try argument for protection. In his model, foreigners gradually learn about the quality of domestic products produced by perfect competitors: foreign demand shifts out with experience in consuming the domestic good. Since all domestic firms are assumed to produce the same quality, there is an externality in that each firm under-invests in facilitating foreign learning. Mayer shows that this creates an argument for export promotion. In his framework, an export subsidy is the first best instrument—the distortion arises because of under-consumption of domestic goods by foreigners, and an export subsidy will target this distortion. However, other policies that promote exports are consistent with this framework: these would include government-subsidized advertising campaigns, government coordinated trade shows; and other creative policies that help to shift out the foreign demand for domestic goods in the relevant sector. In most cases, these programs need only be temporary, because once the national reputation for quality in the relevant industries is established, there is little return to further promotion.

For this argument to be valid, two key things are needed: learning by customers must shift the demand curve; and there must be spillovers across domestic producers. The need for learning restricts the class of industries—the argument would not apply to standardized goods sold on spot markets where quality is easy to assess (although there could be reputational issues affecting the ability of home firms to honour contracts, to be timely in their delivery, etc). The need for spillovers is important because, if the reputation and learning effects are specific to individual firms, then they can invest in their own reputations.

In the absence of spillover effects across firms, there can still be market failures arising from asymmetric information about product quality. However, in this case the policy implications are sensitive to the set-up of the model. Gròssman and Horn (1988) assume that individual firms can choose their own quality and can develop their own reputations. There are no reputational spillover effects across firms and consumers have rational expectations. Subsidies reduce welfare in this model because they allow the marginal (low quality) firm to enter, thus reducing the