Self-enforcing subcontractors in the construction industry – why not?

Johan Nyström, VTI

Most transport infrastructure is funded by the tax payers. Clients are public agencies or organisations regulated by public procurement legislation. This legislation entails that contractual relationships cannot be infinite but has to be exposed to competition for each project. Hence, past performance cannot alone be decisive in receiving a contract for a new public project. This is an important difference between public procurement and the private market. A private client is not restricted to formally renew the contract for each project. If the contractor has done a good job, the private client can prolong the relationship without putting the next assignment out for all contractors to bid on. Not using the direct market tool (i.e. formal bidding) but instead relying on the incentives from future work is often described as a *self-enforcing contract*. However, this mechanism is not applicable for the public client, due to public procurement. In order to investigate the extent of self-enforcing on the infrastructure construction market, this paper focuses on the relationship between main- and subcontractors. A multifaceted set of data from interviews, contracting documents and questionnaires reveals that main-subcontractor relationships often can be characterised as one-off projects, with the main contractor letting the subcontractors compete in prices for each new project. Evaluating subcontractors past performance and the power of long-term self-enforcing contracts are underrepresented in the material. This finding contradicts theoretical implications that long-term self-enforcing contracts are common in the private construction market. The paper goes on explaining this contradiction, providing general arguments adding to standard contract theory with specific explanations from the constructions industry.