OC13053

Export Subsidies and Least-Developed Countries: Entry-Deterrence Model under Complete and Incomplete Information

Kyoungwon Rhee
Department of Economics, Dongguk University, Seoul, Republic of Korea

and

Moonsung Kang
Division of International Studies, Korea University, Seoul, Republic of Korea

Abstract

This paper shows that export subsidies may be harmful when they are used to support a technologically inferior firm relative to the competing foreign firm in the exporting market. To explain this, we consider a three-period entry deterrence model, where, particularly, the firms producing a homogeneous good compete a la Bertrand if entry occurs. Under complete information, only a subsidy policy can deter entry. We also investigate if the 'no subsidy' policy can deter entry under incomplete information, where the government's policy on export subsidy is assumed to be unknown to the foreign firm. Following the Milgröm and Roberts (1982) model of limit pricing, in the separating equilibria, only the firm with a subsidy policy can deter entry. However, in the pooling equilibria, under a certain condition, even the firm without a subsidy policy can deter entry by setting the price which is different from its true monopoly price. The separating equilibria environment is preferred by the importing country than complete information due to the lower price.

Keywords: Export subsidies; least-developed countries; entry-deterrence model; WTO; strategic trade policy; trade and development; signalling model.

JEL Classification: F12; F13; L11; L12