Industrial Strategy and Public-Private Partnership under Severely Incomplete Information

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  - industrial strategy cannot be sector neutral

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- Consequence 2: informational asymmetry between private firm and government

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- Type 2 mistake: dropping a probable "loser" too late—a policy pitfall

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- The design of the incentive scheme needs to be robust to the (severe) information constraints

A Model Example—Subsidy of Innovation Project

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- The cost of investment is αk for (per period) investment $k \in [0, 1]$

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$$p(K, p_0) < p^* \triangleq \frac{\alpha}{\lambda (\Pi_F + \Pi_G)} < p^F$$

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  - government uses the max-min objective function to evaluate policy

Optimal Policy under the PPP

- Criterion under PPP: a project is dropped as a **"loser"** if and only if

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- The matching subsidy that can implement this criterion has

$$\phi^{**} = \frac{\frac{\Pi_G}{1+\gamma}}{\Pi_F + \frac{\Pi_G}{1+\gamma}}$$

or

$$\text{Cost share} = \text{Benefit share}$$

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- But, bad policies are not inevitable!