



Understanding pre-contractual transaction costs for Public–Private Partnership infrastructure projects

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Abstract

While public entities are still increasingly interested in Public–Private Partnerships (PPPs), we recently observe increasing reluctance from private partners to engage in PPP-bidding. Up-front costs that PPP bidders make, are considered too high compared to the bidding chances, and may result in less bidders in the future. In this paper, we empirically analyze transaction costs of PPPs in the pre-contractual stage and compare these to similar costs borne by private partners for traditional public procurement. Statistical analyses based on sample of 172 public infrastructure projects enable the estimation of the pre-contractual cost burden. Based on the study results, suggestions are made to lower these costs or to improve the cost position of the private sector, in order to safeguard the competitive setting of the PPP market.

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1. Introduction

Literature on Public–Private Partnerships (PPPs) from the perspective of both political/social science (e.g., Hodge and Greve, 2007) and economical/technical engineering (e.g., Iossa and Martimort, in press) have tackled most key economic and financial issues (see the Kwak et al. (2009) and Tang et al. (2010) for an overview). Most notably, the theoretical analysis of why and under what conditions PPPs are to be preferential to Traditional Public Procurement (TPPs) has been established in the framework of the theory of incomplete contracts (e.g., De Bettignies and Ross, 2010; Hart, 2003). Together with an increasing number of PPP projects in operation, numerous evaluation studies (see Hodge and Greve, 2009 for an overview) and reviews (e.g., Hodge and Greve, 2007; Kwak et al., 2009) have tried to quantify and assess the cost savings and value for money that can be achieved through PPPs (for an overview see Hodge and Greve, 2009).

However, these reviews demonstrate that one issue has not received much attention so far in evaluating procurement methods of public infrastructure projects: transaction costs. Coulson (2008) and Boardman and Vining (2010), for instance, note that evaluations are mainly based on production costs and neglect the impact of both external costs and transaction costs. Transaction costs, in the PPP context, refer to the costs of establishing and maintaining a partnership; more specifically, Dudkin and Väililä (2005) and Soliño and Gago de Santos (2010) indicate that they encompass legal, financial, and technical advisory costs incurred by both public and private sectors in the procurement and operational phases of a project. The importance of quantifying the transaction costs of PPPs is attributed to their eroding characteristics of potential cost savings. Experts (e.g., Dudkin and Väililä, 2005; Grimsey and Lewis, 2007) and academics (e.g., Chan et al., 2010a, 2010b; Siemiatycki and Farooqi, 2012; Trangkanont and Charoenngam, 2014) warn that apart from their direct negative impact on the financial and economic viability of the project, the high cost of bidding constitutes an obvious hurdle for potential bidders to enter the bidding process. This, in turn, undermines the power of ex-ante competition, which is at least in some infrastructure and public service sectors the only form of

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