Is There a Case for Trade and Investment Promotion Policy?

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Abstract

Despite major reductions in tariffs and other policy-induced barriers to trade over the past 50 years, there is a great deal of evidence that substantial trade frictions between countries still exist. Whether government policies aimed at reducing trade and investment costs lead to welfare improvements depends on the source of the costs and the mechanism by which costs are reduced. This paper investigates the rationale for export and investment promotion programs, focusing on market failures. The tentative conclusions are that sunk costs prevent many firms from becoming engaged in foreign markets, and that many of these costs are information related, raising two potential sources of market failure—information spillovers (or externalities), and problems related to asymmetries of information. The market creates incentives for firms to respond to these problems in various ways. Theory and some limited empirical however suggest that these responses go only part way towards resolving the underlying problems establishing a market-failure based case for some government activity in the area of export and investment assistance and promotion. The types of activity that may help address market failures are discussed and the small empirical literature on the effectiveness of existing export promotion programs is examined.

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