PUBLIC-PRIVATE PARTNERSHIPS IN DEFENSE PROJECT: EXPERIENCE AND REFERENCE

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Abstract: *Public-Private Partnerships (PPPs) are gaining popularity in defense since 1990s. Practice of defense PPPs in many countries have resulted encouraging outcomes, including releasing budget constraints, saving capitals and mitigating project risks. The PLA is building a modern logistics system and integrating the development of military and civilian sectors to improve supporting efficiency and effectiveness. Defense PPPs can be incorporated into this reform and serve as a spur.*

Keywords: *PPPs, private sector, defense project*

1. INTRODUCTION

Although public and private sectors has a long history of providing public services and goods in wide ranges, the cooperation between the two in defense areas gains popularity only in the recent one or two decades. Since it is initially introduced into defense area in UK in 1990s during the campaign of New Public Management, Public-Private Partnerships (PPPs) in defense, due to its distinct advantage in reallocating risks and promoting project performance, has gained great recognition, and from then on it has been put into the practices of defense procurement in main developed countries, such as UK, Australia, US and Singapore. This paper tries to trace the path of PPPs evolution and explain what Public-Private Partnerships (PPPs) is and why PPPs becomes so popular in defense procurement?

According to OECD definition (2008, p.17.), PPP is "an agreement between government and one or more private partners (which include the operators and finances) according to which the private partner provide the service in such a way that the service delivery objectives of the government are aligned with the profit objectives of the private partners and where the effectiveness of the alignment depends on a sufficient transfer of risk to the private partnership".

Generally PPPs are "situated between traditional procurement and full privatization" (2008, p.21.). That is to say, PPPs is an alternative of traditional procurement to help defense departments to "get better and cheaper weapons faster, and to work more effectively" (UK MOD, 1999).

In the past, PPPs are most commonly noted in other public-utility constructions, especially those infrastructures projects, such as transportation sectors(i.e., bridges, roads, highways, railways and airports), water and waste managing utilities, and buildings concern public welfare(i.e., hospitals, parks, schools). After been introduced into these non-defense areas, public-use facilities amounting to approximately 887 billion US dollars have been successfully delivered by private contractors globally, as statistics show (AECOM, 2005). Since 1996, more than 63 defense PPPs deals have been innovative signed by UK, MOD, involving accommodation, training, equipment, infrastructure, and these contracts amount as high as 10.08 billion pounds [1].

There are two invisible hands pushing defense PPPs forward in UK and around the world. On one side, main countries need to put more into defense area to improve national security and maintain stable.

After the "cold-war" especially in the "post-911" era, the world is undergoing tremendous changes and adjustments.

Global challenges are continually on the increase, and new security threats keep emerging. For one thing, struggles for strategic resources, strategic locations and strategic dominance have intensified.

For another, non-traditional security issues such as terrorism, environmental disasters, climate change, serious epidemics, transnational crime and pirates are becoming increasingly prominent[1].

In such a world with uncertainty, governments have a strong imperative to consistently promote its national by enlarging defense expenditure.

World annual defense expenditure reached 1,000 billion in 2006 for the first time after "cold-war", and keeps amounting up.

On the other side, to constraint financial deficits, a huge amount of defense budget cannot always get approved by parliament.

Certain important projects if they are not critical important, would be commonly curtailed to some kind of degree.

2. MAIN CHARACTERISTICS OF PPPs

While PPPs provide a normal form for public departments and private sectors to cooperate on public-use projects and gain a growing popularity around the world, defense PPPs seem lag behind.

With no standard definition of PPPs, different countries, departments and stakeholders interpret PPPs in varying ways. In summarization, there are some key characteristics help us to distinguish PPPs from traditional procurement and privatization (or outsourcing).

2.1 Providing financial flexibility. In traditional defense procurements, many projects are canceled or delayed due to financial constraints and budget disciplines.

However, the flexibility provided by PPPs erodes the public budget constraints by allowing more and more defense construction and procurement to be undertaken through private financing. PPPs tools such as Private Finance Initiative (PFI) could be feasible only when "they can offer the potential to achieve greater value for money[2] than could be achieved under more traditional ways of doing business, while improving or sustaining front-line capability" (UK MOD, 2001).

As an alternative defense project financing options, PPPs work better only when those projects are large enough in scale and provide relatively stable revenues for private investors.

2.2 Optimizing project risks allocation. Besides saving capitals, there are more prominent characteristics in PPPs.

The PPPs mode emphases an optimal transfer of project risks to the party that best able to manage them with least cost, faster completion and improved quality.

There are different levels of risks in a defense project, and the private partners are proficient in dealing with market level risks but obviously noncompetitive in handling risks of state level.

Proper project risk-sharing is one of the pillars for successful PPPs mode, and there are diverse modes of PPPs for delivering services and goods.

By properly reallocating project risks and liberating the armed forces from non-core competence building, private contractors enable the armed forces to focus on mission-critical activities (or combat capabilities)[2].

"Through PPPs, the public sector seeks to bring together the expertise and resources of the public and private sectors to provide services to the public at the best value for money" (Singapore Ministry of Finance, 2009(b)).

2.3 Using quantitative measuring tools. To ensure efficiency and effectiveness of PPPs projects, some countries have developed quantitative measuring tools.

1 http://www.china.org.cn/government/central_government/2009-01/20/content_17155577.htm

2 The optimum combination of whole-of-life costs and quality of the goods or service to meet the users' requirement.

In fact, the MOD, UK, has first developed an economic tool called the Public Sector Comparator (PSC) in order to better compare the value gained in the transfer of risk and determine whether traditional procurement or PPPs is the better choice. As the most prominent quantitative measuring tools, the public sector comparator (PSC) is widely used in UK, Australian and Singapore. In such an assessment, PSC would calculate the in-house implementation of the defense project as a benchmark, and then compare with the total cost completing the same project using a PPP mode. Besides, competitive bidding is also applied in some cases as a means to find the suitable private contractor [3].

2.4 Availability and usage based payments. There are basically two main kinds of application of PPPs, the Design-Build-Operate (or COGO) and Build-Own-Operate model (or COCO). The difference lies that in the COCO model the private sector retains the ownership, and the COGO model allows for public ownership while utilizing private financing. PPPs contract is a set of property exchange, in which the public sector impart the right of building, operating and managing of the projects to private sectors, while the private sectors contribute capital and management expertise to provide service or goods to defense departments[4]. As a typical defense PPPs contract could last as long as more than 20 years, to mitigate managing risks, defense departments and private sectors would set up a long term contracts, which detail that unless qualified service or goods are supplied, can private sector achieve payments.

3. PLA's ACHIEVEMENT IN COOPERATING WITH PRIVATE SECTORS

In a wide range of scopes, the PLA is still responsible for providing all the goods and services directly, and thus it has to processes all necessary resources. In a PLA traditional equipment or service procurement, the defense department has to take responsibilities for the whole risks and responsibility in the entire spectrum of acquisition activities.

Even if there are private partner, however, these private contractors are only partially involved into the project, and assume corresponding responsibility in limited cases.

The New Public Management (NPM), which emphasize on market orientation, has clearly exerted certain influence on the PLA.

To further improve operational effectiveness, the PLA has greatly improved its traditional procurements, partially switching from self-sufficiency to market supply.

In fact, the PLA has already selected a market oriented path for logistics reforming. In order to enhance its logistical support capabilities for diversified military tasks, the PLA is working on a multilateral approach to build a modern logistics system by speeding up the process of outsourcing services, managing its logistical support systems in a more scientific way.

In December 2007 the CMC promulgated the Outline for Building a Modern Logistics System, specifying the guidelines, principles, objectives and tasks for the development of modern logistics.

Aiming at enhancing the cost-effectiveness of logistical support, the PLA vigorously promotes outsourcing in logistical support method to build a modern logistics system.

To speed up this outsourcing process, the PLA outsources the commercial and housing services of combat units stationed in large- and medium-sized cities, general-purpose materials storage, capital construction, logistical equipment production and logistical technical services. Also, the PLA try to promote diversity in investors in defense-related enterprises. In 2010, the Ministry of Industry and Information Technology and the PLA's General Armaments Department jointly issued the Implementation Measures for the Licensing of Weaponry and Equipment Research and Production to further encourage different types of economic bodies to participate in the defense scientific research and production of weaponry and equipment. The 18th National Congress of CPP made it clear that the PLA will continue to follow a Chinese-style path that integrate the development of military and civilian sectors[5,6].

Pushed forward by these driving factors, it would be reasonable to deduct that it is worthwhile to incorporate the PPPs mode into the procedure of building a modern logistics system. However, there are multiple obstacles needed to be overcome prior to the acceptance of PPPs. For example, as the defense department is obligated to provide public security, whether PPPs projects deliver value for money should not only rely on financial balance and revenue only, but more importantly, also on whether projects risks can be managed more effectively . The fact is few come into realization.

4. RECOMMENDATION ON PROMOTING PPPs IN PLA DEFENSE PROJECTS

The concept of civil –military integration is nothing new. UK defense PPPs continue to gain momentum since the first PPPs contract was signed in 1996, which is mainly about providing combating vehicles to MOD.

And since then different types of privatization have been introduced into China, such as outsourcing, contracting out and marketization. But in PLA, there are more tough works waiting to be done for the innovative uses of defense PPPs.

4.1. Overcome certain budget constraints. Traditional defense procurement style is fully funded, which requires a large portion of capital to be tied up early in a project's life cycle.

In the near future, it seems PLA will still not suffer from capital shortage, but with the costs of cut-edge technology and infrastructure keeps climbing, PPPs continually remains as an appealing financing approach apart from traditional modes of appropriating funds.

In an era with growing tight budget, defense department has to compete with other departments and projects fiercely to justify the value of every penny spent.

Confronted by the residual impact of the global financial crisis and other uncertainties, the tension between revenue and military expenditure in China's finances persists.

Thus, a tight fiscal constraint would necessitate the practice of PPPs to serve as a supplement of its military budget or help to remove its national debt "off-balance sheet"[7].

4.2. Continue to modernize concepts of logistics management. Admittedly, China remains slow in catching up with the development of PPPs in defense procurement due to a series of bureaucratic requirements, under-developed marketization and excessive oversight in private sectors. The adoption of PPPs is not only an efficient governance tool to release national debt containment, but also symbolize a concept transformation to modern logistics. In a principle-agent relationship, the PPPs mode has inevitably transformed the role of defense department from a manager of resources to manager of contracts, so the public sector has to develop a set of new management skills, particularly contract managing skills.

Whether defense procurement in China will embrace a PPPs contract depends on how the PLA define the relationships between defense department and private sectors. To further improve PPPs implementation in China's defense area, the PLA must pay more attention to market as invisible hands.

4.3. Develop quantitative measuring tools to evaluate risk transfer. It is common knowledge that PPPs process many different kinds of definition and is consisted by different forms, but in every PPPs contract, responsibility and levels of risk are synonymous.

The MOD, UK, would only approve projects that offer lower lifecycle cost, or the best value for money, in the acquisition cycle with PFI.

With its own unique fiscal system, operating system and defense priorities, however, the PLA would find it is difficult to decide whether to pursue a PPP mode in a certain defense project, because the quantitative measuring tools, like PSC, are "highly subjective and vulnerable to bias", and "its complex financial models are also prone to error" .

That's to say, a change in the discount factor or the assessment of risks may reverse PPP's favor. Some defense projects cannot be commonly found in private sectors and are complex to define and practice.

As a result, a major concern of the PLA pursuing PPP mode is to develop its own quantitative measuring tools and to learn to identify, quantify and verify the value of risks have been transferred to private contractors.

4.4. Select proper defense areas and PPPs modes to make experiments. The spectrum of PPPs could be divided into three categories. The first and most prominent is known as Private Finance Initiatives (PFI), in which the public sector contracts to purchase goods and services in long run. This includes projects in which private sectors shoulder responsibilities for providing public services, like constructing and maintaining military assets.

The second category involves introducing the private sector partnership into state owned military industry enterprises using a strategic partner, usually with a minority stake. The third partnership arrangement is using private sector expertise and financial resources to exploit the commercial potential of military assets [8].

Modern Logistics System puts great effort on raising cost-effectiveness. Following this principle, it continues to push forward the process of outsourcing daily maintenance services, and takes steps to outsource other services, such as general-purpose materials storage and integrated civilian-military equipment maintenance.

After entered into the new century, the PLA has taken multilateral approaches to building a Modern Logistics System.

It seems that there are a wide range of areas in defense procurement that are more suitable to adapt a PPPs mode by contracting out to private sectors of expertise, like military accommodation, transportation, medical treatment, training facilities, equipment servicing and other technologically sophisticated equipment projects.

Especially, PPPs should be capable of providing direct supports for front-line operations, including military operations other than war (MOOTW).

5. CONCLUSIONS & ACKNOWLEDGMENT

Despite of the weakness and difficulty have been pointed out, the PPPs mode which adheres to the principle of building Modern Logistics System, would still serve as a spur to PLA modernization.

However, in an unpredictable and fast-changing world, misunderstanding and ambiguous objective in defense PPPs implementation may yield costly economic and social consequence.

The PLA has to improve its policy guidance and legislation to pave the way for more defense PPPs especially by allowing more private industries to compete equally with state-owned war industries and acquiring more skills of contract management.

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