Abstract:

Public projects typically generate both monetary revenue and social benefits that cannot be monetized. Anticipated revenues from government-owned projects increase the likelihood that the government will be able to repay its debt and thus improve its credit rating and lower the financing costs of the debt. This should give monetary revenue an added value relative to social benefits. However, informational problems -- dynamic inconsistency and adverse selection -- push the government to an excessive emphasis on social benefits, ignoring the external effect of monetary revenue on debtholders. Since the credit market anticipates this, the government's credit rating is adversely affected and it is thus unable to extract the full potential of the projects. Finally, we show that while privatization can sometimes alleviate these problems, there are cases in which the government would be better off if its hands were tied and it were not allowed to privatize.