Diversification - the Pathway for Economic Recovery

ASIA’S PATH FORWARD

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INTRODUCTION

Bangladesh’s economic recovery from the Covid-19 and global economic shutdown depends on the country’s ability to restart the economy. The curve will be shaped by how quickly the businesses can produce outputs and workers return to work. It also depends on the economic portfolio of a country. A diversified economy recovers faster because it can shift production from one sector to another. Insufficient diversification on the other hand can cause the economy to fall into the 'I' curve; a never-ending drop in the economy.

The Covid-19 pandemic has impacted every sector as assembly lines have been closed down, global trade came to halt as well as transportation being disrupted. The supply chain mechanism from producer to consumer has faltered amidst the crisis. Both national and international supply chains have broken as countries opted for lockdown. The Covid-19 crisis has exacerbated the already brittle state of the economy. The manufacturing sector is braced for further losses from the ongoing pandemic. Subsidies in various form coupled with low cost of labor enhanced the growth of the economy to an extent that it has turned into lifeline of the country. The export sector crashed with earnings hitting its lowest since 2005-06. International supply chains of ready-made garments, the single largest export industry, have seen order cancellations due to low demand. As a result, garment owners have failed to disburse worker salaries.

The vertical drop in export earnings calls for a paradigm shift. The agricultural sector suffered a great deal as well during the crisis as produce has been lost to wastage when it could not reach the markets. A shortage of agricultural labor in deficit areas due to immobility arising from the shutdown has slowed down an already lengthy supply chain with intermediaries at different points. The poultry and fisheries sector have faced huge losses as transportation process stood still and producers resorted to dumping. Disruption has negatively impacted the service sector involved in various stages of the manufacturing and agricultural sectors. This article proposes a 10-point agenda to reconfigure the portfolio of the economic sectors.

Domestic Capacity Expansion

Departure from ‘Rice-led’ Growth Towards Food Security

Agricultural output grew immensely at the start of the century. With High Yield Variety crops, Bangladeshi production grew faster than in most other South Asian countries. Once known for jute production, the country has shifted towards cereal production as such crops can be grown round the year. High production intensity has enabled the country to attain self-sufficiency in cereals yet prevalence of severely food insecure population is 10.2%. Intake of essential nutrients has worsened, as indicated an increase in wasting in children under 5, from 11.8% in 2005 to 14.3% in 2016 due to lack of diversity in food. The growth is concentrated mainly in rice, which also limits the income of the farmers.

Despite drop of its share in GDP, agriculture still employs the largest share of the population with 40.1%. Agricultural outputs at this stage should not only meet the local demand but also produce surplus for export. For example, maize has emerged as a potential option since production increased exponentially in last ten years, from 365 thousand tons in 2005 to 2272 thousand tons in 2015. Maize production is now 3% of the overall crops produced in the country whereas rice still holds the largest share with 75% of total crop production. Efforts are also needed to advocate for vegetables, oil seeds, fisheries and livestock.

Raising the Domestic Capacity for Job Creation and Retention

Export expansion has steadily contributed an increasing portion of manufacturing growth. Yet it has concentrated mostly in the ready-made garment sector. Given the vast domestic demand of more than 160 million people, enhancement and diversification of domestic capacity is the way forward. Such efforts are, in the long run, preparations for strengthening export competitiveness too. This would result in creation of decent employment as well as moving away from informal sectors. Narrow domestic capacity has constrained the manufacturing sector as Bangladesh still depends heavily on countries like China and India for both agricultural and manufacturing products. Import of oilseeds and wheat has remained steady. Imports of intermediate goods have been increasing at an average growth rate

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of 12.12% in the last ten years.\(^4\) The manufacturing sector is mostly oriented towards producing final goods. Backward linkages have not taken foothold.

**From Constricted Base to Widening Support**

Fiscal support in the form of subsidies and tax relief provided to the ready-made garment sector have undoubtedly aided its growth but has also limited its productivity and competitiveness. The cracks in the sector have widened during the general shutdown from Covid-19 with garments business owners failing to pay workers. The government again had to intervene in the form of a stimulus package to disburse the dues. The clientelistic nature of government policy in providing tax exemptions and subsidies to a certain group aggravates the condition. The government's move to fix the same rate of interest for all sectors irrespective of size will impede SME access to loans as banks may deem such loans riskier. A virtually non-functional scam-ridden share market limits access to long-term financing. The government as a result had to mark out USD 588 million as interest payment to provide low-cost loans to SMEs and agricultural sector during the crisis.\(^5\) Dedicated supply chain finance in place of traditional bank loans may speed up working capital for manufacturing industries and service sectors.\(^6\)

**Rural Diversification to Curb Outmigration**

Rural areas have seen outward migration to urban industries. Urban poverty at the same time increased compared to rural poverty. A large section of both documented and undocumented migrant workers are set to return and will exacerbate the unemployment scenario.\(^7\) An integrated solution to boost the agricultural and manufacturing sector through a rural area regeneration industrial fund would raise the employment and wage level. Technological advancement in the agricultural sector at the same time would release the underemployed population.


\(^7\) Unemployment at the same time will reach 7.3 percent from the Covid-19 crisis (Unnayan Onneshan, 2020)
Export Capacity Expansion

Narrow to Varied Product Baskets

Only 10 types of garment products account for 68% of the RMG export. Production has concentrated in lower value products. Reportedly, certain companies of some countries are contemplating relocation due to the ongoing trade frictions between the United States and China and a majority of these are planning for Vietnam, Cambodia, which are in competition with Bangladesh. Besides business environment, skills are to be improved for increased productivity to augment competitive edge to attract industries that might seek relocation. Adapting to new technologies and innovations will diversify the narrow product basket.

Concentration to Spreading Out in Export Destinations

The export destinations are heavily concentrated to the European and North American countries. Exports to Europe are concentrated in few countries like France, Germany, the United Kingdom, and Italy. A shock in the importing country can adversely affect the export. It is now time to search for newer markets. Exports to neighboring countries, with high imports flowing in from China and India, remain low due to non-tariff restrictions. China has recently announced 97% duty free access, with details yet to be made available, and the benefit to Bangladesh is contingent upon which sectors are included in the remaining three per cent. The Balkan region and Eastern European countries can be potential market. Trade with South American countries are still very miniscule. It is also time to explore developing countries with diversified product base.

Strengthening Diplomacy for Tariff-free Advantages

Bangladesh must derive maximum benefit from the existing policies for LDCs, as it is expected to graduate from this tier by 2024, implying that strategies need to be devised in order to utilize LDC benefits before they are lost. Tariff-free entry has given Bangladeshi products an advantage over competitors. The EU Everything but Arms agreement allowed tariff free entry to the largest export destination. Once the country moves out of LDC status, an additional 7-8% worth of tariffs will take

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effect, significantly dampening the competitiveness of Bangladeshi firms. In this context, Bangladesh needs to ramp up its diplomacy to ensure tariff-free entry to markets through bilateral Free Trade Agreements. The graduation will be finalized within three years. Such negotiations should begin early so that Bangladesh can qualify for a GSP+ trade agreement with the EU. GSP+ comes with tougher conditions like workers’ rights and standards which are shambolic in Bangladesh. FTA with individual countries can boost the diversification as well.

**Balancing Trade Deficit**

Bangladesh has huge trade deficit with China and India. At the same time, it has failed to maximize the potential of trade with Nepal and Bhutan. Regional trade agreements would help tap into markets of these countries. Stiff non-tariff barriers and anti-dumping policies in India have been impeding export opportunities for Bangladesh. Export to Nepal and Bhutan can be raised through ensuring third-party connectivity, which is the subject of ongoing negotiations. Bhutan has not ratified the Bangladesh Bhutan India Nepal Motor Vehicle Agreement while the other parties are still negotiating its implementation. As an LDC Bangladesh will get the zero treatment from its largest source of imports, China. 8,256 Bangladeshi products will fall under this treatment as some 3,095 products are already enjoying duty free access under the Asia-Pacific Trade Agreement, though the trade deficit remain abysmally high.

**Discovering Untapped Markets for Manpower**

Current manpower employed abroad is mostly concentrated in Middle Eastern oil economies. The top five remittance income countries are all Middle East countries. A staggering 74% of overseas Bangladeshi workers are employed in Saudi Arabia. This concentration of expats in middle income countries puts Bangladesh in a vulnerable position. Oil shocks and strong regulations often results in job losses. At the same time most of the workers are low skilled and thus earn low wages. Job markets in Europe requires higher skills and comes with higher wages as well. Expanding the manpower market can dissipate the shock in remittance earning.

Foreign investment can play a bigger role in terms of diversification as capital and technological accumulation by the developed nations coupled with abundant labor can augment the productivity

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and diversification.

The government at this moment should look to open new doors. The concentration of products and supply chains in the economy lies deeper as government policies have created and amplified the concentration. Providing adequate benefits to sectors can diversify the economy. New manufacturing sectors should be given facilities to grow. The diversification process requires a coordinated and concerted effort from both the public and private sectors. Productivity and competitiveness in the private sector coupled with government policies can usher the economy towards a safer and shock-free state.

This Asia’s Path Forward paper addresses **Diversifying Supply Chains**. Visit [CIPE.org](http://CIPE.org) for further Asia’s Path Forward papers on the six essential themes for an economic recovery roadmap:

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Dr. Rashed Al Mahmud Titumir is a Professor of Economics at the Department of Development Studies of the University of Dhaka. He has worked in diverse constituencies, namely, academia, governments, think-tanks, international organizations and media. He is engaged in research for pioneering approaches to developmental public policies and innovative solutions on the ground. He has led numerous projects for diverse organizations including governments, development partners and international organizations at home and abroad. Prof. Titumir holds Ph.D. in Economics from the University of London, M.Sc. in Development and Financial Economics from the University of London, Certificate in Trade Policy and Commercial Diplomacy from the Universities of Carleton and Ottawa, BSS (Hons.) from the University of Dhaka, and HSC and SSC from Jhenidah Cadet College. As a senior staff member and a senior advisor, Dr. Titumir has working experience with international organizations, civil society and NGOs in multicultural, multinational and diverse environments at home and abroad. He has provided advisory services to governments on multilateral negotiations such as WTO, UNFCCC, UNCBD. He has been contributing as a member of committees of experts of different UN bodies. Professor Titumir is on boards of different organizations and is the founding Chairperson of the Unnayan Onneshan, a multidisciplinary independent think-tank. He served on the Syndicate, the decision-making body of a university, and was Joint Secretary General of Bangladesh Federation of University Teachers' Association. He also has taught at the Royal Holloway, University of London and the Bangladesh Open University. He also acts as an Independent Director in publicly traded private companies and Member of Board in different social welfare organizations. He has written books and articles on implications of structural adjustment, poverty reduction strategies, world trading system, regional economic cooperation, climate change, and in the areas of state formation, macroeconomic and sectoral policies, agriculture, biodiversity, education and health. Prof. Titumir is currently researching on ideas of state and policymaking in developing countries, focusing on five areas, namely expansion of productive capacity, fiscal and monetary policies, social policies, natural resource management, and agrarian transition.