

The Limits of Competition in Defense Acquisition
Defense Acquisition University Research Symposium, September 2012

The Limits of Monopsony Pricing Power in the Markets for Defense Goods

David T. Day, 1st Lt, USAF
18 September 2012

Overview

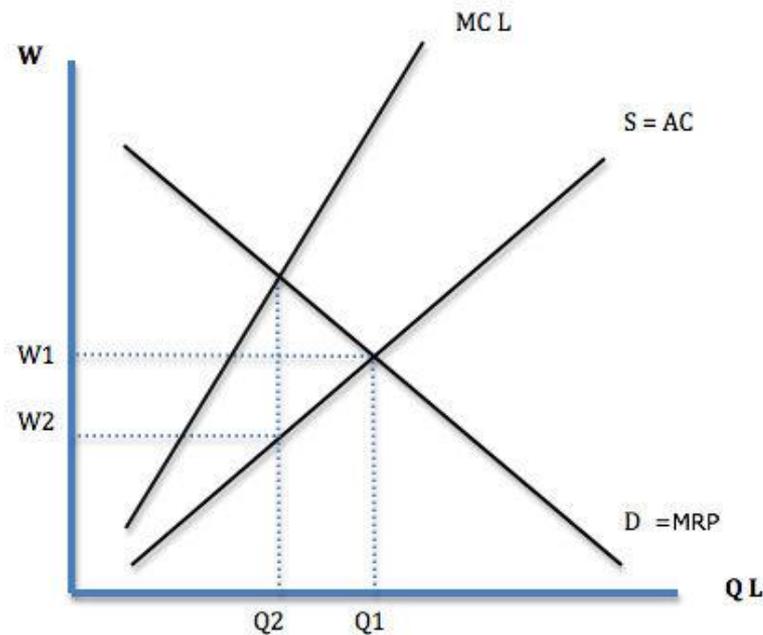
- ▶ Monopsony Definition
 - ▶ Monopsony in Defense Acquisition Literature
 - ▶ Operational Level Markets
 - ▶ Systems Level Markets
 - ▶ Effects of Consolidation
 - ▶ Potential to Increase Market Power
 - ▶ Summary
 - ▶ Questions
- 

Monopsony Definition

- ▶ What is a monopsony?
 - Market with only one buyer
- ▶ Industry examples
 - Typically examined for purchase of inputs

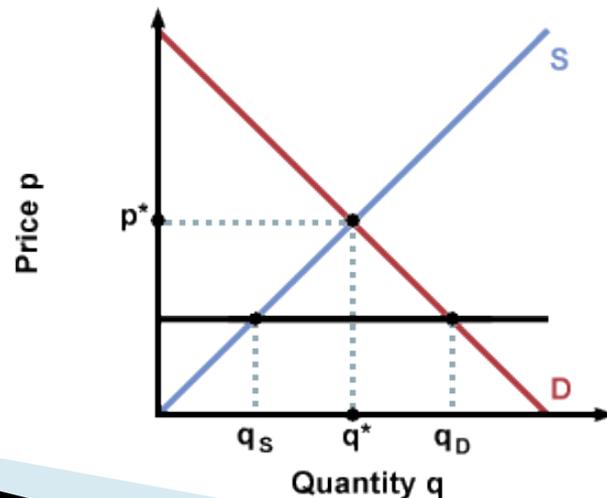
How Does a Monopsony Work?

- ▶ Most monopsonies focus on production and maximizing profits



How Does a Monopsony Work?

- ▶ DoD produces a unique “public good” which is not for sale
- ▶ Mission drives DoD’s costs, revenues brought in from budgets and taxes
- ▶ Instead, DoD will always try to minimize costs



Monopsony in Defense Acquisition Literature

- ▶ Basic Assumption
 - ▶ Very little examination of unique economic nature
 - ▶ Focus primarily on interactions rather than market structure
- 

Monopsony in Defense Acquisition Literature

- ▶ Imperfect nature of government–industry interactions
 - Oligopoly masks true costs
 - Acquisition policy “shelters” producers from market forces
 - Personal relationships between negotiators
- 

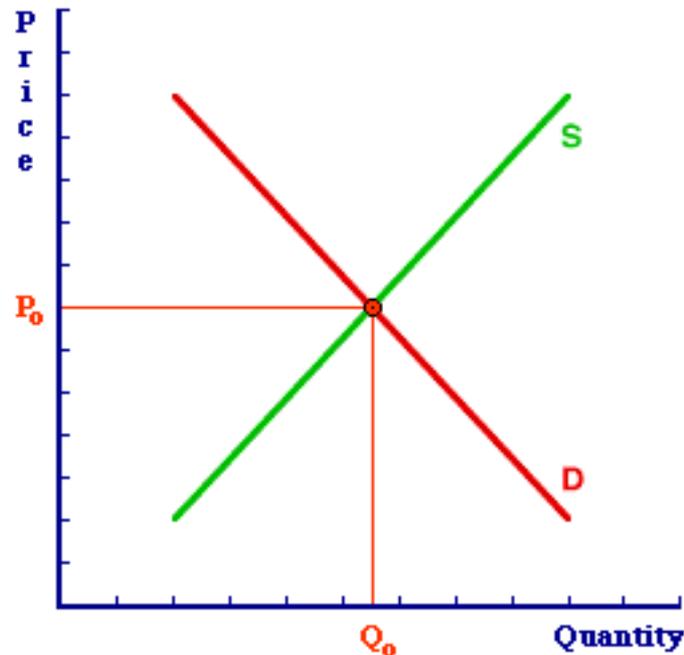
Operational Level Markets

- ▶ Types of goods purchased
- ▶ Does a monopsony exist?



Operational Level Markets

- ▶ Competitive market structure
- ▶ Multiple buyers, multiple sellers



Operational Level Markets

- ▶ Monopsony cannot exist if:
 - Goods have widespread civilian application
 - Multiple DoD offices are buying the same thing

Operational Level Markets

- ▶ Potential to increase monopsony power:
 - Centralization of *military-specific* purchasing
 - Prevents DoD buying activities competing against each other



Systems Level Markets

- ▶ Types of goods purchased
- ▶ Monopsony market structure exists
- ▶ Monopsony established by laws, regulations



Monopsony Pricing Power

- ▶ Can DoD effectively use monopsony power?
- ▶ F-22 example
 - Per-unit price rose as quantities decreased



What Makes Defense Acquisition Unique

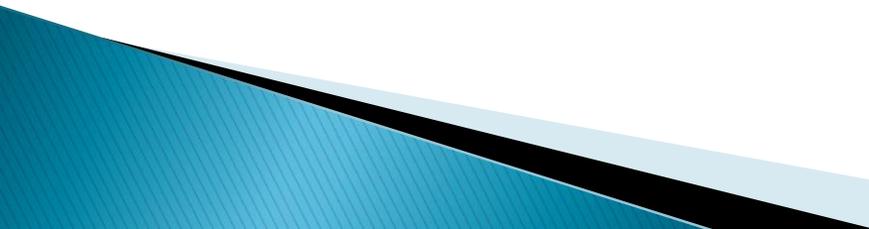
- ▶ Why can't DoD use its monopsonist position?
- ▶ Structural problems prevent true monopsony power
 - Quantities dictated externally
 - Producers retain power
 - Political pressures



Effects of Consolidation

- ▶ Consolidation of purchasing has little economically predictable affect at the systems level
 - ▶ Individual monopsonies already exist
 - ▶ Creating new, larger monopsonies still does not overcome structural limits on pricing power
- 

Potential to Increase Market Power

- ▶ Potential savings are very limited
 - ▶ True monopsony for very limited operational level goods
 - Requires effective centralization
 - ▶ Although monopsony present at systems level, not a driver of cost savings
 - Savings come from finance and accounting, not economically predictable
- 

Summary

- ▶ Overview
 - ▶ Monopsony Definition
 - ▶ Monopsony in Defense Acquisition Literature
 - ▶ Operational Level Markets
 - ▶ Systems Level Markets
 - ▶ Effects of Consolidation
 - ▶ Potential to Increase Market Power
- 

Questions

