Does domestic demand matter for firms' exports?

Paulo Soares Esteves, Miguel Portela and António Rua*

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Abstract

The existence of a link between exports and domestic demand challenges the standard theoretical assumption in international trade models and carries out important policy implications. In our empirical setup the estimated relationship between exports and domestic sales results directly from a monopolistic model of a firm selling to both domestic and external markets. We find a noteworthy negative relationship between domestic sales and firms' exports covering the manufacturing sector over the period 2009 – 2016. This result holds for almost all industries although with a heterogeneous magnitude. Additionally, there is also evidence that this effect is stronger for larger firms.

Keywords: international trade, firms, exports, domestic demand, foreign demand, panel data.

JEL Classification: *C23*, *C26*, *D21*, *D22*, *F14*, *F41*

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*Esteves: Banco de Portugal, pmesteves@bportugal.pt. Portela: NIPE/Universidade do Minho & IZA, Bonn, mangelo@eeg.uminho.pt. Rua: Banco de Portugal & NOVA School of Business and Economics, antonio.rua@bportugal.pt. Acknowledgements. The opinions expressed in the article are those of the authors and do not necessarily coincide with those of Banco de Portugal or the Eurosystem. Any errors and omissions are the sole responsibility of the authors. The authors thank to Pedro Portugal for helpful comments on an earlier version of the paper. The authors would also like to thank two anonymous reviewers for comments and suggestions. Miguel Portela acknowledges that this paper is financed by National Funds of the FCT – Portuguese Foundation for Science and Technology, projects UID/ECO/03182/2019 and PTDC/EGE-ECO/29822/2017. The data used in this paper are proprietary. The data is made available under an individual protocol between Statistics Portugal and the researchers. All Stata codes used are available from the authors upon request.

1 Introduction

The empirical literature on the link between exports and domestic sales has been gaining momentum over the last years. Such a development represents a departure from standard international trade models where it is assumed a constant marginal cost as in the seminal work by Krugman (1979, 1980) and Melitz (2003). Such an assumption implies that foreign and domestic markets can be treated independently.

However, based on several alternative approaches, there is by now some evidence suggesting that the firm decisions are affected by both markets.[1] Vannoorenberghe (2012) finds a negative relationship between exports and domestic sales for French firms, while, also for France, Berman et al. (2015) conclude that domestic sales are positively influenced by exports. Altomonte et al. (2013) consider four European countries namely France, Germany, Italy and the UK and find that domestic demand conditions are important in driving export market participation with firms more likely to export during a downturn of the domestic market. Blum and Horstmann (2013) document a negative relationship between exports and domestic sales for Chilean firms while Ahn and McQuoid (2017) find a negative correlation between domestic sales and exports for Indonesia. Drawing on data for Italian firms, Bugamelli et al. (2015) report a significant relationship between exports and domestic sales with the sign depending on the business cycle phase.

The link between exports and domestic demand has also been fuelling the recent policy debate. In particular, the presence of a negative relationship may constitute an additional economic adjustment channel, in particular in the Euro area countries, where a common currency in a low inflation environment leads to the rigidity of real exchange rates. From an economic policy stance, this issue is key for the discussion about the effectiveness of the economic adjustment programs applied to countries under stress during the sovereign debt crisis. Herein, we focus on Portugal, one of the hardest hit economies during the latest economic and financial turbulence episode. The potential relevance of this channel has been highlighted in Pisani-Ferry et al. (2013) and Blanchard and Portugal (2017).[2]

After Greece in May 2010 and Ireland in November 2010, in May 2011, Portugal became the third Euro area country to receive economic and financial assistance, accepting to implement an economic program designed by the so-called troika namely, the European Commission (EC), the European Central Bank (ECB) and the Interna-

[1] At the macro level, Esteves and Rua (2015) present strong evidence of a negative relationship between exports and domestic demand for Portugal while Bobeica et al. (2016) extend the supporting evidence to a panel of eleven Euro area countries.

[2] In this respect, Esteves and Prades (2018) argue that the exporting behaviour may differ across countries, depending negatively on product concentration and thus explaining the less successful adjustment of the Greek economy.

tional Monetary Fund (IMF). This economic and financial assistance program clearly reinforced the effects of the 2008–2009 recession on economic activity in a way never recorded in Portugal. Considering 2007 as the reference year, real GDP declined almost eight per cent until 2013, while domestic demand decreased around fifteen per cent, starting to recover gradually thereafter. At the same time, total exports grew well above foreign demand which resulted in huge exports market share gains which cannot be explained by the evolution of the real exchange rate (see Esteves and Rua (2015)).

This paper outlines a theoretical model relaxing the assumption of constant marginal costs allowing for the interplay between foreign and domestic markets. Solving such a firm optimization problem yields a model specification for firms' exports to be estimated. When compared with previous literature, the empirical and testable relationship between exports and domestic demand is directly obtained from a monopolistic model of a firm selling to both domestic and external markets. This implies a non-linear relationship between exports and domestic demand that is not typically taken on board in the estimation.

In our empirical analysis we use firm-level data that covers the Portuguese manufacturing exporters for the period 2009–2016. Such a time window encompasses a very challenging period for the Portuguese firms which makes it a natural case study. As usual in the international trade literature, the estimation is conducted using a log-linear model. Additionally, we also consider the pseudo-maximum-likelihood estimator using a fixed effects Poisson procedure as proposed by Silva and Tenreyro (2006) in order to cope with potential heteroskedasticity.

We find that external demand has a positive impact on firms' exports while there is a negative and statistically significant relationship between exports and domestic sales. However, one should highlight that the theoretical elasticities of exports to domestic demand and to external demand are not constant. This is a new but intuitive result. In fact, both elasticities depend on the relative importance between domestic and foreign demands, or equivalently between domestic sales and exports. Concerning the elasticity of exports to domestic demand, it is zero when firms do not sell to the domestic market as in this case the firm cannot by definition shift sales from the domestic to the foreign market. Naturally, the elasticity becomes more negative as the domestic sales are relatively more important on firms' sales. Regarding the elasticity of exports to foreign demand, the positive reaction to external demand shocks is higher if there is scope for the firm to shift sales from the domestic to foreign market. These results are supported both by the theoretical model as well as by the empirical results, which hold for different estimation methods and samples. We also find that the results are robust across manufacturing industries, as this negative relationship holds for almost all industries being statistically significant in 13 out of the 18 industries considered.

Nevertheless, the magnitude of the effect depends clearly of the industry considered. There is also evidence that this effect is less strong for smaller firms. Hence, larger firms, which are known to be more prone to export, seem to be more able to shift sales from the domestic to the foreign market.

The paper is organized as follows. In Section 2, a theoretical model underlying the link between exports and domestic demand is presented. The dataset is described in Section 3 and the estimation strategy is discussed in Section 4. In Section 5, the main empirical results are reported while Section 6 explores the heterogeneity both across industries and firms size. Finally, Section 7 concludes.

2 Theoretical framework

We consider two markets, a foreign (F) and a domestic (D) market, which are assumed to be segmented so that different prices can be charged by the firm in each market. By assuming monopolistic competition, each firm i at time t faces a downward sloping demand curve in the foreign market, q_{it}^F, given as

$$q_{it}^F = \Phi_t^F z_{it}^F \left(p_{it}^F\right)^{-\eta} \tag{1}$$

where Φ_t^F represents the aggregate export market size, z_{it}^F is a firm-specific export demand shifter, p_{it}^F is the firm's export price and $\eta > 1$ is the price elasticity of demand (as in, for example, Aw et al., 2011 and Vannoorenberghe, 2012). Hence, the corresponding inverse demand function is given by

$$p_{it}^F = \left(\Phi_t^F z_{it}^F\right)^{\frac{1}{\eta}} \left(q_{it}^F\right)^{-\frac{1}{\eta}} \tag{2}$$

In the domestic market, q_{it}^D, firms face similar demand conditions, *i.e.*,

$$q_{it}^D = \Phi_t^D z_{it}^D \left(p_{it}^D\right)^{-\eta} \tag{3}$$

and

$$p_{it}^D = \left(\Phi_t^D z_{it}^D\right)^{\frac{1}{\eta}} \left(q_{it}^D\right)^{-\frac{1}{\eta}} \tag{4}$$

where Φ_t^D represents the common aggregate domestic demand, z_{it}^F is a firm-specific domestic demand shifter and p_{it}^D is the firm's domestic price.[3]

Using (1) – (4), revenues on the foreign and domestic markets can be expressed, r_{it}^F and r_{it}^D, respectively, as

$$r_{it}^F = \left(\Phi_t^F z_{it}^F\right)^{\frac{1}{\eta}} \left(q_{it}^F\right)^{\frac{\eta-1}{\eta}} \tag{5}$$

and

$$r_{it}^D = \left(\Phi_t^D z_{it}^D\right)^{\frac{1}{\eta}} \left(q_{it}^D\right)^{\frac{\eta-1}{\eta}} \tag{6}$$

Typically, in international trade structural models it is assumed that marginal costs do not depend upon the quantity of the good supplied by the firm (see Clerides et al., 1998, Melitz, 2003, Das et al., 2007, Aw et al., 2011, among many others). This implies that demand shocks in one market do not affect the decision in the other market and the optimization problem for each market can be considered separately. Herein, we relax that assumption which makes the decisions by firm i in both markets interrelated. In particular, likewise Vannoorenberghe (2012), we consider a total cost function for each firm, c_{it}, given by

$$c_{it} = \theta_i \left(q_{it}^F + q_{it}^D\right)^{\alpha} + f_i + f_x \tag{7}$$

where θ_i is a firm-specific cost parameter, f_i is a firm-specific fixed cost of producing and f_x is a fixed cost of exporting. The parameter α defines the type of marginal cost, that is, constant marginal cost when $\alpha = 1$, decreasing marginal cost when $\alpha < 1$ and increasing marginal cost when $\alpha > 1$.

Hence, the optimization problem to be solved by each firm is given by

$$\max_{q_{it}^F, q_{it}^D} \left(\Phi_t^F z_{it}^F\right)^{\frac{1}{\eta}} \left(q_{it}^F\right)^{\frac{\eta-1}{\eta}} + \left(\Phi_t^D z_{it}^D\right)^{\frac{1}{\eta}} \left(q_{it}^D\right)^{\frac{\eta-1}{\eta}} - \theta_i \left(q_{it}^F + q_{it}^D\right)^{\alpha} - f_i - f_x$$

[3] The demand curves faced by firm i in the foreign and domestic markets can be generated by the Dixit-Stiglitz utility function over varieties.

Solving this problem involves equating the marginal revenue in each market (derived from (5) and (6)) to the marginal cost (resulting from (7)). This leads to the following optimal quantities

$$q_{it}^F = \left(\frac{\eta\alpha}{\eta-1}\theta_i\right)^{-\frac{\eta}{1+\eta(\alpha-1)}} \left(\Phi_t^F z_{it}^F\right)^{\frac{1}{1+\eta(\alpha-1)}} \left(1+\frac{\Phi_t^D z_{it}^D}{\Phi_t^F z_{it}^F}\right)^{-\frac{\eta(\alpha-1)}{1+\eta(\alpha-1)}} \tag{8}$$

and

$$q_{it}^D = \left(\frac{\eta\alpha}{\eta-1}\theta_i\right)^{-\frac{\eta}{1+\eta(\alpha-1)}} \left(\Phi_t^D z_{it}^D\right)^{\frac{1}{1+\eta(\alpha-1)}} \left(1+\frac{\Phi_t^F z_{it}^F}{\Phi_t^D z_{it}^D}\right)^{-\frac{\eta(\alpha-1)}{1+\eta(\alpha-1)}} \tag{9}$$

The corresponding export sales are obtained by substituting (8) into (5) and can be expressed as

$$r_{it}^F = \left(\frac{\eta\alpha}{\eta-1}\theta_i\right)^{\frac{1-\eta}{1+\eta(\alpha-1)}} \left(\Phi_t^F z_{it}^F\right)^{\frac{\alpha}{1+\eta(\alpha-1)}} \left(1+\frac{\Phi_t^D z_{it}^D}{\Phi_t^F z_{it}^F}\right)^{\frac{(1-\eta)(\alpha-1)}{1+\eta(\alpha-1)}} \tag{10}$$

whereas the domestic sales result from using (9) into (6)

$$r_{it}^D = \left(\frac{\eta\alpha}{\eta-1}\theta_i\right)^{\frac{1-\eta}{1+\eta(\alpha-1)}} \left(\Phi_t^D z_{it}^D\right)^{\frac{\alpha}{1+\eta(\alpha-1)}} \left(1+\frac{\Phi_t^F z_{it}^F}{\Phi_t^D z_{it}^D}\right)^{\frac{(1-\eta)(\alpha-1)}{1+\eta(\alpha-1)}} \tag{11}$$

Focusing on the exports equation (10), one can see that exports are positively influenced by foreign demand, $\Phi_t^F z_{it}^F$. On the other hand, for $\alpha > 1$, that is, in the presence of increasing marginal costs, one obtains $\frac{(1-\eta)(\alpha-1)}{1+\eta(\alpha-1)} < 0$. This means that the relative importance of the domestic to the foreign market, $\frac{\Phi_t^D z_{it}^D}{\Phi_t^F z_{it}^F}$, has a negative effect on exports. In other words, as one can show that $\frac{r_{it}^D}{r_{it}^F} = \frac{\Phi_t^D z_{it}^D}{\Phi_t^F z_{it}^F}$ using (10) and (11), the larger is the domestic to export sales ratio, the larger will be the negative impact on exports. Note that, in the case of constant marginal costs, $\alpha = 1$, $\frac{(1-\eta)(\alpha-1)}{1+\eta(\alpha-1)} = 0$ and exports are not influenced by domestic sales as it is commonly assumed in the literature.

3 Data

3.1 Definitions and sources

Exports

Data for exports at the firm level are from the external trade database of Statistics Portugal (INE), the Portuguese national statistical office, classified according to the 2010 Combined Nomenclature (NC) (INE, Statistics Portugal, 2018a). This database includes nominal values of internationally traded goods between Portugal and other Member States of the European Union (intra–EU trade) and between Portugal and non-EU countries (extra-EU trade). Data on extra-EU trade are collected from customs declarations, while data on intra–EU trade are collected through the Intrastat system. Each transaction record includes, among other information, the firm's identifier, product code (8 digits), the destination country, the value of the transaction in Euro.

Domestic sales

Data regarding domestic sales for each firm comes from the Integrated Business System (SCIE) (INE, Statistics Portugal, 2018b). This database results from a process of statistical data integration that covers enterprises and is based on administrative data, with an emphasis on Simplified Business Information (IES). The set of information available encompasses many other variables, including the sector of activity. INE compiles and validates a concise version of the database releasing it for the period 2006–2016. As each firm has an unique identifier, the two sources of information could be matched.

Foreign demand

The evolution of foreign demand is naturally crucial for exports behaviour. At the macro level, such a variable is usually computed as a weighted average of the imports of the main trade partners where the weights reflect the relative importance of those trade partners for the country exports (see, for example, Hubrich and Karlsson, 2010, for its use at the Eurosystem). In the same spirit, a foreign demand, in moment t, can be computed at the firm level, $FD_{i,t}$. In particular, one has to take into account both the product and the geographical export specialization of each firm yielding

$$FD_{i,t} = \sum_{p=1}^{P} \sum_{j=1}^{J} \omega_{i,p,j} M_{j,p,t} \tag{12}$$

where $\omega_{i,p,j}$ is the average share of the exports of product p ($p = 1, ..., P$) to country j ($j = 1, ..., J$) in firm's i total exports, while $M_{j,p,t}$ measures the imports of country j of each product p and at time t (in line with Berman et al., 2015).

The firm level weights, $\omega_{i,p,j}$, are constant over time and are computed using the above mentioned database for the Portuguese external trade. The imports data for the trade partners are obtained from BACI (CEPII, 2018), which is a world trade database developed by the CEPII with a high level of product disaggregation based on original data provided by the United Nations Statistical Division (COMTRADE database). We consider the most disaggregated version available for all the period, *i.e.*, the Harmonized System at 6 digit level following the 1996 classification (HS6–1996). As such data is released in US Dollar, it has been converted to Euro using the annual average exchange rate. The data is then merged with the Portuguese external trade database using only the 6 initial digits. The resulting dataset covers 213 trade countries/territorial units partners and a total of 4,875 products. In this way, we obtain the foreign demand faced by each firm taking into account its product and destination orientation.

3.2 Descriptive statistics

Several descriptive statistics are reported in Table 1. In particular, we provide a set of standard statistics for the following variables: exports, domestic sales, the ratio between domestic sales and exports, and foreign demand. We report statistics for the year 2009, the last year available for this type of data which is 2016 and for the whole period.

In Panel A, we consider all manufacturing firms leading to a sample of 21,749 observations and 3,996 firms. Looking at the figures for the ratio between domestic and exports sales, it is clear that this variable is being influenced by firms reporting a very small value for exports relatively to domestic sales. Therefore, in order to avoid the contamination of the results due to such extreme observations, another sample is considered. Firstly, all the firms reporting total sales less than one thousand Euro are excluded to avoid very small firms which are more prone to reporting errors. Secondly, firms are considered if exports represent at least one per cent of domestic sales or if domestic sales represent at least one per cent of exports. The idea is to narrow the analysis to firms that are effectively present in both markets. This sample has 19,381 observations and 3,655 firms (Panel B). Finally, a third sample is analysed (Panel C). As the theoretical model considered does not deal explicitly with the entry and exit of firms, the sample was further restricted to firms that are present in both markets in all periods. This sample has 8,784 observations and 1,098 firms.

Table 1: Descriptive statistics

Variables	*Mean*	*s.d.*	P_{10}	P_{50}	P_{90}
Panel A: full sample					
Year 2009 $N = 2,014$					
Exports ($X_{i,t}$)	5,547	21,776	29	1,178	11,137
Domestic Sales ($DS_{i,t}$)	6,876	26,555	89	1,256	13,457
Ratio $DS_{i,t}/X_{i,t}$	316	8,267	0	1	59
Foreign Demand ($FD_{i,t}$)	304,963	680,887	1,006	68,789	840,613
Year 2016 $N = 3,064$					
Exports ($X_{i,t}$)	8,121	39,542	31	1,328	14,052
Domestic Sales ($DS_{i,t}$)	6,474	27,135	88	1,167	12,172
Ratio $DS_{i,t}/X_{i,t}$	2,895	153,184	0	1	36
Foreign Demand ($FD_{i,t}$)	461,944	1,066,017	2,650	111,290	1,188,191
All years $N = 21,749$ $firms = 3,996$					
Exports ($X_{i,t}$)	7,286	37,639	38	1,298	13,107
Domestic Sales ($DS_{i,t}$)	6,530	26,676	84	1,157	12,121
Ratio $DS_{i,t}/X_{i,t}$	677	58,577	0	1	34
Foreign Demand ($FD_{i,t}$)	448,014	1,057,308	3,111	100,624	1,157,586
Panel B: drop observations if ratio < 0.01 or > 100					
Year 2009 $N = 1,726$					
Exports ($X_{i,t}$)	6,033	23,354	76	1,353	12,084
Domestic Sales ($DS_{i,t}$)	7,044	28,111	136	1,278	13,473
Ratio $DS_{i,t}/X_{i,t}$	7	15	0	1	19
Foreign Demand ($FD_{i,t}$)	308,245	685,833	2,508	76,417	813,648
Year 2016 $N = 2,704$					
Exports ($X_{i,t}$)	8,082	39,967	78	1,426	13,831
Domestic Sales ($DS_{i,t}$)	6,621	27,115	134	1,257	12,362
Ratio $DS_{i,t}/X_{i,t}$	6	13	0	1	16
Foreign Demand ($FD_{i,t}$)	472,918	1,083,265	5,124	116,852	1,206,248
All years $N = 19,381$ $firms = 3,655$					
Exports ($X_{i,t}$)	7,364	38,806	83	1,362	12,885
Domestic Sales ($DS_{i,t}$)	6,620	26,545	127	1,225	12,283
Ratio $DS_{i,t}/X_{i,t}$	6	14	0	1	16
Foreign Demand ($FD_{i,t}$)	457,465	1,076,704	5,383	105,835	1,173,118
Panel C: drop observations if ratio < 0.01 or > 100 & firms in all periods					
Year 2009 $N = 1098$					
Exports ($X_{i,t}$)	7,398	23,805	174	1,724	16,452
Domestic Sales ($DS_{i,t}$)	9,121	34,195	227	1,859	16,650
Ratio $DS_{i,t}/X_{i,t}$	5	12	0	1	15
Foreign Demand ($FD_{i,t}$)	331,861	775,894	5,148	78,588	835,320
Year 2016 $N = 1098$					
Exports ($X_{i,t}$)	12,518	42,578	401	3,193	27,073
Domestic Sales ($DS_{i,t}$)	9,224	33,265	249	1,985	18,252
Ratio $DS_{i,t}/X_{i,t}$	3	8	0	1	7
Foreign Demand ($FD_{i,t}$)	424,925	909,002	10,165	109,854	1,158,784
All years $N = 8,784$ $firms = 1,098$					
Exports ($X_{i,t}$)	10,534	36,636	371	2,534	22,371
Domestic Sales ($DS_{i,t}$)	9,187	33,475	237	1,919	17,432
Ratio $DS_{i,t}/X_{i,t}$	3	8	0	1	8
Foreign Demand ($FD_{i,t}$)	422,984	944,244	9,562	106,645	1,107,321

Notes. The information used in the regressions spans over the period 2009 – 2016 (the data is available since 2006, but we loose three periods once we build the two instruments defined in Section 4). Labels: *s.d.*, standard deviation; N, number of observations; $firms$, number of firms; P_{10}, P_{50}, and P_{90}, percentiles 10, 50 and 90. Monetary units are in Euro $\times 1000$.
Source: Own computations.

4 Estimation strategy

The stochastic version corresponding to equation (10) can be put simply as

$$X_{it} = \beta_{i0}\; FD_{it}^{\beta_1} \left(1 + \frac{DD_{i,t}}{FD_{i,t}}\right)^{\beta_2} \xi_{it} \tag{13}$$

where X_{it} is exports by firm i in period t, $FD_{it} = \Phi_t^F z_{it}^F$, $DD_{i,t} = \Phi_t^D z_{it}^D$ and ξ_{it} is an error factor.

As discussed earlier, β_1 is expected to be positive as exports are boosted by foreign demand. In the case of β_2, one should recall that $\beta_2 = \frac{(1-\eta)(\alpha-1)}{1+\eta(\alpha-1)}$. As $\eta > 1$, the sign of β_2 is determined by the parameter α which defines the type of marginal cost. In particular, increasing marginal costs implies $\beta_2 < 0$, decreasing marginal costs lead to $\beta_2 > 0$ whereas $\beta_2 = 0$ with constant marginal costs. Naturally, in the latter case, the non-linearity disappears and one is left with exports being influenced only by foreign demand as it is standard in the literature. In fact, taking on board the variable $\left(1 + \frac{DD_{i,t}}{FD_{i,t}}\right)$ to capture the non-linearity, derived from the above theoretical model, has never been considered up to now in model estimation.

An important feature of this specification is that exports depend on the relative importance between both markets. As it is clear, the elasticity of exports to domestic demand is not constant, depending on the relative dimension between the two markets which can differ across firms and over time. More formally, one can show that using equation (13), the exports elasticities to foreign demand, $\varepsilon_{x,fd}$, and domestic demand, $\varepsilon_{x,dd}$, are given, respectively, by

$$\varepsilon_{x,fd} = \beta_1 - \beta_2 \frac{R}{1+R} \tag{14}$$

and

$$\varepsilon_{x,dd} = \beta_2 \frac{R}{1+R} \tag{15}$$

where R stands for the ratio between domestic (DD_{it}) and foreign (FD_{it}) demands. Figure 1 depicts the relation between the model coefficients β_1 and β_2 and the above elasticities considering that $\beta_1 > 0$ and $\beta_2 < 0$. As the domestic market becomes more important, in relative terms, the elasticities of exports to foreign demand and domestic demand asymptotically converge towards $\beta_1 - \beta_2$ and to β_2, respectively.

Intuitively, in the case of $\varepsilon_{x,dd}$, a percentage decrease in domestic sales that ends up being reoriented to the export market, will translate into a large (small) elasticity, in absolute terms, if domestic sales are large (small) in relative terms. Naturally, if there

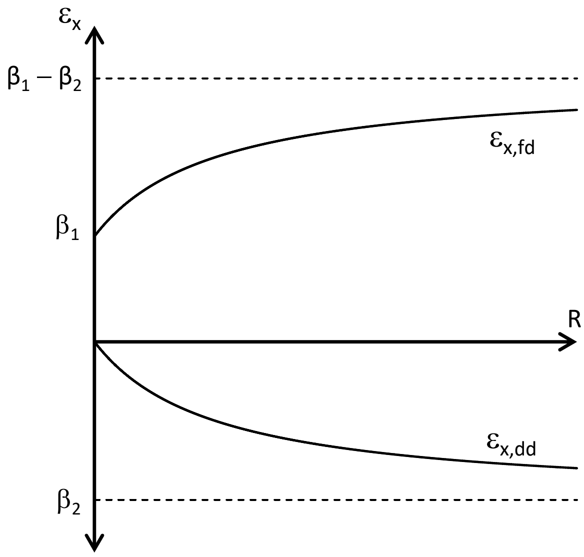

Figure 1: Exports elasticities

are no domestic sales, then no reorientation is possible and the elasticity is zero. In the case of $\varepsilon_{x,fd}$, if there are no domestic sales, the elasticity is given by β_1. As the domestic market gets more important, there is scope for reorientation, and the elasticity is higher.

Concerning the estimation of the model, the following issues should be highlighted. The first is related with the use of a log linearised version of equation (10). In this respect, one should mention that in the right hand side one cannot separate out domestic demand from foreign demand as the relevant variable becomes $ln\left(1+\frac{DD_{i,t}}{FD_{i,t}}\right)$. In fact, one should avoid approximating $ln\left(1+\frac{DD_{i,t}}{FD_{i,t}}\right)$ by $ln\left(\frac{DD_{i,t}}{FD_{i,t}}\right)$ as such approximation only works if the ratio $\frac{DD_{i,t}}{FD_{i,t}}$ is large. As the focus is on exporters, for many firms the foreign market is much larger than the domestic one.

Given the lack of information concerning domestic sales by product for each firm and total domestic demand for each product at a high disaggregation level, it is not possible to compute the domestic demand faced by each firm as it is done for foreign demand. However, as one can show that in equilibrium the ratio between domestic and foreign demands is the same as the ratio between domestic sales and exports for each firm, then we will consider the latter in the estimation of the model. Note that one considers either the ratio between the two demands or between the two market sales. Naturally, the use of such a variable raises further issues of endogeneity that are not solved by the typical fixed-effects procedure. To handle such endogeneity, we consider the above mentioned ratio in the previous period, that is, we use $\frac{DS_{i,t-1}}{X_{i,t-1}}$ to replace

$\frac{DD_{i,t}}{FD_{i,t}}$ in the estimation of equation (13). Intuitively, it seems natural to use the ratio between domestic sales and exports in the previous period as it represents the degree of relative exposure to both markets in the period before the reaction takes place. We assume that FD_{it} is exogenous which is clearly plausible in the case of a small open economy like Portugal.

As standard in the literature, we proceed with the estimation of the log-linear model by fixed-effects. However, as discussed in Silva and Tenreyro (2006), in the presence of heteroskedasticity, the fixed-effect estimator applied to the log-linear model may lead to biased estimates. In this case Silva and Tenreyro (2006) propose a pseudo-maximum-likelihood procedure, specifically a Poisson model on the levels of the dependent variable, as described in equation (13). In our current setup we have longitudinal data, so we use a fixed-effects Poisson procedure.[4]

5 Empirical results

5.1 Main results

The estimations are reported in Table 2. The design of the different specifications and estimators is the following. First, we estimate the 'traditional' log-linear model by fixed-effects, columns '$ln\,(X_{it})$ (FE)'. Transforming equation (13), the dependent variable is defined by the natural log of firms' exports and the model estimated is given by

$$ln(X_{it}) = \beta_1\, ln(FD_{it}) + \beta_2\, ln\left(1 + \frac{DS_{i,t-1}}{X_{i,t-1}}\right) + u_i + \nu_{i,t} \tag{16}$$

where u_i represents firms' unobserved heterogeneity and $\nu_{i,t}$ is a white noise error term.

Second, following the discussion in Silva and Tenreyro (2006) and in Egger et al. (2015), we account for heteroskedasticity and implement a (pseudo-maximum-likelihood) fixed-effects Poisson estimator (FE Poisson). The dependent variable is now firms' exports (in levels) and the model to be estimated is

$$X_{it} = \beta_{i0}\, FD_{it}^{\beta_1} \left(1 + \frac{DS_{i,t-1}}{X_{i,t-1}}\right)^{\beta_2} \xi_{it} \tag{17}$$

The results are shown under columns 'X_{it} (FE Poisson)'.

The results reported in Table 2 are in accordance with the model outlined in Section 2 concerning the sign and significance of the parameters β_1 and β_2. We find that, regardless the estimation method and the sample considered (panels A, B and C), all

[4]For a detailed discussion on the estimation of this type of models using panel data see Egger et al. (2015).

Table 2: Determinants of firms' exports: FE & Poisson

	Panel A		Panel B		Panel C	
	$ln(X_{it})$ (FE)	X_{it} (FE Poisson)	$ln(X_{it})$ (FE)	X_{it} (FE Poisson)	$ln(X_{it})$ (FE)	X_{it} (FE Poisson)
$\hat{\beta}_1$	0.477***	0.386***	0.406***	0.349***	0.416***	0.304***
	(0.011)	(0.043)	(0.013)	(0.040)	(0.020)	(0.044)
$\hat{\beta}_2$	-0.137***	-0.237***	-0.125***	-0.183***	-0.256***	-0.277***
	(0.024)	(0.045)	(0.013)	(0.040)	(0.027)	(0.057)

Notes. FE corresponds to the linear fixed-effects estimator; FE Poisson reports fixed-effects Poisson estimates. The fixed-effects are at the firm level. Robust standard-errors in parenthesis (clustered by firm). Significance levels: 1%, ***; 5%, **; 10%, *. All models include time dummies (which are jointly statistically significant in all estimations). The models are estimated for three samples, panels A, B and C, respectively. Panel A corresponds to the full sample. In Panel B we drop observations if ratio < 0.01 or > 100, while in Panel C we drop observations if ratio < 0.01 or > 100 and keep just the firms that are in all periods. The first sample has 21,749 observations, corresponding to 3,996 firms. The second sample uses 19,381 observations and 3,655 firms, while the third sample has 8,784 observations and 1,098 firms. See Section 3.2 for a description of the data and Section 4 for a discussion on the estimation strategy. *Source*: Own computations.

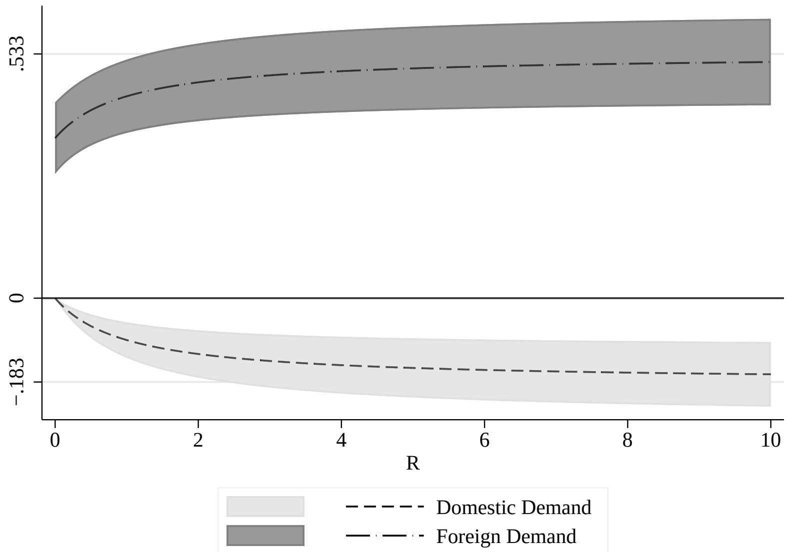

Figure 2: Estimated exports elasticities

the coefficients are statistically significant at the 1% significance level with the foreign demand presenting a positive sign whereas the variable related with the ratio between domestic sales and exports records a negative sign.[5] As the estimated value for β_2 is negative, this result points to the presence of increasing marginal costs as discussed earlier. In terms of magnitude, the log-linear specification, when compared to the FE Poisson, delivers the highest coefficients for the former and the lowest (in absolute terms) for the latter. However, following the discussion in Silva and Tenreyro (2006) the estimates under column '$ln\,(X_{it})$ (FE)' in Table 2 should be read with caution and the estimates under column 'X_{it} (FE Poisson)' should be favored.[6]

[5]Note that, given the usual degree of business cycle synchronization across countries, the inclusion of foreign demand as explanatory variable may be crucial in order to avoid a misspecification problem that can lead to a spurious positive correlation between exports and domestic sales.

[6]Furthermore, as the eventual presence of autocorrelation on exports may influence the estimation results, we have also considered a dynamic formulation of the log linearised version of equation (13). We

To summarize the results we show in Figure 2 the estimated exports elasticities, which compares with Figure 1. We provide both, the point estimates, as well as the 95% confidence intervals for the estimates of the elasticities defined by equations (14) and (15). These elasticities were computed using the estimates for model 'X_{it} (FE Poisson)' and Panel B provided in Table 2. For instance, if one takes a representative value of 6 for R, our estimates indicate that the elasticity of exports with respect to domestic demand is -0.16 while the elasticity of exports to foreign demand is 0.51.

6 Heterogeneity across industries and firm size

There are reasons to believe that the link between domestic demand and exports could be different across firms. In fact, as illustrated by equation (10), the relation between exports and domestic demand depend of some factors as the elasticity of demand and the costs structure. Therefore, in this section we investigate empirically how the negative relationship between exports and domestic demand depends on some firm characteristics. Firstly, we focus on the sectoral dimension. Intuitively, the characteristics of goods should play a role, namely their ability to be reallocated between markets, i.e. its degree of 'tradableness'. Secondly, the importance of the firm size is analyzed within each sector. One could argue that a larger firm within a specific sector is more capable to absorb shocks and shift sales from the domestic to external market.

In Table 3 below we report the results for eighteen industries within the manufacturing sector, using the sample defined in Panel B of Table 1 and the fixed-effects Poisson pseudo-maximum-likelihood estimator.

We find that the negative relationship between exports and domestic sales holds for almost all sectors (17 out of 18 industries), which corroborates the results discussed in Section 5, but it is statistically different across industries. At the one per cent statistical significance level, the estimated coefficient is negative for 10 industries (13 industries when considering the ten per cent statistical significance level). Nevertheless, among those industries where the effect is statistically significant, the magnitude of the coefficient varies quite substantially, ranging from -0.094 for the furniture industry to -0.711 and -0.765 in paper and motor vehicles industries, respectively. The smallest and non-significant coefficient is recorded for the pharmaceutical industry. Such heterogeneity reinforces the importance of looking at sectoral disaggregation when trying to understand the overall evolution of exports. Finally, the foreign demand indicator has a positive and statistical significant coefficient for all industries.

find that the main results hold qualitatively. All the estimation details are provided in the Appendix.

Table 3: Determinants of firms' exports by industry (Poisson FE)

Industry NACE code	10	11	13	14	15	16	17	18	19 & 20
$\hat{\beta}_1$	0.412***	0.513***	0.585***	0.390***	0.157***	0.756***	0.113***	0.160***	0.510***
	(0.060)	(0.091)	(0.121)	(0.067)	(0.043)	(0.202)	(0.031)	(0.043)	(0.101)
$\hat{\beta}_2$	-0.360***	-0.309***	-0.248	-0.240***	-0.362***	-0.284*	-0.711***	0.233***	-0.035
	(0.095)	(0.059)	(0.159)	(0.089)	(0.103)	(0.156)	(0.121)	(0.055)	(0.096)
Observations	1,502	825	1,389	1,891	1,610	1,079	386	267	485
Firms	268	160	250	374	290	201	63	58	87
Industry NACE code	21	22	23	24 & 25	26 & 27	28	29 & 30	31	32
$\hat{\beta}_1$	0.412***	0.217**	0.599***	0.518***	0.221***	0.246***	0.452***	0.427***	0.374***
	(0.076)	(0.097)	(0.115)	(0.058)	(0.053)	(0.079)	(0.151)	(0.057)	(0.075)
$\hat{\beta}_2$	-0.034	-0.253**	-0.057	-0.185***	-0.209***	-0.180***	-0.765***	-0.094*	-0.154***
	(0.034)	(0.102)	(0.059)	(0.043)	(0.048)	(0.044)	(0.197)	(0.055)	(0.058)
Observations	139	1,206	1,831	2,987	767	1,151	552	958	356
Firms	24	209	343	586	135	208	114	221	78

Notes. The sample corresponds to the one used in Panel B of Table 1. Estimates are performed by fixed-effects Poisson pseudo-maximum-likelihood. The fixed-effects are at the firm level. The dependent variable is Exports (in levels). Industries: 10, Food Products; 11, Beverages; 13, Textiles; 14, Wearing Apparel and Dressing; 15, Footwear, Articles of Fur; 16, Wood and Cork; 17, Paper and Paper Products; 18, Publishing, Printing and Reproduction; 19 & 20, Fuel and Chemicals; 21, Pharmaceuticals; 22, Rubber and Plastic; 23, Other Non-Metallic Mineral Products; 24 & 25, Basic Metals and Fabricated Metal Products (exc. Machinery and Equipment); 26 & 27, Computing, Communication and Electrical Machinery; 28, Machinery and Equipment; 29 & 30, Motor Vehicles; 31, Furniture, 32, Other Manufactures. Robust standard-errors in parenthesis (clustered by firm). Significance levels: 1%, ***; 5%, **; 10%, *. All models include time dummies (jointly statistically significant in all models). See Section 3.2 for a description of the data and Section 4 for a discussion on the estimation strategy. *Source*: Own computations.

Table 4: Determinants of firms' exports by industry & size (Poisson FE)

					Small				
Industry NACE code	10	11	13	14	15	16	17	18	19 & 20
$\hat{\beta}_1$	0.501***	0.309***	0.335***	0.172***	0.288***	0.254***	0.152***	0.809***	0.426***
	(0.089)	(0.069)	(0.057)	(0.064)	(0.074)	(0.083)	(0.055)	(0.184)	(0.054)
$\hat{\beta}_2$	-0.214**	-0.146***	-0.124	-0.225	-0.308***	-0.222***	-0.524**	-0.043	0.060
	(0.101)	(0.054)	(0.080)	(0.197)	(0.116)	(0.082)	(0.264)	(0.105)	(0.043)
Observations	417	243	368	561	442	322	104	62	138
Firms	86	54	84	126	99	68	22	17	30
					Medium				
$\hat{\beta}_1$	0.376***	0.211	0.183***	0.440***	0.072	0.357***	0.562***	0.228***	0.145*
	(0.075)	(0.167)	(0.051)	(0.105)	(0.051)	(0.102)	(0.168)	(0.041)	(0.086)
$\hat{\beta}_2$	-0.250***	-0.188**	-0.439***	-0.468***	-0.314***	-0.363***	-0.593***	0.017	-0.454***
	(0.082)	(0.096)	(0.103)	(0.121)	(0.078)	(0.124)	(0.154)	(0.102)	(0.058)
Observations	491	289	489	633	540	349	158	86	153
Firms	91	54	84	125	95	68	22	19	27
					Large				
$\hat{\beta}_1$	0.417***	0.549***	0.707***	0.418***	0.179***	0.848***	0.112***	0.125***	0.546***
	(0.078)	(0.097)	(0.137)	(0.097)	(0.062)	(0.215)	(0.024)	(0.031)	(0.103)
$\hat{\beta}_2$	-0.411***	-0.359***	-0.317	-0.163	-0.430**	-0.273	-0.669***	0.253***	0.016
	(0.134)	(0.068)	(0.258)	(0.129)	(0.213)	(0.219)	(0.140)	(0.050)	(0.091)
Observations	594	293	532	697	628	408	124	119	194
Firms	91	52	82	123	96	65	19	22	30

Note: see notes to Table 3.

Table 4: Determinants of firms' exports by industry & size, Panel B (Poisson FE) (continued)

	Small								
Industry NACE code	21	22	23	24 & 25	26 & 27	28	29 & 30	31	32
$\hat{\beta}_1$	0.363**	0.289***	0.308***	0.431***	0.381***	0.347***	0.305**	0.439***	0.367***
	(0.167)	(0.111)	(0.048)	(0.052)	(0.097)	(0.081)	(0.122)	(0.067)	(0.128)
$\hat{\beta}_2$	0.074***	-0.188**	-0.078	-0.061	-0.130	0.095	-0.222	-0.152	-0.566***
	(0.029)	(0.091)	(0.051)	(0.064)	(0.107)	(0.078)	(0.151)	(0.101)	(0.213)
Observations	45	293	500	775	216	327	180	287	99
Firms	9	62	112	198	45	67	40	75	26
	Medium								
$\hat{\beta}_1$	0.364***	0.328***	0.402***	0.404***	0.224***	0.376***	0.228*	0.404***	0.277***
	(0.053)	(0.122)	(0.050)	(0.060)	(0.050)	(0.063)	(0.133)	(0.091)	(0.059)
$\hat{\beta}_2$	-0.056	-0.093	-0.128**	-0.098**	-0.250***	-0.072	-0.387	-0.153**	-0.168***
	(0.036)	(0.166)	(0.050)	(0.050)	(0.052)	(0.049)	(0.250)	(0.063)	(0.057)
Observations	40	422	588	973	262	361	181	304	111
Firms	7	75	114	191	44	67	38	73	24
	Large								
$\hat{\beta}_1$	0.414***	0.199*	0.668***	0.547***	0.221***	0.195	0.508***	0.422***	0.468***
	(0.140)	(0.112)	(0.153)	(0.074)	(0.064)	(0.132)	(0.185)	(0.085)	(0.078)
$\hat{\beta}_2$	-0.012	-0.346**	-0.028	-0.221***	-0.198***	-0.273***	-0.912***	-0.079	-0.124***
	(0.024)	(0.136)	(0.077)	(0.055)	(0.062)	(0.087)	(0.214)	(0.069)	(0.042)
Observations	54	491	743	1,239	289	463	191	367	146
Firms	8	72	117	197	46	74	36	73	28

Note: see notes to Table 3.

Given the heterogeneity across sectors, we proceed to assess the importance of the firm size within each sector. In particular, we classify the firms in each sector in terciles (small, medium and large) based on the average number of employees working in the firm throughout the sample period. In Table 4, we present the results for each sector and firm size. We find that the foreign demand indicator is positive for all pairs of industry and firm size (and statistically significant for 46 out of 54 cases at a one per cent significance level). Regarding the relationship between exports and domestic sales the results suggest that firm size matters. In particular, for small firms there are four industries where the coefficient is statistically significant (at the one per cent significance level) whereas this figure goes up to nine and eight for medium and large firms, respectively. Regarding the magnitude of the coefficient, and focusing on the cases where it is statistically significant, we find that there is only one industry where the highest coefficient (in absolute terms) is recorded for small firms, namely 'Other manufactures'. This figure goes up to five in the case of medium firms and is even higher in the case of large firms (six industries). In this respect, we also find that the coefficient is more negative for medium and large firms than for small firms in 14 out of 18 industries, being such a difference statistically significant in six sectors.

Hence, the above results suggest that the effect tends to be more marked for medium and large firms which supports the view that firm size also plays a role for the ability to reallocate sales.

7 Concluding remarks

The link between exports and domestic demand has been fuelling recent economic literature and the policy debate. In particular, the presence of a negative relationship may constitute an additional economic adjustment channel, in particular in the Euro area countries, where a common currency in a low inflation environment leads to the rigidity of real exchange rates.

The focus is on Portugal, one of the countries which underwent a severe crisis during the latest economic turbulence episode. The economic and financial assistance program implemented in May 2011 reinforced the effects of the 2008 − 2009 recession on economic activity in a way never seen in Portugal. However, at the same time, Portuguese total exports grew well above foreign demand which resulted in large exports market share gains which cannot be explained by the evolution of the real exchange rate. The Portuguese success of the adjustment process has been partly attributed to the behaviour of the exporting firms.

When compared with previous literature, there are two noticeable departures. Firstly, the empirical and testable relationship between exports and domestic demand is directly obtained from a monopolistic model of a firm selling to both domestic and external markets. It implies a non-linear relationship between exports and domestic sales that is not typically considered in empirical studies. Secondly, in order to deal with the heteroskedasticity problem which may affect the traditional log-linear approach, a fixed-effects Poisson procedure is also used.

The empirical findings confirm the shifting behaviour from a weaker domestic market to stronger external markets by Portuguese firms during the latest economic and financial crisis. In particular, drawing on firm-level data for the Portuguese exporters for the period 2009–2016, we find a negative and statistically significant relationship between exports and domestic sales. One should note that the implied elasticities between exports and domestic demand and between exports and foreign demand are not constant across firms as it depends on the relative degree of exposure to the domestic and foreign markets. Naturally, firms' exports should not react to domestic market conditions if the firm does not sell in the home country whereas the reaction is expected to be larger if the scope for shifting is larger.

Overall, the results are robust for both static and dynamic formulations of the model, as well as across different estimation strategies. Based on a sectoral analysis, we also find that such a relationship holds for almost all industries within the manufacturing sector although the magnitude differs from industry to industry. Furthermore, there is evidence that the effect is stronger for larger firms.

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Appendix

As the potential presence of autocorrelation on exports may affect the estimation results, it is considered a dynamic formulation of the log linearised version of equation (13),

$$ln(X_{it}) = \gamma_0 \, ln(X_{i,t-1}) + \gamma_1 \, ln(FD_{it}) + \gamma_2 \, ln\left(1 + \frac{DS_{i,t-2}}{X_{i,t-2}}\right) + \tau_t + u_i + \nu_{i,t} \qquad (18)$$

where τ_t is a set of time dummies, u_i represents firms' unobserved heterogeneity and $\nu_{i,t}$ is a white noise error term. On the one hand, one would expect some form of dynamics in firms' exports with γ_0 capturing its degree of persistence. On the other hand, this solution can be seen as an alternative to deal with endogeneity underlying equation (13). To address the problem associated with the correlation between $ln(X_{i,t-1})$ and the u_i, dynamic panel data procedures are used to estimate the parameters of interest. In the first differences model, the correlation between $\Delta ln(X_{i,t-1})$ and $\Delta\nu_{i,t}$ is solved by using the GMM solutions discussed, first, in Arellano and Bond (1991), and, later, in Arellano and Bover (1995) and Blundell and Bond (1998).[7] Given the presence of $ln(X_{i,t-1})$ in the right hand side of equation (18), and to avoid simultaneity issues, we will use $ln\left(1+\frac{DS_{i,t-2}}{X_{i,t-2}}\right)$ instead of $ln\left(1+\frac{DS_{i,t-1}}{X_{i,t-1}}\right)$ as regressor and treat it as endogenous.

Table 5 reports the estimates for the difference GMM approach of Arellano and Bond (1991) for the three samples we use.[8] Each one of the three columns corresponds to a different set of instruments used in the estimation of equation (18). Under column 'Lags: 2–3' we report the results for the difference GMM estimator when one uses lags two to three of the variables $ln\left(X_{it}\right)$ and $ln\left(1+\frac{DS_{i,t-1}}{X_{i,t-1}}\right)$ as instruments for the first-differenced equation; $ln(FD_{it})$ and the time dummies have been treated as exogenous in all regressions, and are also included in the instrument set. In the last two columns we replicate the analysis with lags two to four, 'Lags: 2–4', and two to five, 'Lags: 2–5', respectively.[9]

The dynamic formulation of equation (18) allows us to distinguish between immediate and long-run effects of variations in the regressors. At the same time, we are able to quantify the degree of persistence of firms' exports. The long-run effect associated with $ln\left(1+\frac{DS_{i,t-1}}{X_{i,t-1}}\right)$ is computed as $\frac{\gamma_2}{(1-\alpha)}$. Taking the results in Table 5 under "Lags: 2–3", the estimate for the long-run parameter is -0.114 $\left(=\frac{-0.082}{(1-0.280)}\right)$ (statistically significant at the 1% significance level). This estimate compares with -0.255 for the static model (column 'X_{it} (FE Poisson-IV)'). Although the magnitude of the estimates varies across samples and estimators, the key findings are robust. Both the sign and the statistical significance of the different estimates are consistent with previous results.

[7] For a detailed discussion see Arellano (2003).

[8] The estimation results obtained from the dynamic panel data system GMM, proposed by Arellano and Bover (1995) and Blundell and Bond (1998), point to a low persistence in exports and suggest the non-adequacy of this procedure.

[9] To limit the overall number of instruments, we use a 'collapsed' instrument set as discussed in Roodman (2009)

Table 5: Determinants of firms' exports: Dynamic GMM specification

	GMM – first-differences		
	(Lags: 2–3)	(Lags: 2–4)	(Lags: 2–5)
Panel A: full sample			
$ln\,(X_{i,t-1})$	0.280***	0.287***	0.287***
	(0.040)	(0.040)	(0.039)
$ln(FD_{it})$	0.449***	0.451***	0.452***
	(0.016)	(0.016)	(0.016)
$ln\left(1+\frac{DS_{i,t-k}}{X_{i,t-k}}\right)$	-0.082***	-0.089***	-0.088***
	(0.023)	(0.022)	(0.022)
Long-run effect	-0.114***	-0.124***	-0.123***
	(0.034)	(0.034)	(0.034)
Observations	13,658	13,658	13,658
Firms	3,405	3,405	3,405
AR(1)	-9.230***	-9.237***	-9.081***
AR(2)	0.786	0.658	0.677
Hansen	2.254	4.433	4.894
Hansen-df	2	4	6
Panel B: drop observations if ratio $<$ 0.01 or $>$ 100			
$ln\,(X_{i,t-1})$	0.244***	0.232***	0.236***
	(0.050)	(0.049)	(0.048)
$ln(FD_{it})$	0.374***	0.372***	0.373***
	(0.019)	(0.018)	(0.018)
$ln\left(1+\frac{DS_{i,t-k}}{X_{i,t-k}}\right)$	-0.049***	-0.054***	-0.054***
	(0.018)	(0.018)	(0.018)
Long-run effect	-0.065***	-0.070***	-0.071***
	(0.024)	(0.023)	(0.023)
Observations	11,682	11,682	11,682
Firms	3,055	3,055	3,055
AR(1)	-7.793***	-7.795***	-7.898***
AR(2)	0.501	0.388	0.390
Hansen	2.833	7.835*	8.441
Hansen-df	2	4	6
Panel C: drop observations if ratio $<$ 0.01 or $>$ 100 & firms in all periods			
$ln\,(X_{i,t-1})$	0.365***	0.349***	0.339***
	(0.054)	(0.052)	(0.048)
$ln(FD_{it})$	0.402***	0.392***	0.395***
	(0.034)	(0.033)	(0.033)
$ln\left(1+\frac{DS_{i,t-k}}{X_{i,t-k}}\right)$	-0.083**	-0.072*	-0.069*
	(0.038)	(0.037)	(0.035)
Long-run effect	-0.131***	-0.110***	-0.104***
	(0.062)	(0.058)	(0.054)
Observations	6,588	6,588	6,588
Firms	1,098	1,098	1,098
AR(1)	-6.524***	-6.619***	-6.819***
AR(2)	0.415	0.520	0.535
Hansen	0.217	2.613	4.395
Hansen-df	2	4	6

Notes. The dependent variable $ln\,(X_{it})$ denotes the (natural) log of . exports for firm i in period t. $ln(FD_{it})$ stands for the log of Foreign Demand; DS stands for Domestic Sales. Estimates under column 'FE Poisson–IV' are obtained by fixed-effects instrumental variables Poisson pseudo-maximum-likelihood procedure. 'GMM – first-differences' corresponds to the dynamic panel data difference GMM estimator discussed in Arellano and Bond (1991). k equals 1 for the 'FE Poisson-IV' and 2 for the GMM estimations. 'Lags: 2–3' indicates that lags two to three of the variables $ln\,(X_{it})$ and $ln\left(1+\frac{DS_{i,t-2}}{X_{i,t-2}}\right)$ were used in the specification of the GMM type instruments – similarly for 'Lags: 2–4' and 'Lags: 2–5'; $ln(FD_{it})$ has been treated as exogenous in all regressions. AR(1) and AR(2) stand for the Arellano-Bond tests for first and second order autocorrelation in the first differences of the idiosyncratic disturbance term. 'Hansen' corresponds to the Hansen J statistic and 'Hansen-df' indicates the number of degrees of freedom of the Hansen test of overidentifying restrictions. The fixed-effects are at the firm level. Robust standard-errors in parenthesis (clustered by firm). Significance levels: 1%, ***; 5%, **; 10%, *. For the AR(.) and Hansen statistics we only report the statistical significance. All models include time dummies (always jointly statistically significant). The models are estimated for three samples, panels A, B and C, respectively. Panel A corresponds to the full sample, in Panel B we drop observations if ratio $<$ 0.01 or $>$ 100, while in Panel C we drop observations if ratio $<$ 0.01 or $>$ 100 and keep just the firms that are in all periods. See Section 3.2 for a description of the data and Section 4 for a discussion on the estimation strategy. *Source*: Own computations.