are not providing frictionless services. However, because of the gaps in both the theoretical and empirical literature noted above, the case for government intervention to provide firm-specific services to assist engaging in foreign markets is very weak. Government activity may help some firms enter foreign markets, but it may also crowd out intermediaries who are assisting other firms to enter foreign markets. Figure 3 illustrates.

Suppose there are two intermediaries labelled 1 and 2, with declining average cost curves AC_1 and AC_2 respectively. Their services will be differentiated substitutes, so they will act as monopolistic competitors. The demands for their services are given by D_1 and D_2. These demand curves are interdependent, so a decline in the price charged by intermediary 1 will shift inwards the demand for the services of intermediary 2. Initially, suppose the price charged by intermediary 1 is p_o and the quantity of services provided is x_1^o. Intermediary 2 is also selling services since its demand D_2^o is high enough to cover its average costs.

Now suppose that the government starts providing the same services as intermediary 1 for free, but that the government is less efficient than the private sector provider—the government's average cost is AC_G. Because the government charges a price of 0 in this example, Intermediary 1 is driven out of the market by government provision. The lower price offered by the government will increase the amount of services provided to x_1^1, increase the producer surplus of firms using these services by area f+e in the diagram, and would increase the number of firms exporting. However, the cost of providing the government services is area a+b+g+d+e+f, which is greater than the increase in producer surplus. The net social loss in the market for type 1 services is therefore a+b+g+d. But this is not the only cost of the policy. Because the demand for the two types of intermediation services are interdependent, the demand for the services of intermediary 2 will shift in[7]. In the example illustrated, the new demand curve is D_2^1, which is below the average cost curve

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[7] For simplicity, I have assumed that the demand cure D_1 takes into account the effect of the price in market 1 on drawing customers away from market 2.