

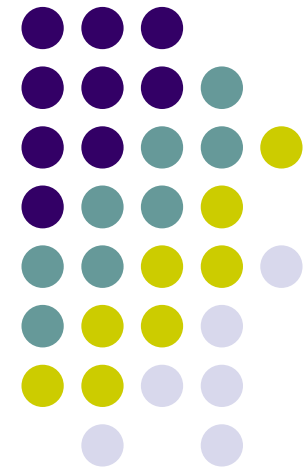
Public Procurement as Auction.

Theoretical Models and Practical Problems

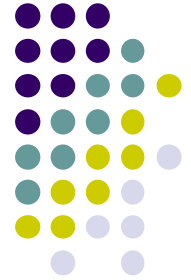
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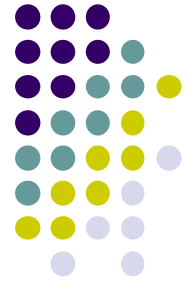


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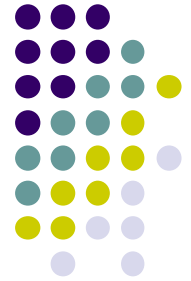
- How can we apply the findings of auction theory to model public procurement?
- Choosing the optimal type of procedure
- Withdrawal from contracts

Auction theory



- Selling an item: price discriminating monopolist, limited information
- Procurement: reverse situation, one buyer chooses from several sellers
- Literature on selling is more extensive, although its results cannot be applied to procurement without restrictions

Auctions in practice - problems



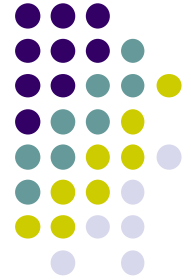
- collusion
- sufficient number of bidders (no obvious winner, e.g. the incumbent)
- reservation price too low
- „political” problems – sealed-bid auction not attractive to bidders, second-price to the seller
- withdrawing a bid
- several small packages to sell or a big one

Public procurement in practice



- Total value of public procurement in Hungary is steadily increasing (5-10% of GDP)
- Tátrai (2009) survey on the practice of public procurement:
 - Tricks to avoid public procurement, no close control
 - Rules and procedures too complicated
 - Remedies are frequent but unpredictable
 - Remedies make procedures longer and more expensive
 - Negotiations are rarely permitted

Public procurement – problems



- Choice of optimal procedure – when should negotiations be permitted, what procedures should be offered to choose from? (Excluding negotiations does not exclude potential corruption.)
- Withdrawal from contracts (as means of collusion) – how to avoid it?

Choice of optimal procedure – auctions or negotiations?



- Simple first-price auction induces lowest possible quality bids
→ the buyer is required to make the tender very exact
- Che (1993): „multidimensional auctions”, including several properties like quality – results can be manipulated
- Huh – Park (2010): combined procedure (auction followed by negotiations)
- Empirical results: in the private sector, the more important the quality, the less likely are auctions to be used

Policy implications: it would be socially desirable to give more freedom to buyers in the choice of procedures.



Withdrawal from contract

- Legal viewpoint: long procedure → unexpected events („unavoidable reasons”) → possibility to withdraw
- Potential for collusion/manipulation
- Indeed a breach of contract – when should a contract be enforced or terminated?
- If performance is impossible, when should the promiser be liable for damages? Who should bear the risk of unforeseen events? – lower-cost risk-bearer (expected damage + insurance)

Policy implications : Public procurement procedures should not allow parties to withdraw free of charge!
Making withdrawal costly would also reduce the possibility of collusion.

Thank you!

