“Institutional Economics and the Cost of Capital”

Monday, October 28, 2019
12:00–1:00 PM • Ostrom Workshop, 513 N. Park

There is robust academic debate on the relative cost of capital of public and private equity providers for infrastructure projects. Arrow and Lind’s influential 1970 article concluded that the social cost of public-sector provided capital is lower than that of private capital because risk is more efficiently spread across numerous taxpayers than across relatively concentrated private investors. Jensen and Meckling, however, studied the agency costs that arise as a consequence of increased separation between equity holders and managers. Those two countervailing forces—risk spreading and agency costs—are critical in determining the cost of capital. We analyze various differences in the nature of residual claims in the public and private sectors, and study their potential effects on the relative social cost of capital. Our analysis suggests that Arrow and Lind’s conclusions may not be as instructive in determining the public sector’s cost of capital as is often thought.