response by the domestic government is less clear, because of the complexities in the market for intermediaries discussed earlier. As was noted, the case for governments providing firm-specific support to overcome issues of adverse selection and moral hazard in dealing with customers, partners, and suppliers in foreign markets is very weak. The possibility that foreign governments may be engaging in such activity does not change this.

Should we be concerned if foreign governments provide export or investment promotion services to help their firms get established in Canadian markets? If markets are competitive, the standard result is that there are both efficiency and distributional effects. An explicit or implicit foreign export subsidy lowers the costs of imports to Canada and increases aggregate Canadian purchasing power, but reduces real income of those who have strong ties to the affected import-competing sectors. A foreign investment promotion policy also has efficiency and distributional effects, but the distributional effects are different—domestic workers are likely to benefit from the increased demand for labour, whereas domestic capitalists may be hurt by increased competition from foreign-controlled firms. Since aggregate purchasing power increases in both cases, the efficiency grounds for responding are weak—the government could deal with the distributional effects of foreign promotion via other instruments (taxes and transfers). The issues here are similar to those in the literature on whether or not it is appropriate to use countervail laws to respond to foreign export subsidies.

If there is imperfect competition, the effects of foreign export subsidies are more complex and depend on market structure. The major issue here is analogous to the concern about predatory pricing—if the effect of foreign export promotion is to drive out a domestic firm that is making profits on domestic sales and to replace it with a foreign firm that makes those profits, then the welfare effect of foreign export promotion could be negative because of the profit-shifting effect. In this case, there are efficiency grounds for a response. But rather than providing an argument for retaliatory domestic promotion policies, the appropriate response would be to use countervail laws.