

pick winners, but that it has to restrict its help to firms trying to break into new markets. Those implementing the policy need to be willing to accept that some firms will succeed and some will fail. Support should target access to the foreign market—essentially to deal with sunk costs of exporting to or otherwise engaging in foreign markets. Long-term public support for production or exporting should not be provided.

What form should government support take? The simplest version of a theoretical model of this type argues for a start-up export or investment subsidy to help cover fixed costs of accessing foreign markets in industries where information spillovers matter. This is illustrated in Figure 2, which focuses on the case of exporters. Consider a variety of possible untapped export markets (different products or locations), and index them by n . Let $\pi^E(n)$ be the expected profits of a typical domestic firm entering market n , and let c denote the sunk costs of becoming an exporter in that market. Because there are information spillovers resulting from the exporting decision, the social benefits of entering a new market exceed the private benefits. Let $SMB^E(n)$ denote the social marginal benefits of entering market n . In the absence of government intervention, the equilibrium number of markets entered by domestic firms is n^* . This is less than the socially efficient number of markets, n_s . Because of the externality, a free market leads to an outcome with not enough exporting.

If the government offers a subsidy s to firms that begin exporting in new markets, then the equilibrium number of markets served by domestic exporters will increase to the socially efficient level, n_s . The cost to taxpayers of the subsidy is area $a+b+e$, but this is offset by an increase in producer surplus of $a+b$, and an increase in information spillover benefits of area $d+e$. The net social gain is d , which is positive. Subsidies to promote exporting into new markets are welfare-improving in the presence of information spillovers.