Market failure and government policy: Summary

The previous section identified several potential sources of market failure and, in each case, discussed some of the policy implications. In this section, I bring these different arguments together and summarize their implications for export and investment promotion policy.

Two main sources of market failure lie behind the case for government intervention in export or investment promotion: information spillovers and problems arising from asymmetries of information.

Information spillovers

Information spillovers are of three different types. First, there is a public good problem associated with general information regarding issues such as market opportunities, how to deal with the foreign regulatory process, or how distribution networks work. Because of the public good problem, such information may be underprovided in the market, and hence this is an argument for government involvement in information provision.

A second information spillover is generated by the demonstration effects arising from the actions of firms that attempt to begin exporting or investing in foreign markets. If there is uncertainty about what strategies will work and what markets will be successful venues for export or investment, then it is necessary for firms to experiment and try different strategies. Because firms will learn from the efforts of others, not all benefits of this activity will be internalized and hence theory predicts that too few firms will attempt to engage too few markets.

This second spillover problem cannot be resolved simply by having the government or intermediaries provide more information to firms—the information can only be generated if more firms try to export and invest in foreign countries. Hence the key policy objective would be to increase the incentives for firms to engage new markets. This type of spillover provides the basis for export and investment promotion activity that is specifically intended to encourage more firms to enter new