# Government Outsourcing:

## Public Contracting with Private Monopoly

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January 8th 2006

**Abstract:** The paper studies the impact of government budget constraint in a pure adverse selection problem of monopoly regulation. The government maximizes total surplus but incurs some cost of public funds à la Laffont and Tirole (1993). An alternative to regulation is proposed in which firms are free to enter the market and to choose their price and output levels. However the government can contract ex-post with the private firms. This ex-post contracting set-up allows more flexibility than traditional regulation where governments commits to both investment and operation cash-flows. This is especially relevant in case of high technological uncertainties.

**Keywords:** Privatization, soft-budget contraint, adverse selection, regulation, natural monopoly.

**JEL Classification:** L43, L51, D82, L33.

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