Worksheet 20.3

Dominican Republic Struggles to find its Comparative Advantage

Trade based on comparative advantage… the theory originally articulated by Adam Smith, later fine-tuned by David Ricardo, suggests that if each nation specializes its economic activity on the products for which it faces the lowest opportunity cost, then trades with its neighbors, total world output and efficiency can be maximized: today this theory represents the philosophical underpinning of all free trade agreements signed between and among the nations of the world.

Through trade, countries can exchange their extra output with other nations for the goods specialized in by others, enabling all nations to enjoy a level of consumption beyond what they'd be able to achieve if they tried to produce all goods domestically.

For many developing countries, with their abundance of either land or labor, comparative advantages tend to lie in either agricultural goods or low-skilled manufactured goods. Since global prices for food are highly unstable and dependency on healthy harvests, good weather, and stable rainfall are all highly risky endeavors for a poor country, developing nations prefer to foster the growth of manufacturing sectors in their path towards economic development.

Strategies for economic growth available to developing nations include *export-oriented* and *inward-oriented* growth. A country like the Dominican Republic, the largest economy in the Caribbean, has pursued a predominantly export-oriented growth strategy, promoting through 'free zones' the growth of a textile industry aimed at producing goods for consumers in developed countries, primarily the US.

To the Domincans, producing textiles for export to America has successfully given the people of this poor nation a grip on a rung of the ladder towards economic development. The import of capital goods has taken previously unproductive workers out of agriculture and put them into an industry where productivity, thus income, has risen, leading to improvements in living standards. Export-led growth, however, runs some serious risks of its own, as is being realized by the people of the Dominican Republic today.

Once a hot destination for American companies looking for a cheap place to 'off-shore' production of labor intensive textiles, the Dominican Republic today faces new competition, and is finding its comparative advantage slip slowly away from textiles due to increased competition from lower cost textile producers in Asia.

A nation's comparative advantage may change over time (from land to labor to capital intensive goods) as the structure of the global economy evolves. Once an economy like the Dominican Republic's has undergone a period of structural changes, away from agriculture and towards industry, the flow of low wage workers from farm to factory begins to slow to a trickle, leading to rising wages and increased competition from countries with more abundant supplies of cheap labor.

The challenge for policy makers is to manage the structural changes as they come, minimizing the negative impact such global shifts of productive resources has on the citizens of a country like the D.R. Clearly, it is in the country's interest to prepare its citizens for a 'new economy', one in which skilled labor will play a larger role. The problem is, this requires a solid education system, which the D.R., it turns out, does not yet have.

In all likelihood, given the increased competition from Asian textile manufacturers, continued economic growth in the Dominican Republic will depend on the country's ability to educate and train its workforce to adapt to a more capital, technology and information-based economy, which, if successful, will eventually lead to rising incomes and higher standards of living for the people of this rising Caribbean nation.

Comparative advantages evolve with the emergence of new competition among developing and developed countries. The negative impacts this evolution has on a particular economy can be managed if wise policy actions are taken to assure a country's workforce is educated and trained to participate in *tomorrow's economy*, rather than yesterday's or today's.

Questions:

1. Why does the US prefer to import textiles from countries like the Dominican Republic and China rather than producing them domestically?
2. Identify two reasons the Dominican Republic's comparative advantage in textile manufacturing has diminished in recent decades.
3. What policies could the government of the Dominican Republic implement to protect its textile manufacturers? What is the opportunity cost implementing protectionist policies in a developing nation like the Dominican Republic?
4. Why would increasing public funding for education better prepare the country for the economic conditions of the future?