif region) of Tanger-Tétouan-Al Hoceima region are very limited so far.

The Tanger Med port is generally considered an example of a major connectivity investment that brought economic benefits to its hinterland.

Several factors may explain why Tangiers has done better as a catalyst of private investment than similar hubs. The location in Morocco and the existence of export flows to the EU explain this. Morocco has had an association agreement with the EU since 1996, which makes the location in Morocco most conducive to taking advantage of the agreement. The choice of governance and the mandate of TM brought clarity and simplification of processes to the investors. The government also invested in the infrastructure to connect the zone to the port (critical for automotive) and more generally the port to the rest of the country: motorways (under ADM-Autoroutes du Maroc), and railway linkages. Those are important to link the plant (Renault and now Peugeot in Kenitra) to the car terminal at the port. Renault Tanger. Given the topography, few activities are directly on the port site, most zones are closer to the city about 50 km away.

Enabling policies, including horizontal reform, have directly or indirectly contributed:
- Reforms with tax and customs and logistics which boosted competitiveness. Export-oriented firms can benefit from the economic operator regime, which is applicable beyond SEZ,
- The government invested in logistics-related initiatives from 2006, including through a dedicated agency: most major logistics companies from Europe are present in Morocco.
- In the context of regionalism, the role of regions in promoting investment domestic or international has been reinforced (“Centre régionaux d’investissement”).
Exports in services – Philippines
Transforming itself as a global hub for business process outsourcing services

Context
The information technology (IT) and business process outsourcing (BPO) industry in the Philippines has been a driver of economic growth and job creation. Globally, the most commonly outsourced services are IT (54 percent), finance (44 percent), payroll (32 percent), and customer services (22 percent) and the demand for outsourced services is projected to continue to grow. The Philippines has become a global hub for BPO and is the second largest provider after India. Services in the Philippines focus on back-office functions such as human resources, IT, and finance, and customer support front-office services. The sector has a robust voice sector (primarily call centers) but service exports also grew rapidly in medical transcription, gaming, and animation.

The strong growth of the IT-BPO sector was facilitated by the universal use of English. Call centers draw on previously underutilized labor pools (youth and female workers), hiring many young workers with high school diplomas. This large labor force in the Philippines allows it to host big offshore services operations and to easily reduce costs for more transaction-intensive activities by developing cities beyond metropolitan areas.

Government Interventions
Investing in the quality of human capital allowed the Philippines to expand exports to higher-value services such as IT which require more trained personnel. One technology (CEDF-IT). When the association was established, Cebu had minimal presence of the IT industry. However, the association foresaw the opportunity and invested into improving the quality of tertiary IT education, early IT skills development, and ensuring job prospects for IT graduates. CEDF-IT played a major role in attracting key international BPO and IT companies to the city over the last 15 years leading to the development of a cluster employing 800,000 people in the Metro Cebu area.

Liberalizing the telecommunications sector has raised the competitiveness of the BPO sector. For example, allowing for foreign market entry, including through greenfield subsidiaries, domestic private entity acquisition, and joint ventures.

The Philippine business process outsourcing sector is characterized by high entry rates and is one of the most liberalized sectors in the country. It is intensive in IT-related services such as software development, animation, contact centers, and transcription. Since the early 2000s, for example, market entry by foreign firms is free as long as the foreign firm is staffed with professionals licensed to provide the service desired, mutual recognition agreement have been expanded automatically recognizing foreign licenses, and there are no separate requirements for foreign workers. By contrast, the Philippine retail sector has substantial restrictions to domestic and foreign entry, is dominated by a few incumbent firms, and only 20 percent of retail firms sell online. For example, foreign retailers that aim to establish a commercial presence need to pass prequalification procedures, meet minimum capital requirements, meet limitations to foreign equity participation, and have most of the board of directors be Filipinos.

Export processing zones have provided high-quality infrastructure services to firms and strong investment incentives. These zones are major enablers for Information investments by streamlining business registration, enforcing favorable regulations, and providing tax incentives. The Omnibus Investments Code consolidates the various investment incentives provided by the authorities in priority sectors such as the BPO industry, offering tax holidays, duty-free imports of equipment and machinery, and other benefits.

Impact
The rapid rise of the BPO was enabled by removing restrictions to FDI into the sector. In less than a decade, the Philippines have attracted large amounts of FDI into the BPO sector. The entry of multinational companies directly contributed to the job growth as individual back offices are typically quite large; for example, Accenture’s operations employed already 45,000 people in 2010, one of the largest employers in the country at the time. And many back-office finance and accounting services operations have more than 10,000 employees each.

The IT-BPO sector has become a major driver of job creation in the country. The IT-BPO sector in the Philippines added almost US$30 billion worth of revenues by 2021 and is the largest employer in the country. Employment grew from zero in early 2000s to nearly 1.5 million workers in 2022 and is projected to expand the number of jobs to almost 2.5 million by 2028. BPO jobs are also well paid: the average salary in the BPO sector is about three times higher than the country’s GDP per capita, reflecting the higher skills demanded by the sector.

The job growth was further facilitated by online outsourcing and job platforms which allowed smaller firms to participate. On oDesk, for example, the Philippines have the largest number of contractors in relation to their populations together with Bangladesh, India, Pakistan, and the United States.
Female employment – Bangladesh
Enhancing the gender dividend in labor-intensive activities

Context
Bangladesh experienced sustained per capita income growth and poverty reduction between 2003 and 2016, accompanied by strong job creation, steady structural transformation, and robust productivity growth.

Much of this success can be attributed to increased labor incomes resulting from positive labor market developments. Bangladesh’s demographic transition, with the working-age population growing faster than the total population, and employment growth with wage employment growing by 5.7 percent annually.

A key driving factor was the large-scale job creation in manufacturing, mostly in urban areas, as the result of female employment, which expanded more than double the rate of that for the working-age population as a whole, bringing millions of women into the labor force.

Government Interventions
The government started with a collaboration in the textile/garment sector between a Korean company (Youngone) and a Bangladeshi company, in which knowledge and skills were transferred to Bangladesh. That factory had around 250 workers who received training from experienced Korean operators. Today, Kihak Sung’s Youngone Corporation employs nearly 85,000 people around the world—with 70,000 work in Bangladesh. Youngone, enlisted in the Seoul Stock Market, has an annual turnover of $3 billion—and one-third of this revenue is from Bangladesh.

The easing of FDI regulations and the introduction of back-to-back letters of credit were complemented by the creation of new export processing zones. Moreover, the government encouraged and directed investments in RMG. It also adjusted its trade policy, so that low wages and the absence of import quotas allowed for a rapid expansion of the sector. The specialization in labor-intensive RMG exports created new and productive manufacturing jobs, many of which were taken up by women.

At Bangladesh’s income level, the female employment rate usually declines with rising incomes, but it remained stable in Bangladesh. The RMG sector in Bangladesh is an example of how FDI and trade can have a transformational impact through knowledge spillovers.

Impact
The Bangladesh economy generated more than 1.15 million new jobs per year on average since 2003, with total employment among the working-age population (age 15–64) growing at 2.4 percent annually. The total level of employment growth was above growth of the working-age population and of the labor force over this period and women employment expanded by 4.4 percent per year between 2003 and 2013—twice the national rate.

Moreover, employment outside the agricultural sector grew substantially faster (3.7 percent), and wage employment grew by 5.7 percent annually—driven in particular by large-scale job creation in manufacturing, mostly in urban areas. This growth in urban manufacturing jobs contributed to 4.4 percent annual growth in female employment, more than twice the rate of growth of the working-age population, bringing millions of women into the labor force. Along with employment growth came strong income growth, with real wages among wage employees rising 4.9 percent annually over this period.

As the apparel-specific wage premium rose, the male–female wage gap fell throughout the economy, not just in the apparel sector, in several countries. The falling wage gap shows that women’s wages were rising relative to men’s wages, suggesting that the entire economy may be affected by the change in a policy affecting a single sector. This result is consistent with the idea that the increase in apparel exports coincides with an increase in the demand for the factor used intensively in apparel—women—that may then have significant long-run poverty-reducing effects.

More women in the labor market with a high share of wage employment

Source: World Bank
Skill development – South Africa

Using an independent employment service providers

**Context**

Youth Employment Service (YES) is a private sector-driven non-for-profit company, offering companies B-BBEE recognition for investing in YES-facilitated work experience placements. The initiative addresses the youth unemployment challenge in South Africa by massively facilitating short-term job creation and work experience for unemployed youth aiming to break the vicious cycle of unemployment and lack of work experience.

**Government Interventions**

With the launch of the initiative in 2018, the government (Department of Trade and Industry) issued amendments to the B-BBEE Codes, which introduces YES targets and allow for raising the B-BBEE recognition status by one to two levels if the YES targets are achieved or exceeded. Furthermore, the amendments include an improvement in the recognition of informal skills development expenditure if these are YES employees/learners. Only YES Measured Entities are eligible to benefit, i.e., YES holds the sole right to implement the scheme.

There are three different options, under which firms can sponsor employment/work experience of a young South African: (1) Companies place youth in their own company. (2) Companies cover the costs and youth are placed in host enterprises facilitated through YES implementing partners (IP) - the turnkey solution; as well as (3) Companies sponsor youth being placed in one of the three YES hubs to grow a new enterprise.

At the moment, 70% of the YES job opportunities are provided through the first model and 29% through the turnkey solution, but YES plans to raise the share of youth to be catered for by implementing partners to 70 to 80%. Irrespective of which option a company chooses, youth will be employed by the sponsoring firm Opportunity Zones (OZ) are not the U.S. government’s first attempt to incentivize private investment in low-income and high-poverty communities. However, the structure of the OZ incentive is a sharp departure from previous attempts, which have been characterized by limited uptake and geographic reach, enormous complexity, and ambiguous economic benefits.

YES is overwhelmingly funded through fees from sponsoring firms. Registration fees range from zero to R20,000 depending on the size of the firm; service fees depend on the package chosen: between R1,700 and R5,000 per youth for company-placed youth (Option 1) and R9,700 per youth for the turnkey option (Option 2 – placement in a host company). The YES package includes a pre-loaded smartphone for each learner, a supervisor app, and a 12-month managing, monitoring, and evaluation company portal. In addition, the sponsoring firm has to cover the monthly allowance for the youth of a minimum R3,760 (minimum wage).

The YES arrangement does not release the company from its SDL obligation and payment of UIF contributions. Since the YES-supported scheme (work experience) is not covered under PIVOTAL learning, firms cannot obtain discretionary grant funding from the learners or benefit from the Learnership Income Tax Allowance. However, they can claim the ETI benefits. Sponsoring companies can be of any size, but most are large corporations.

**Impact**

Thus, OZs are an experiment in what place-based policy can achieve through a more decentralized, flexible, and scalable model. They are also an experiment in whether an incentive linked to the tax treatment of capital gains can generate widespread and economically productive activity in low-income and high-poverty communities.

Since its inception, YES has worked with more than 1,500 sponsoring companies of which around 500 have already raised their B-BBEE level as a result of the intervention. Some 70,000 youth, 58% of them female, have so far been provided with job and work experience opportunities through the program, which represents an injection into the economy through allowances paid to youth of over R3.95 billion.
Skill development – Germany
Promoting partnerships with companies through Workplace-based Learning (WBL) programs

Context
Different models of inter-company partnerships in training have a long tradition in Germany. Partnerships between companies and special training providers are meant to jointly take over high-quality training responsibility for a comprehensive occupational qualification, where employers alone would not be able to accommodate the full range of competencies required. These partnerships are usually applied for apprenticeships and can take different forms, depending on special requirements, challenges and local conditions; the principle of sharing responsibility in training is fully covered by the German Vocational Training Act.

Government Interventions
Typical forms of partnerships include:

- **Lead employer model**: Small, specialized enterprises cannot cover all competencies required for a qualification and venture into partnerships with other enterprises that can cover the remaining elements. The apprenticeship contract is signed and managed by the lead employer, and usually the majority of training is conducted in the lead enterprise. Selected training modules are offered by the partner(s) which benefit from the training experience of the lead employer and possibly other arrangement that may improve the training quality in the partner enterprises, including for example, using workshop and training facilities of the lead employers.

- **Outsourcing of training**: SMes that cannot cover all training modules required for a qualification may outsource certain parts of the training to education providers, inter-company training institutions, or also to other companies. Flexible outsourcing models are possible depending on requirements. The regular employer, who signs the apprenticeship contract, will cover the costs of the training that is contractually delivered by the partner.

- **Training consortia**: In order to improve the depth and quality of training, several enterprises team up on equal footing to exchange and rotate apprentices among each other. In line with its specific expertise, competence and specialization, each partner takes over selected parts of the training. Each apprentice has a regular employer, who signs the learning contract and is responsible for the management and quality of the apprenticeship and for ensuring that the learner is provided with the full range of competencies. Training consortia are a particularly flexible partnership, which may or may not be based on formal agreements between the partners.

- **Training associations ("Ausbildungsverein")**: These are formal training organizations that take over a range of formal functions and organizational services around apprenticeship training. Functions and services may differ. They would typically include recruitment, administration of the learning contract, payment of apprenticeship wages, quality assurance, trade test preparation, support during crises and disputes, etc. Training associations are funded through membership fees of the participating companies. Inter-company training partnerships are promoted through special programs. A recent subsidization program of the Federal Ministry of Education and Research has incentivized training partnerships and outsourcing of training during the coronavirus pandemic to facilitate a continuation of training in case a company has to temporarily interrupt training activities. Chambers and other competent bodies provide information and support to enterprises to access such support programs.

Impact
WBL increases the labour market relevance of skills development programs and the employability of their graduates. There is ample evidence that WBL improves the quality and depth of skills development and is especially effective in supporting the transition from education to work.

Evidence from Europe indicates that countries with an established apprenticeship culture and high participation rates of youth in apprenticeship training, consistently experience relatively smooth transitions from school to work, low youth unemployment rates, and generally lower gaps between youth and general unemployment rates. Analyses of the outcomes of formal apprenticeships also clearly demonstrate that former apprentices fare better than their peers who graduate from school-based training.

WBL can also be beneficial for enterprises, providing a good return on investment. There is a general agreement that apprenticeships can be worthwhile for employers, if and when the framework conditions are conducive, and the system is well-designed. Studies have demonstrated positive returns on apprenticeship training for the companies involved, including small companies, depending on design factors such as the amount of the apprenticeship allowance and other costs involved in training, the time of the WBL program learners spend in the workplace, the wage differential between learners and normal workers, the overall training duration and the level of government support to companies employing apprentices.

Significant long-term benefits occur, furthermore, for companies that employ learners after graduation stemming from better availability of skilled labour, saved recruitment costs, better match between the skills profiles of workers and company-specific skills requirements, increased staff loyalty or reputational gains for the company. The latter benefits, however, only occur if companies can and do retain learners after the end of the program. In India, for example, small businesses experience difficulties in retaining apprentices after graduation.
Skill development – India and Nigeria

Reaching to clusters

The Indian IAI Grant Scheme.

**Context**

The Industry Apprenticeship Initiative (IAI) Grant Scheme was launched in 2019 with funding from the World Bank-assisted Skills Strengthening for Industrial Value Enhancement (STRIVE) project. It introduces for the first time in India systematic support to business associations (called ‘industry clusters’) for getting involved in promoting and organizing apprenticeship training among its member companies.

**Government Interventions**

The IAI scheme aims to: (i) support the emergence and further development of dual apprenticeship programs in line with labour market needs; (ii) encourage and enable SMEs to become providers of formal apprenticeship training; (iii) strengthen the involvement of business associations/industry clusters in apprenticeship training; and (iv) create capacities among apprenticeship stakeholders (basic training providers; firm management and supervisors of apprentices; business associations) to design and implement apprenticeship training programs.

The IAI scheme provides grant funding to selected industry clusters (ICs) to implement a pre-defined IAI. An IAI is a project that promotes demand-driven, quality apprenticeship programs in a dual training mode provided by members of an IC. An IAI is always under the leadership of an IC. An IAI may support the introduction of any registered apprenticeable or dual trade, or alternatively new, needs-based apprenticeship programs, developed by the cluster and registered under the Optional Trade system (an arrangement in India that allows companies to run apprenticeship programs that are not designated as apprenticeable trades). In the latter case, costs to undertake needs assessments and curriculum development would be covered under the grant. In order to be eligible for grant funding, an IAI must always include a quality assurance plan, procedures for reporting on learning progress of apprentices (i.e. logbooks), and a training and capacity-building plan for supervisors and managers in participating companies that will engage apprentices.

**Impact**

An impact evaluation to assess the impact of the interventions is ongoing.

The Nigerian IDEAS project

**Context**

The World Bank-funded Innovation Development and Effectiveness in the Acquisition of Skills (IDEAS) Project of the Nigerian Government aims to introduce improved and structured apprenticeship training in selected trade clusters throughout the country.

**Government Interventions**

In close cooperation with local trade associations, the project delivers a comprehensive capacity development intervention package to selected informal sector clusters, including (i) organizational development support to trade and cluster organizations, and support to set-up digital platforms and business networks; (ii) skills upgrading training, digital literacy training, pedagogical and business management training and environmental awareness creation for MCPs; (iii) supplementary basic skills, theory, soft and digital skills and entrepreneurship training for apprentices, as well as foundational skills training as needed; (iv) access to NSQF-based assessment and certification for formal recognition of skills to both MCPs and apprenticeship completers; and (v) business development support through mentoring, limited provision of tools and shared modern equipment, and facilitation of access to other needed business development services.

**Impact**

An impact evaluation to assess the impact of the interventions on both, the benefitting apprentices as well as the MCPs, is ongoing.
Inclusive finance – Egypt
Promoting digital payment in underserved areas

Context
Egypt has the following barriers to electronic payment acceptance:
(i) it has a high preference for cash for retail payments and a large informal economy;
(ii) low financial/digital literacy levels and lack of trust;
(iii) low adoption of electronic payments for key use cases bank-led model for payment services, mobile network operators need to partner with banks to provide mobile wallets);
(iv) banking practices and economics of acceptance (economic incentives skewed against acquirers due to caps on acquiring margins, low profitability for acquirers; banks make it convenient for consumers with high availability of ATMs; acquiring banks do not actively recruit merchants);
and (v) government tax policies and incentives not working in the right direction (high import duty on Point-of-Sale terminals; high sales tax; and no tax incentives for merchants).

Government Interventions
Egypt adopted a holistic approach with a range of interventions.

On a policy level the President is heading a National Council of Payments to coordinate intersectoral financial inclusion initiatives including gender strategy for financial inclusion, fintech strategy and digital initiative.

On a legislative level banks are mandated to push financial inclusion; a Law was adopted to promote cashless payments for corporate and government payments; the licensing regime for fintech and e-payment activities was updated; and more.

On practical level the Central Bank piloted a set of interventions in 2 provinces and make sure that there were several banks supporting this initiative. Key project pillars were: (i) setting up a financial literacy and marketing campaign; (2) design effective financial products (prepaid card); (3) develop financial incentives (cash and reward points). It was also recognised that there was need for access point (ATM, POS, bank branches and bank agents) as project enablers. The pilot had clear target: women using digital payments, in two governorates, for 1 year.

Impact
The pilot had tangible (preliminary) results as it issued 146K prepaid cards to women and 97K pre-paid cards to men. The issuance of the pre-paid card let to a substantial increase in remittances received by women (48% increase in women remittance receivers; 48% increase in the number if remittances received by women; 41% increase in the value of remittances received by women).

Further, 122 new merchants were onboarded; there was 13% increase in POS transactions; and 49% increase in ATM transactions. The cash-back incentive for digital payments was seen as very popular.
Inclusive finance – Brazil

Trustin g Open finance

Context

More and more countries are implementing open finance, a multilateral and open data-sharing regime that enables all parties that meet defined requirements to exchange data, including customer data. The policy motivations for open finance range from increasing competition in concentrated financial markets by allowing new entrants to engage with consumers and their financial data more easily; to encouraging product innovation through better consumer data and enabling payment initiation; to deepening financial access and inclusion for consumers.

Government Interventions

Brazil’s early success and sharp uptake can be attributed to enabling factors such as the implementation of the interoperable, fast payments system (Pix), and a vibrant fintech market (e.g., Mercado Pago, PicPay, NuBank).

As a precondition to open finance, account access and regular usage should be key considerations for impact to expand beyond higher income segments. Smartphones are therefore an easy and readily available channel to access open finance services and provide necessary consent through an app.

The existence of key open finance enablers, however, may not guarantee the current uptake will continue to scale, penetrate lower-income segments, and deepen financial inclusion. A key element of open finance regimes is that data sharing is conditioned on customer consent. This requires customers to be aware of the option to participate in open finance and to be willing to exchange their data for additional value, such as a lower interest rate. Among those who were willing to share data, 27% reported having joined open finance. Again, we found that women, low-income customers, and those with more limited banking use have lower adoption rates.

Impact

Brazil’s rapid expansion of open finance shows its potential to transform financial services. Less than two years after its launch, Brazil’s open finance ecosystem reported over 27 million customers with 41 million accounts participating as of September 2023.

Of those who joined: 15% were men and 7.4% were women;

The promise of better terms of credit is currently the primary driver of open finance adoption in Brazil. For those that have joined open finance, the main motivations were increasing their credit limits (55%) and improving the conditions of a loan (20%), followed by the convenience of having a consolidated view of their accounts (14%) and better control of their finances (12%). For those who haven’t joined open finance, the main reasons were lack of awareness (31%), lack of interest (26%), and security concerns (9%).

The outlook is bright as uptake has been faster than in other markets and there are promising use cases that are emerging that are already seeing adoption amongst customers. Key use cases include credit scoring, personal financial management (PFM), personalized offers (including but not limited to, credit cards aligned with the spending profile of individuals, better credit limits, and discounts on specific stores), account onboarding, deposits between accounts of the same individual, P2P payments using funds from different accounts, and business financial management.
Inclusive finance – Burkina Faso and Madagascar
Access to Finance for MSMEs – portfolio guarantee

Context
The portfolio partial credit guarantee is a (50-50) risk-sharing facility that usually has a multiplier of 2 but it could go to 3 or exceptionally to 4. With a multiplier of 2 and risk sharing of 50-50 1 dollar of endowment can support an amount outstanding of credit guaranteed of 4 dollars.

Government Interventions
Burkina Faso
Critical characteristics of the portfolio partial credit guarantee are the following:

1) automaticity: each credit that meets eligibility criteria must be entered on the guarantee. This is to avoid adverse selection (meaning that participating financial institutions select ‘bad’ credits to be guaranteed by the scheme;
2) The participating financial institution (PFI) does the credit analysis. This means that there is no need for the scheme to redo the credit analysis;
3) There is fast registration on the guarantee as it is a mass product;
4) Payment of claims should happen within thirty days;
5) He guarantee should be silent to prevent moral hazard;
6) It is important to have favorable treatment of capital asset ratio and provisioning.

The Portfolio Credit Guarantee Scheme in Burkina Faso has four windows: (i) MSME; (ii) agriculture; (iii) women; and (iv) crisis. The scheme is managed by a guarantee fund licensed by the central bank. The private sector participates in its capital.

There are currently nine PFIs participating.

Madagascar
The Portfolio Credit Guarantee Scheme in Madagascar started in 2014 with a MSME window and was followed by an agriculture window in 2017 and a crisis window in 2021. It was managed by a private company licensed by the central bank.

At the beginning there was only 1 bank participating in the scheme, today 9 PFIs (banks and MFIs) are participating.

Impact
Burkina Faso
In total cumulatively 3,521 borrowers 6,934 credits for an amount outstanding of USD 75.5 million US dollars. It is important to note that there are 69% new borrowers in the MSME window, 54% new borrowers in women window.

Madagascar
For MSME window cumulatively July 2014 to May 2023, 12,375 borrowers (of which 60% are new borrowers) with 18,715 credits for an outstanding amount guaranteed of USD 179 million with an endowment of 12 million dollars. It is important to note that the MSME window is profitable.
Inclusive finance – Sweden
Access to Finance for MSMEs – early-stage finance

Context
Improving the business environment, strengthening the entrepreneurship ecosystem and creating a new channel of finance (away from traditional bank financing) can be catalytic for MSMEs development. Early-stage capital formation by businesses and funds is often limited by the scarcity of institutional and individual investors in both businesses and funds. Sweden is among the fastest growing European hubs by Venture Capital (VC) funding, and its private equity (PE) industry is also growing. This is partly thanks to holistic approach implemented by the Swedish government over the past 20 years, combining (1) policies, regulation and tax reform: (2) ecosystem development; and (3) financial instruments tailoring.

Government Interventions
Policies, regulation and tax reforms: (i) simplified regulatory processes as the Swedish Companies Registration Office (Bolagsverket) has streamlined procedures for company registration, making it easier for entrepreneurs to start businesses; (ii) e-residency and work permits as the Swedish Migration Agency has made it easier for tech talent and entrepreneurs from outside the EU to work or start a business in Sweden; (iii) promotion of Internationalization: Business Sweden, an organization jointly owned by the government and the industry, assists Swedish companies in expanding abroad and attracts foreign investment to Sweden; and (iv) Tax reforms such as capital gains tax which helped in encouraging investments, tax deductions for micro companies to stimulate job creation and growth, R&D tax credits to incentivize investment in research and development, and employee stock options to help startups attract and retain talent.

Ecosystem development: (i) Support for Business Incubators and Science Parks as Sweden has numerous business incubators and science parks that support startups. Many of these receive support from local, regional, and national governments (e.g. Minc in Malmö and Sting in Stockholm); (ii) innovationskontor (Innovation Offices). These offices, funded by Vinnova, are attached to universities and provide support to commercialize academic research; (iii) Educational and Networking Initiatives through organizations like Startup Sweden organize boot camps, training, and networking events that bring together entrepreneurs, investors, and experts.

Financial instruments tailoring: (i) Innovation Grants: The Swedish Innovation Agency, Vinnova, offers various grants to startups and research projects that have the potential to lead to commercially viable companies; (ii) Investment Promotion: Almi, a government-owned company, provides financing to startups, ranging from the ideation phase to early growth. It offers both loans and venture capital through its subsidiary, Almi Invest; (iii) Soft Loans for Innovation Projects: The Swedish government has provided soft loans (loans with better terms than market rates or which are interest-free) for innovation projects through institutions like Vinnova. (iv) Co-Investment Schemes: The government, often through Almi Invest, co-invests with private investors in startups, thereby reducing risk and stimulating more private investments.

Impact
The impact in Sweden as a result of the holistic approach has been enormous. The total transaction value between 2007 – 2022 amounted SEK 1,03 trillion (USD 100 billion). The number of companies invested in during this period amounted to 6,714.
Inclusive finance – Nigeria
Infrastructure Credit Guarantee

Context
The Infrastructure Credit Guarantee Company Ltd. (InfraCredit) is a private company established in 2017 by GuarantCo and the Nigeria Sovereign Investment Authority to provide credit enhancements for Nigerian local-currency debt instruments for infrastructure financing.

Through these instruments, InfraCredit addresses the lack of long-term local-currency bank financing by enticing institutional investors (such as pension funds and insurance companies) to buy infrastructure long-term assets (bonds). These credit enhancements (guarantees) are irrevocable and unconditional. InfraCredit guarantee obligations are secured by (a) the right to reimbursement of any amount paid against the issuer under a recourse agreement between InfraCredit and theissuer, (b) a first lien on specific properties or assets of the issuer, and (c) a first floating charge over the issuer’s remaining assets under a security deed.

Government Interventions
The business focus of InfraCredit is on reducing the risk associated with local-currency corporate and project bonds, with the purpose of mobilizing investments from Nigerian institutional investors and pension funds and deepening the domestic debt capital markets. InfraCredit maintains a local AAA credit rating from both Agusto & Co (Nigeria) and GCR Ratings (South Africa). According to both credit agencies, under current conditions, the amount of the financially sustainable credit guarantees portfolio with InfraCredit’s capital base (from global investment grade investors) is about 5 to 1. With a capital base of US$178 million, the potential amount of credit guarantees in Nigerian naira (N) for the local currency capital market is equivalent to US$890 million.

To address market barriers constraining its deal flow in Nigeria, InfraCredit is working to create strategic partnerships with donors and other DFIs that could unlock new sources of early-stage capital and promote well-structured, bankable infrastructure projects. The goal is to bring the projects to market, thereby expanding the market for good-quality operating infrastructure projects for institutions like InfraCredit. The effort is to create a facility that is complemented by the structuring of new financing products to support early-stage infrastructure investments such as contingent refinancing guarantee products (to refinance construction equity and loans in local currency) and a PPP guarantee product supporting offtake payments by a government agency or SOE (similar to IIGF in Indonesia). The interaction of the proposed facility and the new financing products will provide financial support across the full cycle of the project and accelerate deal flow that will help scale up InfraCredit’s guarantee portfolio.

GuarantCo and InfraCo Asia are replicating the InfraCredit experience in Pakistan. In November 2020, GuarantCo launched a private credit guarantee institution (InfraZamin Pakistan) to provide credit enhancements to tap into local currency pools of liquidity held by institutional investors in Pakistan. Shareholders (InfraCo Asia and Karandaaz) are providing a US$25 million equity contribution complemented by a contingent capital line provided by GuarantCo in the amount of US$50 million. Leverage of these resources could be close to 5 to 1 in the first five years, supporting an issuance amount of project and corporate bonds in local currency equivalent to US$375 million.

In short, InfraCredit provided partial credit guarantees supporting debt in local currency to finance sustainable infrastructure. Government, Multilateral Development Banks, donors and institutional investors were able to join forces. This allowed InfraCredit to have the capacity to provide US$ 865 million of Partial Credit Guarantees with only US$ 178 million of capital. Money that is being used to support infrastructure investment in for instance energy and transport.

Impact
As of December 31, 2021, eight projects had reached financial completion for the equivalent of N60.3 billion (equivalent to US$159.4 million).

Credit guarantees provided by InfraCredit are structured as full-wrap instruments covering 100 percent of debt service payments.

Based on its available capital (that is, core capital, callable capital, and subordinated debt), InfraCredit’s par-to-capital ratio was 0.5x at the end of March 2021.

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<td>Capacity to provide Partial Credit Guarantee for US$ 865 MM (5 times its capital)</td>
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<td>Callable Capital</td>
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<tr>
<td>Total</td>
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<td>178MM</td>
<td>100%</td>
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Urban development – Asian cities
Improving spatial planning through digital platforms

Context
Many cities are confronted with the following challenges:

- **Lack of rudimentary data**: Data that is incomplete, unavailable, and/or of poor granularity inhibits cities’ understanding of service provision demand, socioeconomic and physical vulnerabilities to external shocks and natural hazards, etc.
- **Lack of data sharing, integration, and maintenance**: Geospatial information has been typically collected in organizational silos; resulting in data duplication, and the use of different standards, formats, and classifications.
- **Lack of tools that enable data-driven analyses and planning**: Digital modeling and data analysis are crucial to developing interventions that optimize urban growth, especially to promote dense, low-carbon, and resilient development.
- **Lack of digital platforms that harmonize data collection, reporting, and integration across systems**: Data availability, access, and interoperability between various databases and systems are necessary to facilitate institutional collaboration, especially when addressing complex urbanization issues such as disaster risk, spatial planning, and infrastructure/asset management.

Government
Spatial Planning Platforms (SPP) are integrated data-sharing platforms, that can transform analog systems to improve data acquisition, interoperability, and integration across various data systems, laying the groundwork for smarter urban planning and management. SPPs can act as a centralized data repository that enables vertical and horizontal data sharing between different levels of governments and across public and private organizations.

Efficient collection and sharing of relevant data are essential for scenario planning to inform decision-making in numerous applications such as urban planning, disaster risk management, public financial management, transport, citizen, and business services, etc. It also reduces fragmentation and information asymmetries, which improves institutional coordination and implementation efficiency. For instance, spatial data can be layered with other data (such as poverty and infrastructure distribution) to model the drought and flood risks of its urban areas and potential physical, economic, and social impacts, allowing decision-makers to identify high-priority infrastructure investments in electricity distribution, public transport, road network expansion, and water supply and sanitation. Clear capital investment plans can then form the basis for a coherent financing strategy based on potential revenues. These core infrastructure investments can guide development away from risk-prone areas and sprawl toward denser, transit-oriented, low-carbon cities with more green and livable areas.

Impact
1. **Improved urban planning.** In Dhaka, Bangladesh, the World Bank supported the development of GeoDASH, a public geospatial data sharing, management, and visualization platform that promotes interagency approaches to urban planning and disaster risk management (DRM) by facilitating the sharing of data, effort, resources, and infrastructure between agencies. The platform has been used to assess the current conditions of schools regarding their infrastructure, water and sanitation facilities, access to roads, and disaster resilience. Geospatial layers have also been used to produce cyclone risk maps intended to guide investment plans for cyclone shelters in urban and rural areas, as well as a coastal embankment improvement project focused on improving vulnerable coastal polders to address erosion. Similarly, the World Bank is currently supporting the development of a SPP in Can Tho, Vietnam that will integrate spatial and non-spatial data onto a publicly accessible web portal, allowing governments, businesses, and citizens to access geospatial information for urban planning, business services, transport and traffic management, DRM, and other applications.

2. **Improved infrastructure asset management.** In Yunnan, China, the province aimed to expand its highway network to facilitate economic development, but it lacked asset management systems and integrated databases that could monitor road conditions and natural disasters, as well as optimize road maintenance strategies. An integrated management information system was established with support from the World Bank to collect data on vehicular traffic and the performance of large infrastructure projects. The data was used as feedback into the decision-making and performance evaluation of highway assets.

3. **Increased resilience to climate change.** In Sri Lanka, the World Bank helped to develop RiskInfo, a public, web-based disaster risk information platform that allows for the collection, storing, processing, sharing, and analysis of geospatial data, including high-quality aerial imagery, risk exposure data, historical flood maps, and land use maps. The platform is used to develop local-level multi-hazard risk maps that enhance understanding of disaster exposure, which supports disaster planning and preparedness, emergency response operations, and prioritize and execute resources for recovery and financial assistance. Timely and reliable data that allows for disaster monitoring in near or real-time has allowed for more effective institutional coordination in Sri Lanka during an emergency response.
Urban opportunity zones – USA
Incentivizing private investment in low-income and high-poverty communities

Context
Opportunity Zones (OZs) are not the U.S. government's first attempt to incentivize private investment in low-income and high-poverty communities. However, the structure of the OZ incentive is a sharp departure from previous attempts, which have been characterized by limited uptake and geographic reach, enormous complexity, and ambiguous economic benefits. Thus, OZs are an experiment in what place-based policy can achieve through a more decentralized, flexible, and scalable model. They are also an experiment on whether an incentive linked to the tax treatment of capital gains can generate widespread and economically productive activity in low-income and high-poverty communities.

While many questions remain unanswered, the emerging evidence suggests that Opportunity Zones have already achieved a combination of expansive geographic reach, large-scale private investment, and significant economic effects that are unique in the history of U.S. place-based policy.

Government Interventions
Opportunity Zones (OZs) were designed with a simple premise: the tax code should encourage private investment in communities that are struggling to attract capital, create jobs, and lift residents out of poverty. Enacted by Congress in the Tax Cuts and Jobs Act of 2017, OZs were first proposed by the bipartisan Investing in Opportunity Act, which was originally introduced in Congress in 2016. OZs provide federal incentives for certain types of long-term, productive investments in low-income urban and rural communities nationwide.

Opportunity Zones are low-income census tracts nominated by governors and certified by the U.S. Department of the Treasury into which investors can now make qualifying investments into new projects and enterprises in exchange for certain federal capital gains tax reductions. There are over 8,700 Opportunity Zones in every state and territory. At the time of designation, 97.4 percent of these communities qualified for OZ status according to the Treasury Department's “low-income community” (LIC) standard, while 2.6 percent qualified under the law's provision allowing tracts adjacent to a LIC to receive designation under certain circumstances. Fully 71 percent of Opportunity Zones communities met Treasury's “severely distressed” definition.

A Qualified Opportunity Fund (QOF) is any private investment vehicle organized as a corporation or partnership with the specific purpose of investing in Opportunity Zones. All qualifying investments must be made through QOFs to be eligible for the tax incentive. QOFs must register with the Internal Revenue Service and invest at least 90 percent of their capital in qualifying investments inside Opportunity Zones communities.

Impact
U.S. investors currently hold trillions of dollars in unrealized capital gains in stocks and mutual funds alone—a significant untapped resource for economic development. Opportunity Zones offer investors three specific incentives for cashing out of these investments and putting their capital gains to work supporting the economic development of low-income communities.

- The taxes due on any capital gains placed into an Opportunity Fund may be deferred until December 31, 2026.
- Investors who keep their money in an Opportunity Fund for five years receive a 10 percent step-up in basis on that original investment and an additional 5 percent after seven years.
- Investors who hold their investments in Opportunity Zones for at least 10 years face no capital gains taxes on the new investments when they sell them.

- OZ investment reached approximately 3,800 communities from mid-2018 through 2020, representing nearly half (48 percent) of the total number of designated OZ communities nationwide. For comparison, it took 18 years for New Markets Tax Credit (NMTC) investments to reach an equivalent number of communities.
- OZ investment is going to communities that are substantially more economically distressed than the rest of the country. Ranked from lowest to highest levels of need, they average in the 87th percentile for poverty, 81st for median household income, and 80th for unemployment.
- Total OZ equity investment reached at least $48 billion by the end of 2020. This capital was raised from roughly 21,000 individual and 4,000 corporate OZ investors and deployed into 7,800 Qualified Opportunity Funds.
- OZ designation caused a “large and immediate” increase in new commercial and residential development activity such that the likelihood of investment in a given month jumped by over 20 percent in designated tracts across 47 studied cities.
- Rather than crowding out local activity, OZ designations carried positive economic spillovers into neighboring communities and boosted development at a city-wide scale. In addition to boosting the supply of housing, OZ designations improved local home values by 3.4 percent from 2017 to 2020 with no observed increase in rents.
Trade facilitation reforms in services – India
Sequencing reforms tariffs, soft and hard infrastructure to reduce the cost of trade

Context

The transportation and logistics sector is an important enabling sector in any economy and plays a large role in facilitating both internal and external trade. India has seen significant reforms in the transportation sector. Before liberalization, the transportation sector was heavily regulated and dominated by state-owned enterprises. However, with the introduction of economic reforms in the early 1990s, the government began to open up the sector to private players. This led to the entry of several private companies in the transportation sector, including airlines, shipping companies, and logistics providers.

Government Interventions

Air transportation was liberalized by removing the monopoly of Indian Airlines on running domestic routes in 1993-94 (Arnold et al. 2016), which led to the entry of competitors running domestic routes. Foreign direct investment restrictions in air transportation were also loosened, initially with a ceiling of 40 percent in 1997-98. From 2004, private airlines were allowed to operate international routes.

In maritime shipping, significant restrictions were removed, including the removal of state-regulated fares for freight. The growth of the sector has been further facilitated by port reforms. Historically plagued by inefficiencies, congestion, and bureaucratic red tape, India’s ports underwent a significant overhaul through a series of reforms initiated in the late 1990s and early 2000s (Arnold et al. 2016). While prior to the reforms, ports were mainly controlled by states, in 1997, FDI of up to 74 percent was allowed in the construction of ports and 51 percent for pier operation. Two years later, in 1999, the limit on FDI in port construction was removed entirely. Furthermore, restrictions that required shipping firms to obtain government approval for repairs at specific shipyards were removed. Restrictions on foreign ownership of ships were also removed.

In road transport and logistics significant restrictions were removed as well, including the removal of requirements of vehicle registration and the removal of restrictions of foreign shipping companies on the transportation of containers from the originating location to the port. Ceilings on the issuance of permits for trucking companies were lifted, allowing for the emergence of larger companies in this sector. Logistical services were further facilitated by the removal of “octroi” duties on inter-state movement of goods. Road construction was further facilitated by laws allowing the levying of road tolls, which helped open the door to private investment in the construction of roads.

Impact

The liberalization of the transportation sector has resulted in increased competition, improved efficiency, and better services for consumers. It has also created new job opportunities and contributed to the growth of the Indian economy. Specifically, as a result of the aviation reforms, currently, the largest airline of the country in terms of fleet size and number of destinations, IndiGo, is a private airline employing over 26,000 personnel, including almost 4,000 pilots and close to 6,500 cabin crew. Moreover, the maritime shipping and port reforms have reduced the average turnaround time at major ports for a container significantly, from 8 days in 1990 to 3.5 days in 2005 (Mattoo et al. 2010).

The reforms in backbone services sectors in India such as transportation also significantly increased the productivity of firms in the rest of the economy, especially among manufacturing firms using these enabling services. It has been estimated that these services liberalizations raised the productivity of manufacturing firms by up to 20 percent. Moreover, the increase in the productivity among manufacturing firms due to reforms in the transportation were larger than the productivity increases from reforms in telecommunications, banking, or insurance (Arnold et al. 2016).

The services sector liberalizations are measured by changes in an index of services restrictions. A one standard-deviation change in the policy index associated with telecommunications, for example, leads to a 19 percent increase of productivity of manufacturing firms.
Rethinking the government – Canada

Program review: identifying which programs are necessary and not the ones to cut

Context

During the election campaign of 1993, all political parties emphasized economic growth and job creation as priorities, with comparable reference to deficit reduction.

The Program Review exercise was initiated in May 1994 and implemented over the following five years. This program was less about ‘what to cut’ and more about ‘what to preserve’ to give Canada the comparative advantages needed to prosper in the future.

Government Interventions

Program Review was a broad-based exercise involving all departments and organizations reporting to a minister, and through a minister to Parliament, including agencies.

One of the most important characteristics of the Program Review process was the reliance on ministers and deputy ministers, equivalent to the UK’s Permanent Secretaries, as the architects of departmental reforms. Minister and deputy ministers as a team were given the responsibility of coming forward with a common proposal for the future role of the department in serving Canadians, taking into account the GoC’s three-year fiscal plan. This approach ensured a strong link between policy choice and policy implementation.

These tests served as the conceptual framework for the exercise. They were framed as six questions:

1. Does the program or activity continue to serve a public interest?
2. Is there a legitimate and necessary role for government in this program area or activity?
3. Is the current role of the federal government appropriate or is the program a candidate for realignment with the provinces?
4. What activities or program should, or could, be transferred in whole or in part to the private or voluntary sector?
5. If the program or activity continues, how could its efficiency be improved?
6. Is the resultant package of program and activities affordable within the fiscal restraint? If not, what programs or activities should be abandoned?

Impact

Over a three-year period (1994-1997), Canada eliminated a sizable budgetary deficit. By 1998-99, all Program Review decisions were implemented. Canada ran consecutive surpluses until 2007-08.

Program Review decisions were announced in Budget 1995 and confirmed in the budget legislation, affording them legal protection. A team consisting of the Program Review Secretariat and departmental Program Review coordinators was established to oversee implementation. A second round of Program Review took place in 1995, focusing largely on horizontal issues that cut across departments. This would yield some additional measures that were announced in Budget 1996.

As a result of Program Review, program spending (which includes all spending except interest payments on the public debt) declined in absolute terms by over 10 percent between 1994-95 and 1996-97 (See Figure). Half of these reductions were the result of changes to statutory programs, including employment insurance benefit payments to individuals and fiscal transfers to the provinces. Some program spending, such as for Aboriginal peoples and children, was increased.

Program Review had a significant impact on the size of the Public Service. Over five years, Public Service employment declined by 45,000 employees, a reduction of 19 percent (see Figure). This included 8,000 employees whose positions were transferred to the private sector, the not-for-profit sector or to other levels of government.

The Program Review’s success drew on lessons from earlier efforts aimed at achieving savings including a 1985 task force review which only saw limited expenditure reductions. This included the realization that cuts and freezes to services in an undifferentiated way have significant perverse effects. It also included the recognition that efficiency measures or ‘doing more with less’ are not viable solutions to eliminate a sizable deficit. These measures may help with internal reallocations from lower to higher priorities but are not a substitute for making choices about the relative importance of government programs. Eliminating a large deficit requires repositioning the role of the government.

Effective governance of the process was key to the Program Review’s successful implementation. Three committees including a steering committee of deputy ministers, a special cabinet committee, and finally, the whole cabinet reviewed departmental proposals. The deputy ministers steering committee chaired by the head of the public service provided technical expertise and peer review of departmental proposals before sharing proposals with a cabinet committee chaired by the Minister Responsible for Public Service Renewal. The process was supported by a small secretariat of seconded officials within the cabinet office who worked with Program Review coordinators within departments.

Another key lesson from Canada’s Program Review is that ambitious reforms require a broader acceptance by the public and political commitment that cuts across party lines. The government managed to build broader public acceptance of expenditure cuts by raising public awareness of the challenge posed by an unsustainable public debt and securing buy-in from political parties across the spectrum. This broader public discussion on the challenges created by the budget deficit laid the groundwork for eventual action.
Rethinking the government – Vietnam

Creating a e-portal to accelerate administrative procedures

Context

The Vietnamese National Public Services Portal was launched on December 9, 2019, and already displayed nearly 300 online services and more than 6 million files processed online in 2020. The project keeps on supporting the deployment across the country and improvement of the Portal, whose attendance doubles every month since its official launch. Vietnam aims to have 50% of administrative procedures handled online by 2023 as part of its efforts to increase the proportion of people and businesses using online public services and digital platforms.

Government

The portal at [http://dichvucong.gov.vn](http://dichvucong.gov.vn) consists of six components, namely; national database on administrative procedures and the frequently asked questions and answers related to the procedures, on-time login and verification system to connect with ministerial and provincial-level public service portals, e-payment system, opinion section for citizens and enterprises, integrated public services of ministries, agencies and localities, and online supporting services.

This platform offers 31 percent of public services at level 4 of digitisation, allowing businesses and individuals to file official documents online, integrate them into a database, make contactless payments and receive virtual responses from government agencies. The transactions traditionally taking place between local elites and businesses are now digitally integrated into the national portal, reducing opportunities for corruption. It offers five online public services in all 63 provinces and cities, including issuance of driving licenses, announcement of promotion activities, reissuance of health insurance cards, provision of electricity services, and payment of electricity bills. To improve online public service use efficiency and encourage people to use online services, Ho Chi Minh City last year reduced fees by 50% for six kinds of services. Quang Nam has also decided to reduce fees by 50% for eight types of fees and five types of charges for those who settle administrative procedures through levels 3-4 online public services.

Several relevant agencies have been tasked to prepare infrastructure and fulfill cyber security conditions to connect national databases. They have been instructed to use data for the implementation of online public services by December 2023. Ministries and agencies must work to improve the capacity and quality of services and expandconnectivity, surveillance, and access control over data transmission networks by September. The government has also organized training for at least 100,000 civil servants by December to meet personnel demands.

Impact

By October 2023, there have over 14 million transactions completed on the e-portal or about 2/3 of all government administrative procedures over the year.

The portal provides a ranking of performance by ministries and provincial governments (see map). It also shares details on transaction completed on time (about ¾) and those that are delayed.

Under the plan, Vietnam will complete the information system for managing administrative procedures at the ministerial and provincial levels and integrate it into the national online public services portal and the one-stop public services system in 100% of the ministries, branches, and localities.