Export diversification: Myths and realities

Selim Raihan

Export diversification has been an important policy agenda in many of the developing countries. It is commonly viewed that export diversification is a necessary condition for a sustained and long-term growth of the economy and job creation. The current discourse of ‘global value chain’ also highlights the importance of diversification of export portfolio for an effective integration with the global value chain.

Among the developing countries, the problem of export concentration is more acute for most of the Least Developed Countries (LDCs). Many of the LDCs are still the exporters of primary products, mainly agricultural, which are not only susceptible to large volatility in the international market, but also provide limited opportunity for value addition. Few LDCs like Bangladesh and Cambodia, have been able to move from agricultural exports to manufacturing exports, but still their export baskets remain highly concentrated around few low value-added manufacturing products. For many of these economies, export diversification is argued to be playing an important role in structural transformation of their economies from producing low value-added products to high value-added products.

One strong view related to the policy for diversification of exports is its heavy emphasis on extensive tariff liberalization with the aim of reduction in anti-export bias. The policy conclusion that emerges from this stance is for low and uniform tariffs and a seamless export-import regime that facilitates least-cost transactions at the border. Tariff liberalization, under this view, is seen as a kind of ‘auto’ driver of export expansion and diversification of the export basket.

While the importance of tariff liberalization can’t be undermined, tariff liberalization alone is not sufficient to trigger an ‘auto’ response of expanding export volumes and diversifying the export basket.

It is also essential to keep in mind that comparative advantage doesn’t necessarily translate into competitive advantage. While many of the developing countries have comparative advantages in producing and exporting several agricultural and manufacturing products, given a domestic environment of high cost of doing business, such comparative advantages are seized to be realized. Therefore, while many of the LDCs are provided with significant market access opportunities in most of the developed countries’ markets through different trade agreements and generalized system of preferences (GSP), the single major reason for their inability to take advantage of such opportunities is their supply side constraints, which undermines their competitive ability to supply to the global markets.

It is important to note that in the discourse of policy reforms for export diversification the political economy perspective is generally ignored and reform of institutions is largely overlooked. A favorable overall incentive structure through the management and distribution of ‘rent’ is important for the diversification of the export basket. Experiences from many developing countries show that the dominant export sector becomes the main beneficiary of different export incentives (both formal and informal) while for other sectors, such schemes appear to be less effective primarily due to various structural bottlenecks as mentioned before. In this process, the dominant export sector grabs the lion’s share of the ‘rent’ being generated through such incentives.

This situation also raises a critical question as to whether ‘rents’ are needed for the promotion of other sectors. Experiences from successful countries highlight the importance of providing effective incentives to other sectors and removing structural bottlenecks in order to generate some ‘rents’ in those sectors. However, it should be kept in mind that while generating such ‘rent’ there is a need for a well-designed and effective industrial policy wherein monetary (interest rate subsidies) and fiscal incentives (reduced taxes or tax holidays) for the emerging dynamic export sectors should be transparent and time-bound. In addition, industrial policy needs to address issues of education and skill development for facilitating higher capabilities for export diversification, attracting FDI and integrating with the global value chain.

Experiences from different countries, who have been successful in diversifying their export portfolios, also suggest that institutional reforms should be considered as a key to overall policy reforms targeting larger export response and export diversification. Improving the bureaucracy quality, enforcing property rights, managing corruption, ensuring contract viability through reduction of the risk of contract modification or cancellation are examples of such institutional reforms. Furthermore, reducing political uncertainties or establishing political stability and generating political capital for a diversified export basket are critically important.
Why do countries differ in export diversification?

Selim Raihan and Mahtab Uddin

In the literature of export-growth linkages, the issue of export diversification draws a considerable interest for reducing risks associated with adverse and volatile terms of trade, slow productivity growth or relatively low value addition in the global value chain. Diversification of exports can lead to reducing the dependence on fluctuating commodity prices as well as can encourage other technology intensive sectors through triggering the knowledge spillovers, which could be attained from the exposure to international markets, business practices, and production processes. A number of empirical studies have shown strong relationships between economic growth and export diversification. While previous studies tried to correlate export diversification with investment, economic structure and development, the objective of our current article is to find out major factors that influence differences in export diversification across countries and time.

For constructing the model, index of export diversification is considered as the dependant variable while the explanatory variables of the model are log of per capita GDP, gross fixed capital formation (as % of GDP), domestic credit to the private sector (as % of GDP), tariff rates (both average MFN and weighted mean applied for all products in %), doing business indicators and institutional variables. Taking into consideration of the individualistic effect, a fixed effect panel regression is used over the period of 1962 to 2010 for 182 countries. In another set of regressions, LDC, Land Locked and Island dummies are used for desegregating the impacts of these variables over the export diversification. In this respect an LSDV model is applied.

The export diversification index is taken from the Export Diversification and Quality Databases (an IMF-DGD collaboration). From the database, data of 182 countries are considered for the period of 1962-2010. The higher value of the index indicates lower diversification; and therefore, for a better understanding, we term this index as export concentration index. The data of per capita GDP, investment, tariff rates, and credit to private sector are taken from the World Bank’s World Development Indicator database. The doing business indicators are taken from the Doing Business database. Institutional variables are adopted from the International Country Risk Guide (ICRG) database. The LDC country dummy variable is created using the UNCTAD’s list of LDC countries while the dummy variables for landlocked countries and island countries are created using Wikipedia.

In the first set of regressions, we have used log of per capita GDP, domestic credit to the private sector and investment. The regression result shows a strong negative association between economic development and export concentration index which means that, with economic development a country’s export basket tends to be more diversified. With the rise of per capita GDP by 10%, the export concentration index will decline by 0.01 points. Analogously, investment and domestic credit to the private sector (as % of GDP) are negatively associated with export concentration. Although the associated coefficients of these explanatory variables are small in magnitude, the strong significance resembles two facts: (i) a strong backbone of financial institutions which promotes smooth access to the private sector can lead a country towards greater diversification of exports; and (ii) a higher level of investment leads towards greater level of diversifications. On the contrary, despite the existence of a common belief that tariff liberalization leads to greater export diversification, the current study found no significant association between these two variables. Both MFN tariff and weighted applied tariff rates are found to be insignificant. Moreover, the time invariant dummies, namely, LDC, land lock and island dummies are found strongly significant and associated positively to export concentration index. On an average, for a country of LDC the export concentration index is higher than that of a non-LDC by 1.48 points, which shows that LDCs’ export baskets are more concentrated than those of non-LDCs. The result also shows that, export baskets of land-locked countries, India tops the list being the most diversified country of LDC the export concentration index is 1.64.

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Electronics industry in Bangladesh is one of the rapidly growing industries having a great potential for export diversification. The demand of electronic products is increasing in leaps and bounds. Due to rapid growths of users, Bangladesh is soon going to be one of the largest cellular phone using countries of South Asia. Therefore, there is a great opportunity for local and foreign traders to open a profitable business by investing more in this sector. However, at present, there are only a few local and foreign companies who are importing spare parts and assembling electronic products to meet the increasing demand. Statistics reveal that the exports of electronic products have risen over last five years. In 2010-11, the export of electronics products was only US$ 62.1 million, which increased to US$ 173.1 million by 2014-15. However, this sector has a larger potential for export earnings. Foreign Direct Investment (FDI) in this sector has not been properly explored and strictly enforced over exchange controls. Lack of enforcement of regulations has allowed local companies to fall below the standards necessary for the stringent regulated export markets. Also, strict controls over foreign exchange deter firms from undertaking critical activities like receiving certifications from overseas regulatory authorities in order to increase exports. Another constraint is understaffed DGDA (Directorate General of Drug Administration) which is the drug regulatory authority in Bangladesh. The two drug testing laboratories under DGDA lack capacity and there is inadequate infrastructural support for DGDA which is further complicated by the involvement of multiple administrative bodies and committees in the regulatory process. The industry does not have a bio-equivalence testing facility, which is mandatory for product registration in developed markets. Necessary steps should be taken to extend the exemption period of Doha declaration regarding WTO-TRIPS, and alongside this there should be preparations for compliance with patent laws in case the exemption is not extended. Another important measure can be the urgent establishment of a full-fledged bio-equivalence laboratory which will enhance exports and improve product quality. There is a need for collaboration with qualified foreign entities which will help in research and development procedures immensely. Appropriate training to the DGDA staff can also help in regulating the market more effectively.

Bangladesh is growing, demand for electrical home appliances is growing with it. These factors show that Bangladesh has a huge potential to invest in electronics targeting both the domestic and export markets. To diminish the obstacles and to pave a smooth path towards the growth of this industry, the government needs to create more opportunities for investment from both local and foreign investors, and especially from the foreign investors. Sound and effective measures by the government, attracting the FDI in this sector, can turn this electronics industry into a high profit generating sector for Bangladesh. However, this industry is facing some specific challenges. The most remarkable challenges are lack of modern technological adaptation, lack of adequate training and skills development. Others include poor infrastructural facilities, shortage of power supply, limited access to credit, disruption in production due to political turmoil, high transportation cost, high import duties on raw materials, high lead time for importing, lower investment in R&D, and restrictions of market access in developed and developing countries.

Leather and Leather Goods

Leather and leather goods exports now account for about $1 billion from a mere $200 million in the beginning of 2000s and captures nearly 2-3% of the world’s leather export market. The growth rate of export earnings has been almost consistently above 10% for the last one decade with near or more than 20% since 2009-10. Until early 2000s, leather export was dominated by processed leather (crust and finished leather) comprising more than 80% of total export earnings. Afterwards, the composition started to change with a large rise in the share of export of leather footwear. Despite significant potentials, this sector suffers from a number of structural problems. Leather sector in Bangladesh has grown in the form of cluster-based model centering the Hazaribagh area of Dhaka. There are around 150 tannery units in the Hazaribagh area within just 50 acres of land. And over the years it has grown haphazardly and in unplanned way in terms of the necessary infrastructure facilities such as roads, drains, congestions, fire safety and environmental quality. The large concentration and current structure and distribution of leather companies in the Hazaribagh area make it almost impossible, both technically and in a viable financial cost-benefit manner, to control and contain the environmental negative impacts of leather processing effluents. This attribute has portrayed Bangladesh’s leather sector as environmentally unfriendly and unsustainable to most environment conscious brands and customers and inhibiting them to put order to Bangladeshi leather firms. Government and industry bodies acknowledging this constraint have developed a planned industrial zone for leather industry in Savar. Most leather firms have already received industrial plots in this zone for relocation of their production facility. Government has also allocated over 1000 crore taka for the establishment of Central Effluent Treatment Plant (CETP) in the zone to ensure international standard environmental standards which would satisfy the demands of environmentally conscious brands and consumers. However, the industry failed to shift their production facility in this zone in the last four years. Huge costs related to machinery shifting and new industrial building erection, the possibility of huge loss due to 8-10 months of production loss, uncertainty about the development of support industries around the zone, etc. have been categorically mentioned by the industry leaders as the major reasons for not being able to shift their production into the zone. Other major problems include lack of up-to-date knowledge, technical and trained man power, research and development (R&D); limited capacity of industry due to short period availability of raw hides and skins to tanner, and huge requirement of processing chemical and working capital in slow cycle processing; constraints to large investment due to lack of assistance by financial institutions to small firms, complex loan appraisal procedures, weak monitoring, high lending interest rate and frequent revisions in lending policies of financial institutions; inefficient export promotional efforts of producers and Export Promotion Bureau (EPB); and increasing lead time of export due to frequent political and labor unrest.
SARNET Regional Conference held at New Delhi, India

SARNET Regional Conference on “Meeting the Challenges of Employment and Inclusive Growth in South Asia” was held on 24-25 October, 2015 at New Delhi, India. The conference was organized by Institute of Human Development New Delhi in association with ILO New Delhi, UN-ESCAP SSWS Office and International Development Research Centre (IDRC), Canada. Dr. Selim Raihan (Professor, University of Dhaka and Executive Director, SANEM) made a presentation on “Trade and Inclusive Growth: Implications for Employment and Regional Integration in South Asia” where he emphasized on the pattern of trade liberalization in the South Asian countries since early 1990s, the pattern of economic growth in South Asia in terms of its effect in reducing poverty, generating employment and enhancing female labor market participation, the linkages between the service sector and rest of the economy, prospects of gains from further trade liberalization in South Asia, and major challenges which include effective role of institutions, managing adjustment costs, diversification of export basket, effective integration with the global value chain and effective regional integration in South Asia. Dr. Raihan was one of the distinguished discussants for the session titled “Economic Growth, Demographic Trends and Changing Structure and Pattern of Labor Markets in South Asia”.

Site visit program for R4D-Employment Project held at Addis Ababa

A site visit program for the R4D-Employment Project (Employment Effects of Different Development Policy Instruments) was held on 19-20 October, 2015 at Addis Ababa University, Addis Ababa, Ethiopia. The roundtable discussion on “Development and Employment: Projects, Problems, and Prospects” was held on October 19, 2015. Welcome address was provided by Dr. Tassew Woldehanna (Vice President for Research and Technology Transfer, Addis Ababa University (AAU)). The second day consisted of a daylong workshop that covered the topics including challenges in firm-level data collection, structure and data needs of the R4D employment project, firm-level data in Ethiopia, Ghana and South Africa, R&D and innovation, compiling data on labor content of trade and measuring SME competitiveness with firm-level data. The workshop ended with a discussion. Dr. Selim Raihan (Executive Director, SANEM) attended the program as a distinguished participant.

57th Annual Indian Labor Conference held at Jammu and Kashmir

Organized by the Indian Society of Labour Economics, the 57th Annual Conference was held during 10-12 October, 2015 at Jammu and Kashmir. Prior to the conference, a pre-conference event was held on 9th October, 2015. During the pre-conference event, Dr. Selim Raihan (Professor, Department of Economics, University of Dhaka and Executive Director, SANEM) was one of the panelists for the discussion session on IER 2016. During the first day of the conference on 10th October, 2015, Dr. Selim Raihan and Dr. Sayema Haque Bidisha (Associate Professor, Department of Economics, University of Dhaka and Fellow, SANEM) presented on “Unpacking Unpaid Labor in Bangladesh”.

SARNET Young Scholars Symposium held at New Delhi, India

South Asia Research Network (SARNET) Young Scholars Symposium on “Education, Skills and Social Protection in Emerging Labor Markets: Issues and Perspectives for Inclusive Growth in South Asia” was held on 26th October 2015 at IIPA Campus, IP Estate, New Delhi, India. The event was organized by Institute for Human Development (IOD) in association with ILO, New Delhi, UN-ESCAP SWS Office New Delhi and IDRC, Canada. Ms. Israt Jahan (Research Associate, SANEM) presented a paper on “Assessing the Impacts of Skill Training on Choice and Quality of Employment in Bangladesh” during the session titled “Skills and Employment”. Dr. Muhammed Mustnada (Formerly of the ILO) was the discussant for this session. Dr. Aliakbar Shafii (Professor of Economics and Dean, Faculty of Social Sciences, Quaid-i-Azam University, Islamabad) chaired this session.

Labor Economics Training for Young Scholars being held at New Delhi

SARNET Labor Economics Training for Young Scholars is being held at New Delhi, India during 27 October – 7 November, 2015. Dr. Selim Raihan (Executive Director, SANEM) has delivered a lecture on “Gender transformation and employment” during the training program. Mahtab Uddin (Research Associate, SANEM) is a participant in the training program.

Book publication ceremony held at Dhaka

The World Bank and Ministry of Commerce of Bangladesh organized a publication ceremony of “Toward New Resources of Competitiveness in Bangladesh: Key Findings of the Bangladesh Diagnostic Trade Integration Study (DTIS)” on October 21, 2015 at The Westin Dhaka. Mr. Amitava Chakraborty (Additional Secretary and Director General, WTO Cell, Ministry of Commerce) provided a welcome note. Mr. Sanjay Kathuria (Lead Economist, Trade and Competitiveness, World Bank Group) presented the key highlights of the report. The Guests of Honor, Ms. Wendy Jo Werner (Country Manager, International Finance Corporation, Bangladesh, Nepal and Bhutan) and a representative from the World Bank provided their address during the ceremony. Special Guest, Mr. Abdul Matlub Ahmad (President, Federation of Bangladesh Chambers of Commerce and Industries) and Chair, Mr. Hedayetullah Al MMOon (nrd, Senior Secretary, Ministry of Commerce) provided their speeches. The Chief Guest for the event Mr. Tofail Ahmed (MP, Honorable Minister of Commerce, Government of the People’s Republic of Bangladesh) provided his speech before the official publication launch. Research associates from SANEM, Andilip Afroze, Mahtab Uddin, Md. Mahedi Hassan, Nabila Hasan and Sunera Saba Khan attended the publication ceremony.

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