

Access to foreign and domestic markets

Access to foreign and domestic markets can provide innovative businesses with learning opportunities and with products and services that support their innovation processes. Improved access to foreign markets may also increase the market size and the performance of innovative companies. Evidence confirms the positive effect of access to foreign and domestic markets on innovative firms. Yet the degree to which markets are open differs across countries. Access to foreign and domestic markets can be facilitated by migrants. Access to finance and business support infrastructure are often critical in accessing foreign markets. Several policies, including reducing tariff and non-tariff barriers and providing support to enter foreign markets, can help innovative businesses.

What is access to foreign and domestic markets?

Access to a market refers to the ease with which foreign firms can supply the market, either through trade (imports and exports) or through foreign direct investment (FDI). A variety of factors determines access to domestic and foreign markets, including most notably the following three that this node will focus on:

- **Tariff barriers**, which is taxation on foreign imports designed to raise their price and thus protect domestic industries.
- **Non-tariff barriers**, which includes all non-tariff barriers that restrict imports, such as import quotas, administrative entry procedures (e.g. bureaucratic delays at customs), standards for certain products and government interventions (e.g. in the form of subsidies to domestic firms).
- **Legal conditions** that limit or encourage foreign firms' entry and the immigration of potentially innovative entrepreneurs. Note: the effects of migration on innovative entrepreneurship are not covered in this node but in the node on Access to labour for innovative entrepreneurship (see [Access to labour for innovative entrepreneurship](#) [1]).

How does access to foreign and domestic markets affect innovative businesses?

- **Access to foreign markets** can support innovative businesses through **learning effects**:

→Foreign Direct Investment (FDI) may benefit innovative firms through technology and knowledge transfer, skills enhancement and enterprise **development through inter-firm linkages and spillover effects**. Foreign direct investment is often considered an efficient way to diffuse technology and better business methods to firms, and to contribute, thereby, to firms' expansion and international competitiveness

→**Imports** can also serve as a channel for **technology diffusion and as a foundation for domestic innovation** by allowing domestic firms to access foreign technologies. These foreign technologies may typically be used in the form of intermediate production inputs for domestic firms' product innovation, process innovation, marketing and organisational innovation.

→Improved **access to foreign markets** may help innovative companies **learn about market opportunities for new products**. Business activity in foreign markets helps firms understand trends in demand for products and services. It can improve a firm's **ability to reflect those demands in their products and services**. To access foreign markets, firms must learn to recognize demands in those markets and adjust their products and services to reflect them. This is particularly important for innovative companies since they must continually innovate and keep up with new technology in order to participate in the global value chain (OECD, 2008a).

- Better **access to foreign markets** increases the size of the market and encourages firms to simultaneously export and invest. These joint decisions generally lead to **increases in sales and productivity gains**. Access to foreign markets can also contribute to improving innovative **firms' performance** through **market diversification**. Access to foreign markets diversifies and expands markets. Market diversification is a useful tool, as it protects against excessive shocks to firms in a single market.
- **Access to the domestic market** contributes to intensifying competition, which can affect incentives for innovation (see [State of competition](#) [2]). Competition impacts innovative efforts, although this can work in two contrasting directions. On one hand, competitive pressure can serve as an incentive to improve efficiency and help a firm survive. On the other hand, competition reduces monopoly rents resulting from innovation and may thereby lessen the incentive to invest in innovation.

Evidence on the importance of access to foreign and domestic markets to the success of innovative businesses

Effects of exports on innovative businesses' success

Empirical literature shows positive effects on innovation resulting from improved access to foreign markets. For instance, Bustos (2011) finds that firms in sectors with higher tariff reductions abroad are more likely to enter the export market and to increase their spending on technology. Aw et al. (2011) find that export market expansion increases participation rates in exporting and R&D investment, both of which contribute to productivity improvement. In contrast, evidence of learning by exporting (i.e. access to foreign markets raising firms' productivity) is rather weak, although some evidence shows a significant effect (Damijian et al., 2008; Hahn and Park, 2009; Park et al., 2010).

Effects of imports on innovative businesses' success

Imports are found to be important for firms' innovative performance and growth. For example, Goldberg et al. (2010) provide evidence that declines in input tariffs resulted in the introduction of new products by Indian manufacturing firms (1989-1997). Fernandes and Paunov (2010), using Chilean manufacturing firm product data from 1997-2003, show that the competitive effects of imports drive innovation, reflected in product quality upgrading. In addition to product innovation, lower input tariffs improve other performance indicators, such as firm productivity. Accessing more advanced technologies in the form of intermediate input from abroad is shown to be all the more valuable for producers in developing and emerging economies, which face a substantial technology gap (Amiti and Konings, 2007).

Effects of foreign direct investment on innovative businesses' success

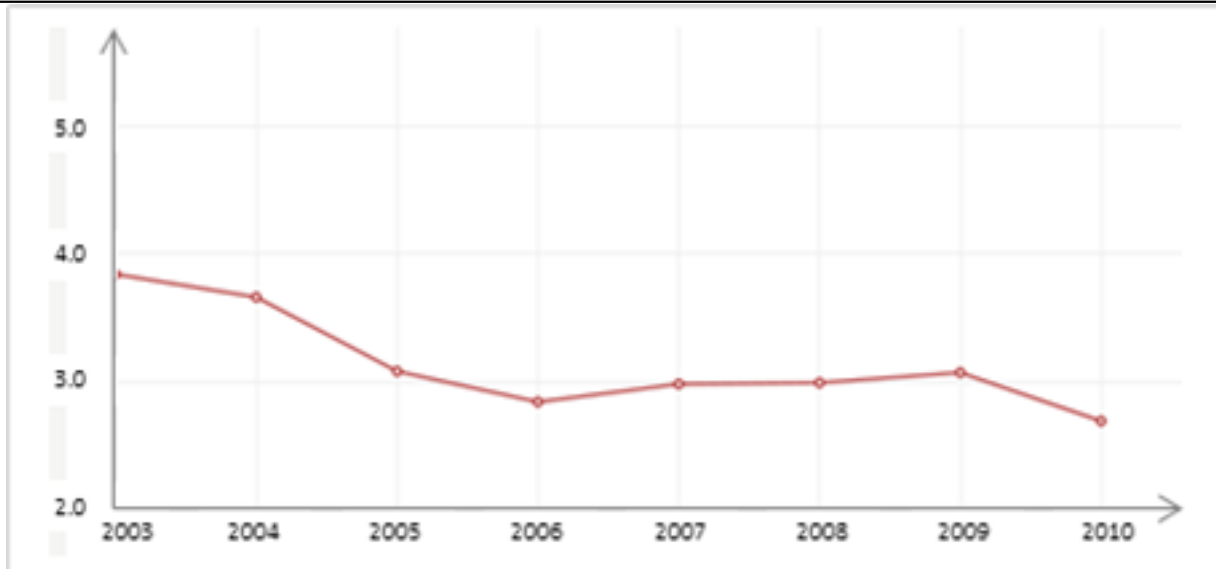
Evidence shows that inward foreign direct investments have generally a positive impact on domestic firm innovation, although the impact depends on multiple factors, such as the distance to the technology frontier and the type of FDI (vertical versus horizontal). For instance, Aghion et al. (2009)

find that the entry of foreign firms led to subsequent productivity growth and product innovations among incumbents in technologically advanced sectors in the United Kingdom in the late 1980s. However, the entry of foreign firms discouraged innovation in industries far from the technology frontier, suggesting that the threat of foreign entry reduces the incentive to innovate in those sectors by reducing incumbents' expected innovation rents. Kugler (2006) notes that vertical FDI have a larger potential for knowledge spillovers than horizontal FDI, since foreign suppliers are less concerned about knowledge leakages toward their domestic clients as they operate in different sectors and are not competitors. Overall, literature suggests that openness to trade and inward FDI may not suffice to support innovative firms. In the 1980s and 1990s, for instance, trade liberalization reforms in Latin American countries did not lead to expected growth (Easterly, 2001). At the same time, the use of diverse types of protectionism by emerging Asian economies has been considered to be critical to the development of their industries (Rodrik, 2011). Existing research suggests that firms in developing and emerging economies have often benefited little from knowledge spillovers from FDI for their own industries. Complementary policies seem necessary for generating the desired benefits (Chang et al., 2009).

What is the evidence on access to foreign and domestic markets and innovative businesses?

Tariff barriers are measured by the World Bank, which computes weighted mean applied tariff. Weighted mean applied tariff is the average of effectively applied rates weighted by the product import shares corresponding to each partner country. Data show a global reduction of these tariffs between 2003 and 2010 (Figure 1). The World Bank also assesses the accessibility of domestic markets by calculating import burden indicators. The import burden indicator is included in the Ease of Doing Business Index. It is the average of three measurements: i) the number of documents required to import goods, ii) the number of days necessary to comply with all procedures to import goods, and iii) the cost and fees levied on a 20-foot container. The cost measure does not include tariffs or trade taxes. Only the official cost required to import the goods is recorded (e.g. costs for documents, administrative fees for customs clearance and technical control). Data show that between 2009 and 2010, 33 economies reduced their barriers to trade and more than 100 economies improved trade procedures in the past 5 years by introducing electronic data interchange systems or by improving customs administration. Trading across borders has become faster and easier over the years. In 2010, it took on average 25.8 days to import goods (excluding maritime transport), compared to 30.9 days in 2006. In OECD high-income economies, import is even quicker and takes on average 11 days. But import burdens still vary substantially across countries, even across OECD countries (Figure 2). While the import burden is very low in Denmark, Korea and Sweden, it is much higher in some eastern European countries (World Bank, 2011).

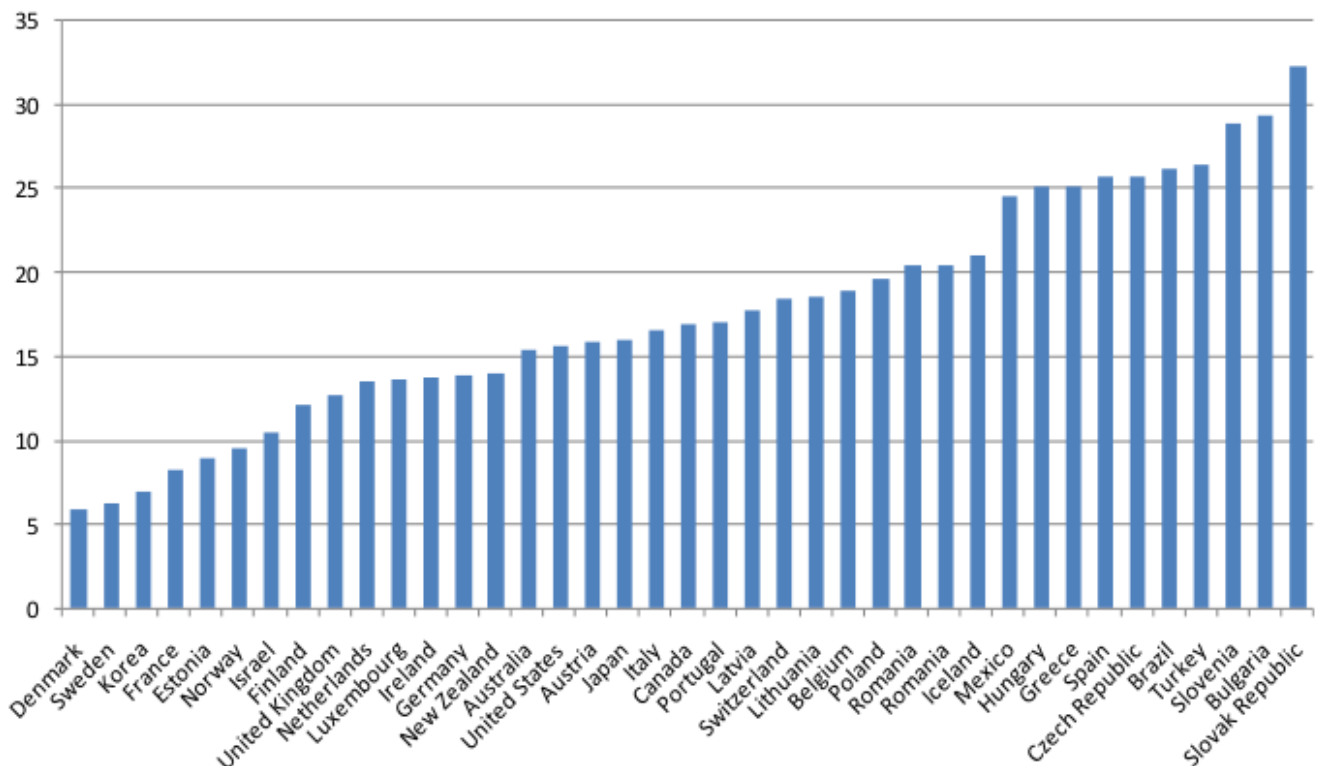
Figure 1: Tariff rate, applied, weighted mean, all products (%)
from 2003 to 2010 worldwide



World Bank staff estimates using the World Integrated Trade Solution system, based on data from United Nations Conference on Trade and Development's Trade Analysis and Information System (TRAINS) database and the World Trade Organization's (WTO) Integrated Data Base (IDB) and Consolidated Tariff Schedules (CTS) database.

Source: World Bank indicator available on <http://data.worldbank.org/indicator/TM.TAX.MRCH.WM.AR.ZS/countries?displ...> [3]

Figure 2. Import burden, 2009, scale from 1 to 100



Note: The scale reflects the average of i) number of documents, ii) time, and iii) cost to import a specific good

Source: World Bank, Doing Business 2009

Measures of non-tariff barriers are also computed by the Heritage Foundation and *The Wall Street Journal*, as part of the Index of Economic Freedom. The measure of non-tariff barriers uses both qualitative and quantitative information. It includes the evaluation of quantity restrictions, price restrictions (e.g. antidumping duties, countervailing duties), regulatory restrictions (e.g. licensing, safety and industrial standards regulations, packaging, and trademark regulations), investment restrictions, customs restrictions (e.g. advance deposit requirements) and direct government intervention (e.g. subsidies and other aid, government industrial policy and regional development measures, government-financed research and other technology policies, competition policies, immigration policies, government procurement policies).

What is the evidence on access to foreign and domestic markets and innovative businesses?

Evidence on tariff and non-tariff barriers

Tariff and non-tariff barriers have been significantly reduced in recent years. But they still remain substantial in some sectors despite the significant efforts made by governments in many forums, including the World Trade Organization (WTO), and through co-operation among regulatory authorities. For instance, technical regulations still work as important trade barriers in the pharmaceutical, chemical and ICT industries.

What other topics relate to access to foreign and domestic markets and innovative businesses?

Migration (see [Migration](#) [4]) can stimulate trade between migrants' countries of origin and host countries, by lowering trade transaction costs as a result of migrants' knowledge of both markets

and their contact networks in both countries.

Access to finance for innovative entrepreneurship (see [Access to finance for innovative entrepreneurship](#) [5]) and **Firms' access to finance for innovation** (see [Firms' access to finance for innovation](#) [6]). Lack of access to finance may prevent domestic innovative firms from expanding internationally, implementing what they have learned from foreign companies, products and markets, and drawing profits from knowledge spillovers. Access to finance can also be a challenge for foreign innovative ventures. Banks are often reluctant to lend to migrants, possibly due to the higher failure rate of migrant businesses compared with native businesses.

The business support infrastructure (see [Business support infrastructure](#) [7]) can provide a wide range of services to help innovative companies to internationalize, such as training for international businesses and information on foreign markets, laws and regulations.

What policies relate to access to foreign and domestic markets and innovative businesses?

Public policy can foster access to domestic and foreign markets by:

Reducing tariff and non-tariff barriers to provide firms with easier access to foreign advanced technologies, knowledge and markets. While there have been successive rounds of tariff reductions, unilateral tariff liberalisation initiatives and widespread regional trade agreements, substantial tariffs and non-tariff barriers still remain in several sectors.

Encouraging co-operation between regulatory authorities to harmonize national procedures. Differences in regulation and duplication of regulatory procedures among trading partners are potential impediments to trade. Co-operation schemes between regulatory authorities can help in mitigating the negative effects of these differences in regulation. In pharmaceuticals, for instance, co-operation schemes between regulatory authorities include a harmonization of procedures (e.g. safety testing procedures, inspection procedures) and standards, which aims at promoting trade of medicinal products.

Providing incentives to attract foreign firms' R&D and innovation. Countries increasingly compete to attract foreign firms' R&D and innovation activities, in order to benefit from the positive effect of inward FDI on domestic firms. Various measures have been adopted, which include introducing tax incentives, offering subsidies to cover the costs of setting up R&D centers and hiring researchers, removing requirements for ownership of resulting intellectual property, and changing the rules concerning the treatment of foreign firms in national R&D programs.

Facilitating knowledge spillover by providing supportive policy measures. Inward foreign direct investment is an important source of knowledge for domestic firms. Policies could foster such knowledge spillover by encouraging partnerships between foreign firms and local firms. This could be done by integrating inward investment policies and cluster policies, promoting corporate spin-offs from foreign direct investors, encouraging joint technology development involving foreign affiliates and local businesses, and improving the flow of information about potential local suppliers to potential purchasers in multi-national enterprises. More generally, domestic firms' ability to absorb and benefit from knowledge spillover depends on a wide range of policies that influence framework conditions (e.g. access to finance, supply of skilled workers capable of using foreign knowledge in innovation).

Providing specific support to innovative ventures that have the potential to succeed in foreign markets. Screening processes that identify domestic firms with a high potential to succeed in foreign markets can be an important way to improve policy efficiency.. Governments can then provide a wide range of services to help those ventures internationalize, such as training in conducting international businesses and supplying information on foreign markets, laws and regulations. Several types of financial support can also be useful, such as export insurance, loans and export credit guarantees, which are widely used to insure exporters against the risk of default by foreign customers.

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