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Publication date:
2012

Document Version
Publisher's PDF, also known as Version of record

Link to publication

Citation for pulished version (APA):
Vogel, A., & Wagner, J. (2012). *Exports, R&D and Productivity in German Business Services Firms: A test of the Bustos-model*. (University of Lüneburg Working Paper Series in Economics; No. 247). Institut für Volkswirtschaftslehre der Universität Lüneburg.

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WORKING PAPER

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by

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University of Lüneburg
Working Paper Series in Economics

No. 247

August 2012

www.leuphana.de/institute/ivwl/publikationen/working-papers.html

ISSN 1860 - 5508

Exports, R&D and Productivity in German Business Services Firms:

A test of the Bustos-model

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[Version: August 23, 2012]

Abstract:

This paper uses newly available data for German business services firms to test a hypothesis derived by Bustos (AER 2011) in a model that explains the decision of heterogeneous firms to export and to engage in R&D. Using a non-parametric test for first order stochastic dominance it is shown that, in line with this hypothesis, the productivity distribution of firms with exports and R&D dominates that of exporters without R&D, which in turn dominates that of firms that neither export nor engage in R&D. These results are in line with findings for firms from manufacturing industries. The model, therefore, seems to be useful to guide empirical work on the relation between exports, R&D and productivity for services firms, too.

JEL classification: F14

Keywords: Exports, R&D, productivity, business services firms, Germany

* The data used in this study are confidential but not exclusive; see www.kombifid.de for a description of how to access the data. All computations were done inside the Research Data Centre of the Federal Statistical Office. To facilitate replication the Stata do-file is available from the first author on request.

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1. Motivation

Building on the seminal paper by Melitz (2003) a large literature emerged during the past ten years that discusses international trade in models with heterogeneous firms (see Redding (2011) for a survey). At the core of this theoretical literature and the closely related micro-econometric literature on firm performance and international trade is the relation between firm productivity and exports (see Wagner (2012a) for a survey). In a recent paper Bustos (2011) makes an important extension to this literature by introducing technology choice in a model of trade with heterogeneous firms. In her model, more productive firms gain higher revenues and therefore are the only ones that find paying the fixed costs that are needed to start exporting profitable (as in the Melitz (2003) model). In addition, only the most productive firms adopt the most advanced technology, because the benefit of adoption is proportional to revenues, while its cost is fixed.

As is proved in detail in Bustos (2011) in the model the underlying productivity differences produce a sorting of firms in three groups: the most productive firms both export and use the advanced technology, the intermediate group exports but still uses the old technology and the least productive firms use the old technology and serve only the domestic market only. In an empirical application the use of advanced technology is represented by spending on research and development (R&D). This leads to the following empirically testable hypothesis:

In a given industry productivity is highest in firms that export and engage in R&D, followed by firms that export and do not engage in R&D and by firms that do neither export nor engage in R&D.

Bustos (2011) finds support for this implication of her model with data from Argentina. Using data for a large sample of German manufacturing firms Wagner (2012b) shows that this is the case in Germany, too. This note looks at data from German business services firms for a further empirical test of the implications of the Bustos model, keeping in mind that 'the credibility of a new finding that is based on carefully analyzing two data sets is far more than twice that of a result based only on one' (Hamermesh, 2000, p. 376). To anticipate the most important finding, results are in line with the theoretical hypothesis for firms from business services industries in Germany, too.

2. Empirical strategy and data

The empirical strategy used here to test the hypotheses derived by Bustos (2011) uses a familiar t-test for differences in the means of productivity between the three groups of firms. Furthermore, it applies a non-parametric test for first order stochastic dominance of one distribution over another that was introduced into the empirical literature on exports by Delgado, Farinas and Ruano (2002). Let F and G denote the cumulative distribution functions of productivity for two groups of firms (say, exporters with and without R&D activities). First order stochastic dominance of F relative to G is given if F(z) – G(z) is less or equal zero for all z with strict inequality for some z. Given two independent random samples of plants from each group, the hypothesis that F is to the right of G can be tested by the Kolmogorov-Smirnov test based on the empirical distribution functions for F and G in the samples (for details, see Conover 1999, p. 456ff.). Note that this tests not only for differences in the mean productivity

of both groups (like in almost all other papers in the literature on trade and productivity) but for differences in all moments of the distribution.

The data used in this study are taken from two sources. The first source is the German business services statistics panel (described in detail in Vogel (2009)). This data set includes the information whether a firm was an exporter in a year or not. Productivity is measured by labour productivity defined as value added per employee. Bartelsman and Doms (2000, p. 575) point to the fact that heterogeneity in labor productivity has been found to be accompanied by similar heterogeneity in total factor productivity in the reviewed research where both concepts are measured. In a recent comprehensive survey Syverson (2011) argues that high-productivity producers will tend to look efficient regardless of the specific way that their productivity is measured. Furthermore, Foster, Haltiwanger and Syverson (2008) show that productivity measures that use sales (i.e. quantities multiplied by prices) and measures that use quantities only are highly positively correlated. Therefore, labor productivity can be regarded as a useful measure of productivity at the firm level. To mitigate concerns that performance differences simply reflect differences in the sectoral composition of the three firm types, and following Girma, Görg and Strobl (2004) and Wagner (2006), value added per employee is calculated relative to the 2-digit industry mean.

The German business services statistics panel has no information on either the share of employees engaged in research and development (R&D), or on the amount of money spent on R&D activities, or on the introduction of innovative services. Therefore, a second source of data is used, the Establishment History Panel (*Betriebs-Historik-Panel*) described in detail in Spengler (2008). Details aside, this data set is built from individual level information for employees covered by social

security and it is a data set with detailed information about the characteristics of the employees in each enterprise in a year. From these data we do not have any direct information on the number of employees working in R&D. However, information on the composition of the workforce includes, among others, the number of engineers and natural scientists in the firm. These highly qualified employees can be expected to work on the development of innovative solutions that will eventually lead to improved or completely new ways to perform business services. Therefore, the share of engineers and natural scientists in all employees can be viewed as a suitable measure for the R&D intensity and the innovativeness of an enterprise.

Data from both sources were combined in the project KombiFiD (an acronym for combined firm data for Germany) for the years 2003 to 2006. Due to the fact that the German business services statistics do not provide information about the export activities of small firms, only firms with an annual sum of turnover and other operational income greater than or equal to €250,000 are considered for the analyses. Furthermore, due to the very small number of firms located in the former communist East Germany the analysis is limited to firms from West Germany. The data are confidential but not exclusive; they can be used for empirical investigations inside the research data centres of the statistical offices in Germany (see www.kombifid.de for details).

3. Results

The hypotheses from the Bustos (2011) model were tested with data for each year from 2003 to 2006. To economize on space, only the results for the first year are

reported here in detail in Table I. Results from the other years (that are available from the authors on request) show very similar results.

The sample includes 2,180 firms in 2003. 317 firms (or 14.5 percent) did not export but reported employees that are engaged in R&D; these firms were excluded from the empirical investigation because this type of firm is not considered in the theoretical model and in the hypothesis derived from this model. 1,358 firms (62.3 percent of the sample) did not export and did not engage in R&D, these are labelled firms of Type 1 here. 345 firms (15.8 percent of the sample) exported without engaging in R&D, these are labelled firms of Type 2. 160 firms (7.3 percent of the sample) were exporters with R&D activities, and these are labelled firms of Type 3.

According to Table I the ranking of the mean values for value added per employee is in line with the Bustos hypothesis: Type 3 firms have the highest average productivity, followed by Type 2 firms, and Type 1 firms come last. A t-test for differences in the means (based on productivity values measured as percentages of the 4-digit industry mean) reveals that this ranking is statistically significant at a conventional error level for Type 1 firms vs. Type 2 firms only. However, results of the non-parametric two-sample Kolmogorov-Smirnov test that is less sensitive to extreme values reported for some firms show that not only the means of the productivity distributions are ranked in this way. Using a conventional error level of five percent, we find that in line with the Bustos (2011) hypothesis the productivity distribution of firms with exports and R&D dominates that of exporters without R&D, which in turn dominates that of firms that neither export nor engage in R&D.

4. Conclusions

This paper uses newly available data for German business services firms to test a hypothesis derived by Bustos (2011) in a model that explains the decision of heterogeneous firms to export and to engage in R&D. Using a non-parametric test for first order stochastic dominance it is shown that, in line with this hypothesis, the productivity distribution of firms with exports and R&D dominates that of exporters without R&D, which in turn dominates that of firms that neither export nor engage in R&D. These results are in line with findings for firms from manufacturing industries in Germany presented in Wagner (2012b). The model introduced in Bustos (2011) and other models with similar predictions, therefore, seems to be useful to guide empirical work on the relation between exports, R&D and productivity for services firms, too.

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Table I: Results of the empirical investigation, Business Services Firms from West Germany, 2003

		Type 1	Type 2	Type 3
		Exports: no, R&D: no	Exports: yes, R&D: no	Exports: yes, R&D: yes
Number of enterprises		1,358	345	160
Value added per employee (Euro)	mean	48,940	67,001	68,663
	sd	114,789	55,625	47,579

	Type 1 vs. Type 2	Type 1 vs. Type 3	Type 2 vs. Type 3
t-Test for difference in means of value added per employee (prob-value)[1]	0.015	0.079	0.886
Two-sample Kolmogorov-Smirnov test for stochastical dominance (prob-value)[2]	0.000	0.000	0.023

[1] Test of H_0: mean of first group equal to mean of second group against H_1: mean of first group smaller than mean of second group. Value added per employee is measured as percentage of industry mean. The t-test is a two-sample test with unequal variances.

[2] Test of H_0: distributions are equal against H_1: distribution of value added per employee of the second group stochastically dominates distribution of value added of the first group. Value added per employee is measured as percentage of industry mean.

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