in entering new markets—that is, the presence of trade-inhibiting costs creates incentives for the private sector to develop expertise to overcome them. However, if market failures or political failures contribute to trade costs, then there is a potential for policy to reduce these costs and to increase the flow of trade and investment.

Many governments operate export and/or investment promotion and assistance programs. Since trade agreements constrain government behaviour by placing restrictions on explicit and implicit export subsidies, these programs typically offer indirect support and broadly available information and logistical assistance, often coordinated through consulates. Although there is a small empirical literature that attempts to determine whether such programs are effective in increasing trade and investment, there has been relatively little work that addresses the question of whether such programs are justifiable at all.

This paper investigates the rationale for export and investment promotion programs. Although in the past there have been various motives for promoting trade and investment—ranging from mercantilism to building international alliances—I focus on market failures. I first ask whether there exist market failures that tend to systematically inhibit the flow of trade and investment; and then ask whether there is any reason to believe that government programs can address these market failures better than private sector responses. If these two criteria are satisfied, then I will argue that there may be a role for government to act to improve the functioning of the market by helping firms to overcome some of the barriers to trade and investment.

The literature in this area is recent, and still somewhat thin. Much research still needs to be done, and so the conclusions reached in the paper are tentative. I first briefly review the empirical evidence on trade costs. A variety of evidence suggests that sunk costs prevent many firms from becoming engaged in foreign markets, and that many of these costs are information related. I next review the theoretical literature relevant to information-related sunk costs, and private sector responses to these problems. Two sources of market failure underlie much of this