Can Innovation Help U.S. Manufacturing Firms Escape Import Competition from China?*

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Abstract

We study whether R&D-intensive firms are more resilient to trade shocks. We correct for the endogeneity of R&D using tax-induced changes to R&D cost. While rising imports from China lead to slower sales growth and lower profitability, these effects are significantly smaller for firms with a larger stock of R&D (by about half when moving from the bottom quartile to the top quartile of R&D). As a result, while firms in import-competing industries cut capital expenditures and employment, R&D-intensive firms downsize considerably less. Finally, we provide evidence that these effects are explained by R&D allowing firms to increase product differentiation.

*We thank seminar participants at INSEAD, Copenhagen Business School, Stanford University, CSEF–University of Naples, Erasmus University and conference participants at the Labex Ecodec Workshop at HEC Paris, the London Business School 2015 Summer Finance Symposium, the 2015 Western Finance Association meeting, the 2015 Workshop on Entrepreneurial Finance and Innovation Around the World, the 2015 Workshop on the Economics of Corporate Ownership, the European Summer Symposium in Financial Markets (Gerzensee) 2015 and the 2015 Econometric Society World Meeting. Hombert acknowledges financial support from the Investissements d’Avenir Labex (ANR-11-IDEX-0003/Labex Ecodec/ANR-11-LABX-0047).

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