
PREFACE

This report examines the incentives created by working capital fund prices for depot-level reparable (DLRs), as implemented by the Air Force, and discusses the problems that may result from these incentives. These problems affect the Air Force's ability to efficiently meet its support goals. The report then recommends changes in the approach to setting prices that should improve the Air Force's ability to meet its goals efficiently.

The pricing policy for DLRs is an evolving topic within the Air Force and, more broadly, within the Department of Defense. Because of the limited Air Force historical experience and data on the effects of prices on behavior, the issues raised and recommendations found in this report are based upon both the extensive economics and accounting literatures on transfer prices and discussions with Air Force military and civilian personnel at bases, depots, and major command headquarters. The authors' intentions are to use insights from these literatures and discussions to shed light on behavioral issues associated with different pricing strategies for DLRs and to present policy options the Air Force may use to shape its pricing policy. The authors recognize that the recommendations set forth here are not consistent with current DoD and Air Force policy and do not represent the official DoD or Air Force view on prices.

In FY 1998, after the conclusion of this research, the Air Force combined three organizations within the working capital fund to create the Materiel Support Division. This organizational change was accompanied by changes to the structure of DLR prices. Overhead and other non-transaction-related working capital fund

costs are now allocated to the prices of reparable components on a different basis than before.

Only one change to the structure of DLR prices addresses the concerns and policy recommendations discussed in this report. The new structure of DLR prices ties recovery of the cost of replacement items for a particular type of reparable component to the price of only that component. (Previously, replacement costs for each type of component were recovered by spreading them across prices for all components.) For those components whose state of repair cannot be affected by customers, this change should increase customer incentives to take actions that are in the best interest of the Air Force. However, with this exception, the concerns expressed in this report about the adverse effects of the structure of DLR prices on customer behavior remain largely unchanged.

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PROJECT AIR FORCE

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