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Transaction costs, relational contracting and public private partnerships: a case study of UK defence

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Abstract

This paper is concerned with the economics of public private partnerships (PPPs)/private finance initiative (PFIs) and in particular the role of transaction costs and the importance of trust in relational contracting. The discussion is illustrated by reference to the UK defence sector. The paper begins by discussing the nature of PPPs/PFIs before moving on to consider how the economics of contracting literature can shed light on their strengths and weaknesses. The transaction cost literature is reviewed alongside a resource-based perspective of procurement decisions. The concepts of trust and reputation are then considered in the context of minimising procurement transaction costs. The theoretical framework developed is then applied and illustrated through a case study of UK defence contracting, in an attempt to assess whether the use of PPPs will necessarily lead to improved economic efficiency. The case study highlights both the

scope of PPPs/PFIs and their potential transaction costs in defence procurement, with the normal perils in terms of contracting given information asymmetry, asset specificity and the resulting scope for opportunistic behaviour.



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Keywords

Public private partnerships; Private finance initiative; Procurement; Trust; Supply chain; Defence contracting

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