Discussion Paper No.41

Investment, R&D and trade in manufactures, by Robert Woods (November 1995)

The new trade literature suggests that, where there is monopolistic competition between firms, an economy's demand curve can shift outwards by increasing the variety of goods it can produce. Similarly, its import demand curve should shift inwards if a greater range of products is available domestically. This paper uses cumulated investment and cumulated research and development expenditures as proxies for variety. It identifies effects from both variables in equations for both exports and imports of UK manufactures. In the exports equations, the formulation which includes R&D appears to encompass the one with investment. The data do not discriminate between the two proxies in the case of imports. The paper also considers a re-specification of the traditional log-linear exports equation as an export share equation, analogous to that used for imports.