

THE ESSENCE AND NECESSITY OF DIVERSIFYING THE STRUCTURE OF THE REGIONAL ECONOMY

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Abstract: *This article examines the essence and necessity of diversifying the structure of the regional economy in the context of globalization and increasing economic uncertainty. The study highlights that excessive dependence on a limited number of industries or sectors makes regional economies vulnerable to external shocks and limits sustainable development opportunities. Diversification is considered as a key factor in enhancing economic stability, increasing competitiveness, and ensuring balanced regional development. The paper analyzes theoretical approaches to structural diversification and emphasizes the role of sectoral restructuring, innovation development, and investment attraction in strengthening regional economic resilience. Particular attention is given to the use of modern analytical tools, including Herfindahl-Hirschman Index and Entropy index, for assessing the level of diversification. The study concludes that effective diversification policies contribute to the expansion of production capacities, development of new industries, improvement of employment levels, and integration into global value chains, thereby ensuring long-term sustainable growth of regional economies.*

Keywords: *regional economy, economic diversification, structural transformation, sectoral diversification, economic resilience, competitiveness, sustainable development, investment attraction, innovation, Herfindahl-Hirschman Index, entropy index*

In the economic doctrines that have taken shape within the system of global economic relations, the diversification of the structure of a regional economy is regarded as an important stage in the trajectory of sustainable economic development. The present section is devoted to studying the regularities of the sectoral diversification of regions along the path of economic development.

Based on comprehensive data on employment of the labour force and on created value added, evidence is presented showing that regional economies go through three main stages across regional cross-sections. In the course of its development, every regional economy first specialises in sectors such as agriculture and the extraction and primary processing of natural resources. In the second stage, the sectors of the regional economy become diversified — that is, economic activity is distributed across a greater number of areas.

However, once per-capita income reaches a certain level, the economy begins once again to specialise in relatively efficient narrow areas. In other words, it has been established that the sectoral concentration of a regional economy changes in a U-shaped manner with respect to the level of income.

In contemporary economic literature, a large body of scholarly findings devoted to the diversification or specialisation of the sectors of a regional economy has developed on the basis of mutual controversy. One group of scholars substantiates the importance of the level

of sectoral diversification for economic development (Kuznets, 1971; Grossman and Helpman, 1992; Dissart, 2003; Pede, 2013; Knott, 2003; Wennekers & Thurik, 1999), while another group, arguing that specialisation is essential in terms of ensuring economic efficiency and high competitiveness, emphasises its importance for regional economic development (Cuadrado-Roura and Maroto, 2016; Besedes and Prusa, 2011). At the same time, there are also scholars who have demonstrated on the basis of empirical research that the significance of sectoral diversification or specialisation is inextricably linked to the development level of the regions concerned (Imbs and Wacziarg, 2003; Dan Ciuriak, 2015).

In the practice of developed countries, cases of introducing diversification processes began to emerge in the early twentieth century, whereas the concept of diversification as an economic category has been applied since the mid-1950s. As an economic category, the term “diversification” has been treated in the literature through several different approaches. Since the present research is specifically devoted to the “diversification of the sectors of the economy” strand of diversification, attention is focused precisely on these aspects, and it is the economic definitions given from this standpoint that are examined below.

In the Explanatory Dictionary of Economic Terms by Sh.I. Mustafakulov, O.A. Rakhimberdiyev and M.Sh. Egamberdiyeva, Diversification of the economy is defined as “the process of increasing the complexity of the sectoral structure of production, in which the variety of product types and the number of specialised enterprises grows”⁵; the Large Economic Dictionary provides the following definition: “Multi-sectoral diversification is the unification, within a single management structure (firm, corporation), of productive forces belonging to different branches of the national economy”⁶. The Macmillan Dictionary of Modern Economic Theory defines diversification as an economic category as “the state of development of industrial branches across regions in different directions”⁷. In the Economic-Mathematical Encyclopedic Dictionary, the process of diversifying the sectors of the economy is defined as “a process aimed at developing economic activities of various kinds and improving their efficiency”⁸.

However, contemporary approaches to economic development require that the diversification of economic sectors be grounded in the conditions of sustainability and in the principles of the green economy. Proceeding from this, and on the basis of the definitions cited above, we consider it appropriate to define economic diversification as “...the process of transforming an economy that relies on limited sources of income into one based on multi-faceted, sustainable sources (sectors and markets) under the conditions of global economic fluctuations and climate change”.

In studying the importance of economic diversification — particularly for developing countries — Imbs and Wacziarg (2003) analyse data drawn from various sources⁹ and establish that the development trajectory of a country or region unfolds in two stages of

⁵Sh.I. Mustafakulov, O.A. Rakhimberdiyev, M.Sh. Egamberdiyeva. Explanatory Dictionary of Economic Terms [Text]. – T.: Innovation Development Publishing-Printing House, 2019, – 489 p.

⁶Bolshoy ekonomicheskiy slovar [Large Economic Dictionary] / ed. by A.N. Azriliyan. M., 1997. <https://economics.niv.ru/doc/dictionary/big-economic/fc/slovar-196-3.htm#zag-2942>

⁷The Macmillan Dictionary of Modern Economics. M.: INFRA-M. 2003. P. 136.

⁸Danilov-Danilyan, V.I. Economic-Mathematical Encyclopedic Dictionary. M.: INFRA-M, 2003. P. 52.

⁹International Labour Office (ILO, 1997); United Nations Industrial Development Organisation (UNIDO, 1997); Organisation for Economic Co-operation and Development (OECD, 1998).

diversification. In the initial stage of development, a country specialises predominantly in agriculture and natural resources and begins to diversify the sectors of its economy. Later, in the course of development, it reaches the highest level of diversification together with a certain level of per-capita income; only after that does it again undergo a process of re-specialisation (Imbs and Wacziarg, 2003).

Accordingly, the specialisation process is not monotonic, as was believed in earlier scholarly research, but rather exhibits a U-shaped pattern. Imbs and Wacziarg (2003) compute the degree of diversification of economic regions through the distribution of employment among sectors (employment data) and through the shares of sectors in total value added (value-added data). According to their findings, initially the economies of countries are strongly specialised in primary commodities (as observed in most cases); they then begin to diversify, and this diversification continues until per-capita income reaches roughly USD 6,500–10,000, after which processes of (efficient) specialisation again set in.

In turn, Ciuriak (2015), studying diversification both at the level of the economic system and at the level of the individual enterprise, describes the stages of diversification in the course of development as follows:

- at the initial stage of the development path, owing to the absence of diversification at the level of the economic system, enterprises and firms individually attempt to diversify their activities with relatively low productivity. In such a situation, a firm is obliged to combine its core activity with almost all the services it needs, and with certain components that would normally be supplied by other sectors which do not yet exist;

- together with the onset of diversification at the level of the economic system, individual specialisation at the level of the firm also begins, since firms no longer need to waste their capabilities on other activities that are necessary but inefficient;

- integration into the international economy and the attainment of a certain level of per-capita income reinforce specialisation both at the level of the economic system and at the level of the individual firm.

In our view, in the third stage — although a country has reached its own level of development and has become highly specialised in those particular sectors that are most efficient for it — activity in other sectors of the regional economy is nevertheless preserved. Such activity may, of course, be of lesser weight compared with the more specialised areas; yet, compared with the corresponding sectors of less-developed countries, the performance of the non-specialised sectors of developed countries may still be considerable, even though less-developed countries may have successfully achieved a high level of diversification in those sectors. Consequently, although developed countries carry out specialised activity in relatively complex, high-value branches, they have not abandoned activity in other non-specialised sectors and still possess a diversified economy, albeit in uneven proportions.

For this reason, at the initial stage of economic development — when most developing countries are specialised predominantly in the use of their own natural resources, and when individual firms are not satisfied with the goods and services supplied to them — state support becomes necessary in order to initiate a diversification process in the relevant sectors.

An analysis of the development directions of economic diversification, drawing on reliable sources provided by authoritative international economic organisations and financial institutions, shows that the diversification processes, taken as an economic category, can be grouped in several ways, taking into account their emergence, type and direction of development (see Figure 1.1). The literature review conducted above indicates that the regional development path associated with diversifying a regional economy unfolds in the sequence “specialisation in primary sectors – sectoral diversification – effective re-specialisation” (Figure 1.2).

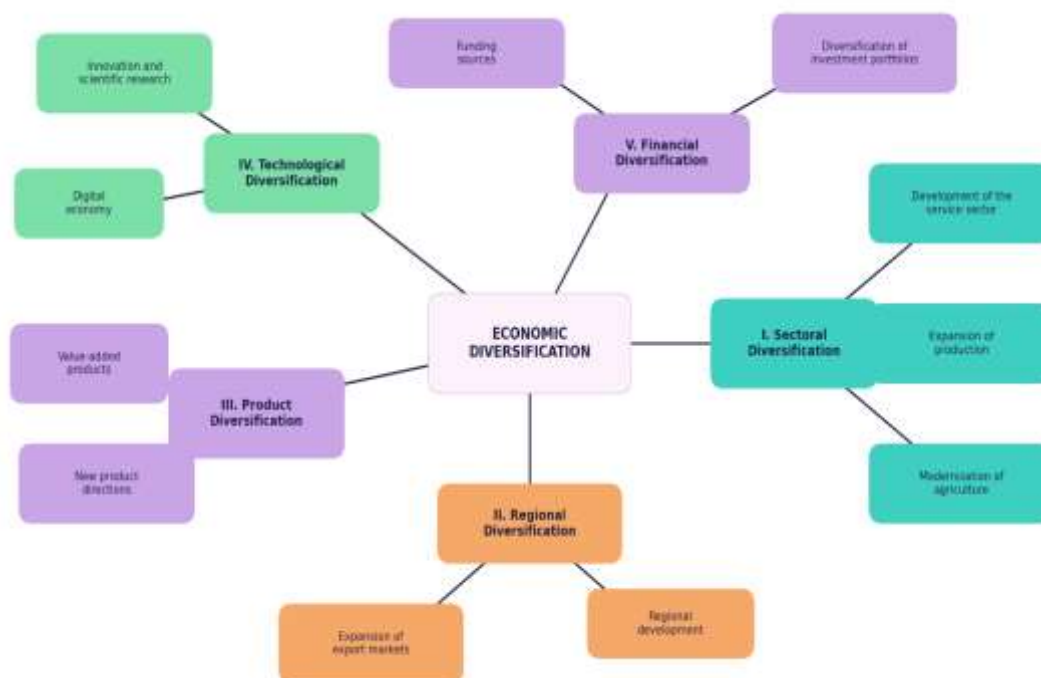
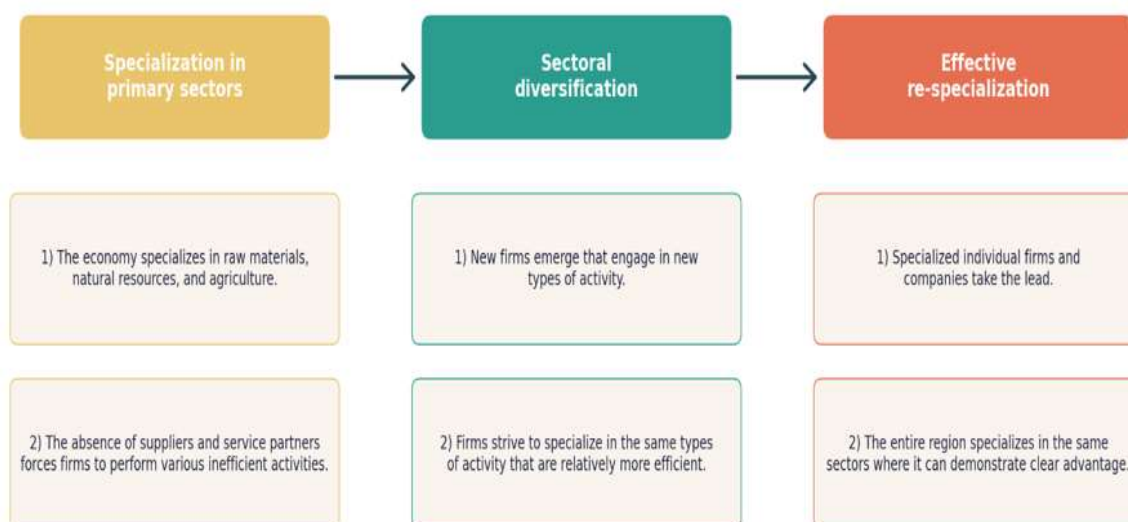


Figure 1. Types and directions of economic diversification¹⁰



¹⁰Compiled by the author on the basis of: United Nations Conference on Trade and Development (UNCTAD) – Economic Diversification in Commodity-Dependent Developing Countries, <https://unctad.org>; World Bank – Economic Diversification and Growth Reports, <https://www.worldbank.org/en/topic/economicpolicy/brief/economic-diversification>; OECD – Strategies for Economic Diversification, <https://www.oecd.org>; International Monetary Fund (IMF) – Economic Diversification in Resource-Rich Countries, <https://www.imf.org>; Economic Research Institute for ASEAN and East Asia (ERIA) – Industry Diversification and Innovation Strategies, <https://www.eria.org>; McKinsey & Company – The Role of Economic Diversification in Emerging Markets, <https://www.mckinsey.com>.

Figure 2. Stages of mutual alternation between economic diversification and specialisation along the path of regional economic development¹¹

As Figure 1.2 indicates, at the initial “specialisation in primary sectors” stage of regional economic development, regions are specialised in economically inefficient sectors such as raw materials, natural resources and agriculture, and the level of sectoral diversification at this stage is very low. As a result, the absence of suppliers and service partners forces firms to perform various inefficient activities, albeit at a poor level of quality.

The main reasons for this are the lack of sufficient knowledge, experience and skills to operate in knowledge-intensive areas, and the impossibility of achieving the scale effect required for efficient operation in certain types of activity.

For this reason, economic agents are compelled to produce in-house all the components they need, and to perform themselves even those services that, under a modern economic approach, should be provided by other entrepreneurial entities.

Nevertheless, as economic development proceeds and the incomes of the population and of economic agents grow, new sectors are gradually mastered and the branches of the economy become progressively diversified; in this way, the transition to the second stage — “sectoral diversification” — takes place.

At this stage, new firms and organisations emerge engaged in new types of activity, because certain kinds of activity that were considered inefficient at the first stage (being highly dependent on economies of scale) begin to become efficient as incomes rise and the scale of the economy expands.

As a result, sectoral diversification leads firms to specialise in those particular activities that are relatively efficient and makes enterprises competitive.

It should be emphasised that a high level of sectoral diversification is extremely important for identifying the driver sectors of each region, since it is only after a certain amount of experience has been accumulated across all areas that it becomes possible to determine — on the basis of the region’s potential and capabilities — which sectors or types of activity are more efficient for that region than others.

This, in turn, serves as the basis for the onset of the third stage, “effective re-specialisation.” Once the driver sectors and activities that are important for the region’s economic development have been identified, these sectors act as the pillars of the local economy and as the directions in which effective re-specialisation is carried out.

At this stage, specific local enterprises take the lead and reach the level of transnational corporations operating internationally, and the entire economic system shapes its international standing on the basis of a clearly defined orientation.

Nevertheless, even developed countries that have distinguished themselves in a specific sector and achieved progress through it have not abandoned other branches, spheres and types of activity; the share of such sectors in GDP is simply disproportionate — that is, from the standpoint of calculation methodology it does not meet the diversification criterion.

¹¹Developed by the author on the basis of the literature review.

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