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Achieving Export Diversification: Lessons from Brazil

Achieving export diversification has been a central objective of development policy for the last 50 years, yet many developing countries struggle to achieve it. Successful export diversification at an economy level requires first understanding the firm-level processes that support the introduction of new products for export. As a rapidly growing economy and large commodity exporter, Brazil provides an interesting case study of how export diversification occurs. This briefing uses evidence from research on Brazilian manufacturing firms to draw lessons for other developing countries on how firms achieve export diversification.

In the 1950s, economists Hans Singer and Raúl Prebisch put forward the hypothesis that terms of trade between primary products and manufactured goods were declining over time. Heavily influenced by this, domestic policies prioritised diversification away from traditional commodity exports, particularly in the 1960s and 1970s. In addition, the evidence shows that until economies reach relatively high levels of per capita income, economic growth is associated with the diversification of production into a progressively wider range of industries and products.

Despite the theoretical and empirical grounding on the benefits of export diversification, many developing countries struggle to achieve it. In addition, there are indications that it is becoming increasingly difficult to break into non-commodity export markets, due to the rise in global competition. Also, current high commodity prices incentivise firms to remain in commodity exports. As a result, most developing economies are faced with exports that are highly concentrated in natural resources, which increases their vulnerability to external shocks. In turn, this prevents these economies from reaping the benefits of diversification.

Box 1 – Benefits of Export Diversification

Export diversification benefits an economy because it:

- reduces vulnerability to trade shocks (and other external shocks) by lowering dependency on specific exports;
- creates learning opportunities in producing new products in new sectors;
- is correlated with high rates of economic growth.

Firm-level Diversification

Although the quantity and quality of empirical evidence on export diversification have increased in the last decade, much of the literature focuses on trade diversification at the country level. However, achieving export diversification at the country level requires individual firms to diversify exports, and little is known about the firm-level processes and innovation efforts required for introducing new products to export.

Through studying a unique dataset of Brazilian manufacturing firms during the 2000s – including information on exports, firm characteristics, production processes and innovation efforts – our research aims to draw lessons for other developing countries that are seeking to encourage export diversification. Our findings will help developing country governments to implement policies that encourage firms to export a more diverse range of goods.

Finding 1: High rates of export failure

Our research found that the majority of new products introduced by exporters are not sustained beyond the first year. In fact, we observed that 57 per cent of export flows are only sustained for one year. Export sustainability is a critical challenge for maintaining diversification.

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Finding 2: It is existing exporters that tend to diversify

Our results show that diversification is mainly carried out by existing exporters, rather than new entrants to international markets. More than 80 per cent of new exports are introduced by existing exporters. Export experience is critical for diversification.

Finding 3: Diversification occurs mainly into similar and less sophisticated products

We analysed the type of products that firms tend to diversify into. We found that, in most cases, new products are similar or related to existing products, either in terms of sector, or the inputs used for production. They also tend to be of lower sophistication or technological content than existing exports. New exports are more sophisticated than existing products in only 32 per cent of cases and of higher technological content in only 6 per cent. Existing firms' capabilities constrain the scope for export diversification.

Finding 4: Firms that diversify are better performers and more internationally exposed

Box 2 summarises the main characteristics of Brazilian firms that successfully diversify. They tend to be larger, more productive and more innovative, with larger market shares and greater international exposure.

Box 2 – Firm Characteristics

Brazilian firms that successfully diversify exports tend to have:

- larger firm size and greater productivity;
- foreign ownership;
- larger domestic market share;
- less reliance on specific key products;
- more innovative production processes and products;
- increased investment in Research & Development (R&D), skilled labour and marketing activity.

Cargo containers are sitting on the docks in Rio, Brazil

iStockPhoto

Policy Implications

In order to facilitate export diversification, developing country governments need to:

1. **Incentivise innovation**
   Policies that incentivise investments in innovation and R&D will help firms acquire the capabilities that are vital if they are to diversify.
2. **Support firms to consolidate in the domestic market**
   Firms must improve their production base domestically, prior to diversifying. Therefore, policy frameworks that encourage export diversification should also focus on eliminating existing constraints in domestic markets.
3. **Support export sustainability**
   While governments need to continue to support firms in breaking into new products and new markets, they equally need to address the sustainability of exports. This requires a more balanced approach of support policies such as Aid for Trade, giving more weight to measures that may facilitate consolidation of new trading relationships over time.
4. **Facilitate Foreign Direct Investment (FDI) and links with international markets**
   Foreign exposure appears to increase diversification, so policies that encourage trade integration, FDI or participation in international value chains can critically assist firms in acquiring the required capabilities to boost export diversification.

Further Reading

Cirera, Xavier; Marin, Anabel and **Markwald, Ricardo** (2012) *Firm Behaviour and the Introduction of New Exports: Evidence from Brazil*, IDS Working Paper 390, Brighton: IDS

Credits

This *In Focus Policy Briefing* was written by Xavier Cirera, Research Fellow in the Globalisation team at the Institute of Development Studies. It was edited by Vivienne Benson and Sarah Nelson. The briefing is based on the IDS Working Paper, *Firm Behaviour and the Introduction of New Exports: Evidence from Brazil* (see further reading section).

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