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Accounting for transaction costs in planning policy evaluation

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ABSTRACT

The costs incurred in the design and implementation of planning policy instruments are not always considered sufficiently. In order to increase the efficacy of planning policy instruments, these transaction costs need to be taken into account. While such transaction costs are expected to vary according to their institutional design and arrangements, up to now there has been no systematic research concerned with how planners should consider transaction costs, and other institutional aspects, as evaluation criteria in planning policy analysis. This paper investigates how, and in which stages, these costs can be included in planning policy design and analysis. Using the literature of transaction costs and new institutional economics, this paper proposes a framework for integrating these costs into evaluating planning policy instruments. This framework consists of different factors that influence transaction costs in designing and implementing a planning policy instrument. Although some researchers have discussed the influence of factors concerning the characteristics of transactions and transactors, there has been limited consideration of the importance of factors related to the characteristics of a policy. This paper argues that policy characteristics, such as, simplicity, age of the policy, precision of the policy, policy approach, public involvement and participation, and policy credibility and consistency, can affect transaction costs in any policy. Therefore, the paper concludes that, in addition to transaction and transactor characteristics, a 'policy characteristics' category should be included to emphasise the importance of policy selection and design in transaction costs of a planning policy instrument.

1. Introduction

It has been argued that there is limited focus in the planning literature concerning what constitutes a good policy or plan. As Alexander and Faludi (1989, p.127) opine, "if planning is to have any credibility as a discipline or a profession, evaluation criteria must enable a real judgment of planning effectiveness: good planning must be distinguishable from bad." Otherwise, it seems that Baer's (1997, p.329) analogy on comparing plans and arts in answering the question "how would you know a good art [plan], if you saw one?" would be valid. He discusses that without evaluation criteria, the apocryphal answer to these questions are the same and would be "I don't know much about arts [plans], but I know what I like." In fact, it is inevitable for planners to answer to these fundamental and normative questions: what is a good policy and what makes it good? Baer (1997) argues that planners sometimes merely rely on some value judgments which tend to be vague and subjective. They may avoid providing an answer, and instead focus on the methods and process of plan making. However, planners are required to develop a set of criteria which enable them to decrease the level of subjectivity in the evaluation process (Lichfield, 2001b; Alexander and Faludi, 1989; Oliveira and Pinho, 2010; Laurian et al., 2010; Seasons, 2003). Without these criteria, any judgment planners make cannot be properly justified and validated (Shahab et al., 2017a). On the other hand, using proper criteria, policy analysts would be able to judge the quality of the policy, and more importantly what the outcomes of a policy are. Also, these criteria provide planners with a framework for systematic evaluation which includes some indicators and measurements to assess the success of a policy. Planners can specify and clarify what the important policy goals are, how they could be measured, what would be the rules for comparing policies and which one should be chosen.

Different policy evaluation criteria are suggested by economists, and policy makers (European Commission, 2008; Oliveira and Pinho, 2009; Talen, 1997; Shahab et al., 2017a). Among those, two fundamental criteria of efficiency and equity, presented by welfare economics theory, are frequently used by policy analysts. Efficiency is associated with maximisation of the result and minimisation of the waste, whereas equity concerns distribution of the resources, goods, and services among individuals. In other words, while efficiency concerns the size of the pie, equity addresses shares or slices of the pie among people and

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groups. One of the factors that influences these two criteria is 'transaction costs'. Welfare economics, however, does not pay sufficient attention to transaction costs, and other institutional aspects, in policy design and analysis (Adams et al., 2008). This is one of the main criticisms which new institutional economists make. They argue that transaction costs should be considered in policy design and analysis. High levels of transaction costs associated with implementing a policy can decrease the efficiency of the policy. According to Rørstad et al. (2007), the costs of managing a policy can have the same importance for efficiency as those of producing goods and services. Transaction costs can be considered as deadweight losses, which reduce efficiency (Buitelaar, 2004). On the other hand, transaction costs are usually not distributed equally among the parties involved in an implemented policy (Coggan et al., 2013a). In addition, these costs vary over the life cycle of the policy. Therefore, the level and distribution of transaction costs might have a considerable effect on the efficiency and equity of the policy. In other words, through decreasing transaction costs, planning policy instruments can be designed and implemented in a more efficient and equitable manner. While many researchers acknowledge the importance of transaction costs in explaining policy outcomes (Moxey et al., 1999; Latacz-Lohmann and Van Der Hamsvoort, 1998), there has been little analysis on how to include transaction costs and other institutional aspects as evaluation criteria in planning policy design and analysis in practice. According to Falconer and Saunders (2002), omitting transaction costs from policy design and analysis might lead to the design and implementation of sub-optimal schemes and policies.

The goals of this paper are; firstly, to highlight the importance of taking account of transaction costs, as well as other institutional aspects, as evaluation criteria in planning policy design and analysis, aiming to increase the efficacy of policy instruments; secondly, to propose a framework whereby planners can incorporate transaction costs in their policy design and analysis. To this end, firstly we discuss, in general terms, the intersection of transaction costs, planning and policy analysis, before giving particular consideration to how planning can benefit from the extensive literature on Transaction Cost Economics (TCE). This paper also investigates when, and in what stages, transaction costs can be included in planning policy design and analysis. Finally, through proposing a framework, this paper aims to present how to take transaction costs into account when evaluating planning policy instruments. The use of the proposed framework advances the ability of planners to evaluate and compare planning policy instruments through the lens of TCE, in order to enhance their efficiency and equity.

2. Transaction costs, planning and policy analysis

There has been an increasing use of the term 'institution' in social sciences over the last few decades. According to North (1990), institutions are the 'rules of the game' and they 'reduce uncertainty by providing a structure to everyday life.' The focus on institutions has its roots in Coase's (1937) seminal paper 'The Nature of the Firm' and has shaped a branch in economics coined as New Institutional Economics (NIE) by Oliver Williamson (Coase, 1998). As an 'interdisciplinary' field, the NIE aims to understand and explain what institutions are, how they are created, what their purposes are, how they alter, and how they should be reformed (Klein, 1998). Transaction costs are one of the central concepts and significant contributions in NIE. The principle that institutions and institutional arrangements should be created, changed, or used to minimise the transaction costs of production and exchange process is at the heart of NIE (Coase, 1937; Williamson, 1985; North, 1990). The emphasis of NIE on transaction costs helps inform how institutions are devised or shaped in order to eliminate or minimise these frictions and uncertainties that together create transaction costs (Adams et al., 2008).

According to Williamson (1998), the transaction is the 'basic unit of analysis' in TCE. He defines a transaction as a transfer of property rights regarding goods or services (Williamson, 1996). Similarly, Buitelaar (2007, p.24) refers to a transaction "as a legal action to increase (or take) control over property rights." The transfer of property rights might occur partially (e.g. in the case of Transferable Development Rights (TDR) programs, in which only the right to develop is subject to transfer) or completely (e.g. in the case of compulsory purchase or eminent domain that requires the transfer of all 'bundles of rights'). Other than goods and services, the transfer of information, knowledge, and ideas can also be considered as a transaction. Transactions differ in terms of their own attributes, as well as the characteristics of agents involved in a transaction, which will be discussed in the following sections. Public policies and their associated processes are usually associated with high levels of transaction costs (McCann, 2013; Falconer, 2002). From the perspective of TCE, the activities associated with public policies can be conceived as a series of transactions. For example, a Compulsory Purchase Order (CPO) can be broken up into a series of transactions, such as, *inter alia*, information collection, public meetings, making objections, valuations, and claiming compensation. The involvement in such transactions creates transaction costs. There is no consensus among new institutional economists regarding the definition of transaction costs (Dollery, 2001). However, they are often defined as costs involved in transactions, other than the sale price. In other words, all the costs that are not directly related to the production of a product (Nilsson and Sundqvist, 2007; Webster and Lai, 2003). This paper will use a more comprehensive definition of transaction costs, presented by Marshall (2013, p.188), "transaction costs are the costs of the resources used to: define, establish, maintain, use and change institutions and organisations; and define the problems that these institutions and organisations are intended to solve."

Although the concept of transaction costs is not new, its introduction into planning literature is much more recent. This concept was introduced into planning theory for the first time by Alexander in his paper 'A Transaction Cost Theory of Planning' in 1992. Alexander (1992) argues that planning can be considered as a process of co-ordination through the lens of TCE or NIE. It is believed that organisational structure is an important part of co-ordination. Therefore, institutional design is an integral step and a necessary supplement to co-ordinate planning processes. He explains that if an agent or organisation aims to implement some strategies and fulfil some objectives, it has to plan its execution in detail, including interaction with other agents that may have different interests. This argument is also in line with Lai's (2005, p.11) explanation of urban planning defined as "an institutionalised control of spatial manifestations of human activities." Lai discusses that planning, as a state institution, is a development rationing mechanism. Planners are involved with the collection and interpretation of information in order to manage development. Institutions or institutional arrangements, as outcomes of public decisions, help planners to reduce the transaction costs. However, designing institutions in planning is an ever-changing process, in which an institution will be replaced by a more efficient option, if it fails to reduce the transaction costs (Lai, 2005; North, 1990).

Since the introduction of transaction costs into planning literature, some researchers have attempted to view planning theory and practice from the perspective of TCE. For example, Lai and Tang (2016) analyse institutional barriers to the redevelopment of urban villages in China by employing TCE. Aiming to analyse the process of farmland conversion, Tan et al. (2012) consider the process as series of transactions. Likewise, Cho (2011) discusses how the housing redevelopment process involves various identifiable transactions, which he analyses in a Korean context. Using TCE, Buitelaar (2004), proposes a framework for comparing institutional arrangements in co-ordinating the land development process. Needham and de Kam (2004), on the other hand, explore how land is exchanged by highlighting the co-ordination between suppliers and demanders through the perspectives of TCE.

Despite increasing studies on transaction costs, and other institutional aspects, in the planning literature (Kauko, 2012; Buitelaar, 2007; Staley, 2001; Dawkins, 2000; Jaffe, 1996), there is little literature