CENTRO DE ECONOMÍA APLICADA

Abstract

The cost of capital for infrastructure investments is significantly higher under a public-private partnership (PPP) than under public provision. We argue that this cost differential should not be held against PPPs when choosing between public provision and PPPs, for two reasons. First, the observed PPP premium may reflect poor contract design. Second, lower costs of capital may be the flip side of efficiency gains attained under a PPP, gains that outweigh the cost differential. We formalize both insights in a simple model that allows for exogenous and endogenous risk (moral hazard) and derive an auction with realistic informational requirements that implements the optimal contract.