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Credibility and the Cost of Export Subsidies

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Abstract

Recurring balance of payments crises in countries that pursued import substitution have led some of them to establish a variety of export incentives, in particular subsidies, as a way to revive and re-orient their economies. However, exporters are likely to be uncertain of the government's commitment to export promotion because of the years of neglect. This paper analyzes the issue of the credibility of export subsidies and suggests that a government is able to convince exporters of its commitment only at a cost, which reduces the attractiveness of promoting exports by means of subsidies.

JEL Classification Numbers
C70, C72, F13

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Contents

Summary

This paper analyzes the cost of export subsidies when the commitment of the government to export promotion is uncertain. This situation can arise when the government in the past has neglected exports by pursuing import substitution policies.

Exporters, when facing a new export regime, are uncertain about the government's interest in promoting exports. A government that has low-export preferences has the incentive to trick exporters into investing more, in order to reduce the budgetary expense of its export promotion program. Exporters are naturally skeptical of a government that merely claims commitment to high-export levels, as it may prove to be a low-export government in disguise.

It is shown, that while a government that is committed to high level of exports will be able to reach its target, by signalling unequivocally its export preferences. This signal will consist of a higher export subsidy than would have been necessary had the export preferences known with certainty.

Illustrative simulations to determine the order of magnitude of the cost of achieving credibility suggest that the costs involved will range between 15-35 percent of total outlays of the export subsidy program--roughly 0.2-0.5 percent of GDP. These cost estimates are troublesome for a policy of export promotion via export subsidies. It may be preferable to stimulate exports by reducing the anti-export bias by other means rather than trying to offset the bias with subsidies.