3. The role of government policy in supporting large indigenous firms: theoretical rationales and case studies

In the following paragraph two main sets of problems and obstacles that justify state intervention are considered. The first set is related to those market failures caused by information asymmetries and information externalities which lead to under-investment in new activities. The second set is more related to problems of coordination and possibility of waste of resources. The static as well as the dynamic implications of these market failures must be taken into consideration.

Firstly, investments in new non-traditional industrial sectors are strictly limited by capital markets failures as well as the lack of firm internal financing resources and equity markets. Moreover, the market price mechanism «does not provide clear enough indication of the profitability of resources that do not actually exist (e.g. new skills and technology)».[37] These market failures are particularly pervasive in developing countries where new investments are perceived by private lenders as highly risky. The state can intervene in two ways. It can directly become a surrogate of the capital market through the provision of subsidies or venture-capital schemes which help new investors especially in sectors with high initial fixed cost. In addition, the state can promote savings accumulation and investments through creating and supporting/controlling financial institutions. The East Asian experience testifies how government intervention has driven the establishment of a 'system of flexible bank finance', as Joseph Stiglitz defines it, that promotes high saving ratios and introduces alternative forms of risk sharing through 'bailouts'.[38] Moreover, as Ha Joon Chang underlines, «state control of the financial sector has been critical [...] to influence private sector investment decisions and, more importantly, by giving it the power to discipline the non-performers».[39]

Secondly, the existence of informational externalities and problems of 'appropriability' in the innovation process drastically affect investments in new activities. Specifically, in the so-called process of 'self discovery',[40] firms invest many resources in order to discover new combinations of factors and proce-

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37 I. ul Haque, *Rethinking industrial policy*, UNCTAD Discussion Papers No. 183, 2007, p. 3.

38 J. Stiglitz, *From miracle to crisis to recovery* cit.

39 H.J. Chang, *Institutional foundations for effective design and implementation of trade and industrial policies in least developed countries*, in *The politics of trade and industrial policy in Africa: Forced consensus?*, Trenton, N.J., 2004, p. 144.

40 R. Hausmann and D. Rodrik, *Economic development as self-discovery*, «Journal of development economics», 2003, pp. 603-633.