



## Comparing International R&D Expenditures

Comparisons of international R&D statistics are hampered by the lack of R&D-specific exchange rates. Two approaches are commonly used: (1) express national R&D expenditures as a percentage of gross domestic product (GDP) or (2) convert all expenditures to a single currency. The first method is straightforward but permits only gross comparisons of R&D intensity. The second method permits absolute level-of-effort comparisons and finer-grain analyses but entails selecting an appropriate method of currency conversion. The choice is between market exchange rates (MERs) and purchasing power parities (PPPs), both of which are available for many countries over an extended period.

MERs represent the relative value of currencies for cross-border trade of goods and services but may not accurately reflect the cost of nontraded goods and services. They are also subject to currency speculation, political events, wars or boycotts, and official currency intervention. PPPs were developed to overcome these shortcomings (Ward 1985). They take into account the cost differences of buying a similar market basket of goods and services covering tradables and nontradables. The PPP basket is assumed to be representative of total GDP across countries. PPPs are the preferred international standard for calculating cross-country R&D comparisons and are used in all official R&D tabulations of the Organisation for Economic Co-Operation and Development (OECD).\*

Because MERs tend to understate the domestic purchasing power of developing countries' currencies, PPPs can produce substantially larger R&D estimates than MERs for these countries. For example, China's R&D expenditures in 2013 (as reported to the OECD) were \$334 billion in PPP terms but only \$191 billion using MERs. However, PPPs for large developing countries such as China and India are often rough approximations and have shortcomings. For example, structural differences and income disparities between developing and developed countries may result in PPPs based on markedly different sets of goods and services. In addition, the resulting PPPs may have very different relationships to the cost of R&D in different countries.

R&D performance in developing countries often is concentrated geographically in the most advanced cities and regions in terms of infrastructure and level of educated workforce. The costs of goods and services in these areas can be substantially greater than for the country as a whole.

\* Some unresolved questions remain about the use of GDP PPPs for deflating R&D expenditures. In analyzing the manufacturing R&D inputs and outputs of six industrialized OECD countries, Dougherty et al. (2007:312) concluded that "the use of an R&D PPP will yield comparative costs and R&D intensities that vary substantially from the current practice of using GDP PPPs, likely increasing the real R&D performance of the comparison countries relative to the United States." The issue, and what if anything to do about it, remains unresolved.