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NATIONAL SECURITY W A T C H

Military Compensation: Balancing Fairness and Sustainability

by Cathleen McCracken

Introduction

To execute the military, strategic and operational plans of the United States, the Department of Defense (DoD) requires high-quality uniformed personnel. To maintain such a force, DoD needs a package of compensation that is reasonable and competitive.

Consistent with section 1008(b) of title 37, United States Code,¹ the Bush administration directed Secretary of Defense Donald H. Rumsfeld on 2 August 2005 to conduct the Tenth Quadrennial Review of Military Compensation (QRMC). The QRMC, which is expected to convene in 2006, is a complete review of military pays and allowances requested by the President at least once every four years. Areas of particular interest include retirement benefits, health care, special and incentive pays, quality of life and reserve component compensation. The President then submits the QRMC report to Congress.

In the presidential memorandum to the Secretary of the Defense regarding the Tenth QRMC, the President recognized the interrelationship between compensation and the rest of the military manpower system, observing that to "continue to recruit and retain highly qualified personnel for the uniformed services . . . the departments concerned must offer . . . compensation appropriate to the services rendered to the Nation."² While military service offers volunteers an honorable career, it must also provide servicemembers adequate compensation for the challenges of military life.

Background

Military Compensation Background Papers, released in May 2005 by the Office of the Undersecretary of Defense for Personnel and Readiness, states that military compensation should:

- support manpower policies;
- be compatible with the technology and tactics requested of and performed by servicemembers;

¹ This section became effective 1 September 1965, and the First Quadrennial Review of Military Compensation was to be completed no later than 1 January 1967.

² President of the United States of America, *Tenth Quadrennial Review of Military Compensation*, memorandum, 2 August, 2005. Available online at <http://www.whitehouse.gov/news/releases/2005/08/20050802-8.html>.

- be fair to servicemembers, which includes being comparable to and competitive with the civilian sector;
- be effective in times of peace and of war so as to adapt quickly to contractions and expansions in the military force;
- be flexible to changes in the national economy and employee pool; and
- motivate servicemembers and encourage performance.³

Several elements comprise the military compensation system, which mixes cash, non-cash benefits and deferred benefits. Funding for these forms of compensation comes from many different budget accounts. The DoD Military Personnel budget allocates cash compensation, such as basic pay, but the DoD Operation and Maintenance budget controls funds for several non-cash benefits, such as post commissaries. The Department of Veterans Affairs budget funds retirement benefits and the Montgomery GI Bill.

Active duty military compensation is known as “regular military compensation” (RMC).⁴ RMC has four elements: basic pay, basic allowance for housing (BAH), basic allowance for subsistence (BAS) and federal income tax advantage. Basic pay, the primary method of compensation to servicemembers, is determined by pay grade and length of service. BAH is intended to cover housing costs for servicemembers authorized to live off base. Geographic location, pay grade and whether the servicemember has dependents determine the amount of BAH. Servicemembers without dependents living in government quarters may be entitled to a partial BAH. BAS offsets the costs of a servicemember’s meals when government mess facilities are not provided, but it does not cover the meals of family members. Most enlisted personnel receive full BAS and then pay out-of-pocket for meals provided by the government. Both BAH and BAS are nontaxable cash allocations. This federal income tax advantage is an “opportunity cost,” which is, effectively, extra income.

In addition to basic pay, both active and reserve component members may receive a variety of special and incentive (S&I) pays meant to address personnel needs. S&I pays are used to encourage servicemembers to volunteer for career fields, assignments and locations that may otherwise experience manning shortfalls. S&I pays also are used to make a military career realistically competitive with nonmilitary alternatives.

Deferred benefits refer to post-service benefits and retirement benefits accrued over a servicemember’s career. The current system supports an “all-or-nothing” retirement program. Servicemembers who complete 20 years of active duty service receive pensions at 50 percent of basic pay, while those leaving with less than 20 years of service receive nothing.⁵

Other benefits included in the military compensation package are “supporting” benefits and manpower-related cost items. Supporting benefits encompass items such as the Survivor Benefit Plan, commissaries and the Thrift Savings Plan. Manpower-related cost items include the Cost of Living Allowance (COLA) for the continental United States, the Veteran’s Educational Allowance and the Family Separation Allowance.

³ Department of Defense, Office of the Secretary of Defense, *Military Compensation Background Papers: Compensation Elements and Related Manpower Cost Items, Their Purposes and Legislative Backgrounds*, sixth ed. (Washington, D.C.: May 2005). Available online at <http://www.loc.gov/rr/frd/mil-comp.html>.

⁴ The reserve component compensation system varies according to the individual’s reserve status. When activated, reserve component members receive active duty military compensation.

⁵ In general, the retirement system vests at 20 years of service with a pension of 50 percent of basic pay and increases by 2.5 percent for each additional year of service. Servicemembers with 30 years of service are eligible to receive a pension at 75 percent of basic pay. It should be noted that the National Defense Authorization Act for Fiscal Year 1993 established Temporary Early Retirement Authority (TERA) to allow all branches of the military to offer early retirements for servicemembers with more than 15 but less than 20 years of service. TERA expired 30 September 2001.

The Issues

In March 2005 Secretary Rumsfeld chartered a panel of civilians recognized as experts in the fields of pay to perform an independent review of the military compensation system. This panel, the Defense Advisory Committee on Military Compensation (DAMC), is examining how the compensation mix can best support the armed forces' commitment to recruitment of quality individuals and retention of experienced personnel while providing servicemembers with a high quality of life. Recommendations made by the DAMC will be submitted to the drafters of the Tenth QRMC for consideration.

Admiral Donald Pilling, USN (Retired), chairman of the DAMC, has said that altering the retirement system will be the "most controversial" change. The current "up or out" system vests a servicemember's retired pay at 50 percent of basic pay upon completion of at least 20 years of service. Because servicemembers must keep getting promoted to stay in uniform, the current system forces some experienced personnel to leave sooner than may be beneficial for the servicemember or the government. The result is that only 47 percent of officers and 15 percent of enlisted personnel serve long enough to retire. Possible alternatives to the current system may include:

- allowing some servicemembers to stay on active duty for 40 years and receive retired pay at 100 percent of basic pay;
- matching contributions to the Thrift Savings Plan, in exchange for which the servicemember will receive a smaller retirement pension; and
- earlier vesting for some career fields.

Any adjustments in retirement benefits will force the system to become more complex in the short term because the armed forces will continue providing benefits already guaranteed to serving and retired members while transitioning to a new system.

Health care is a notable concern because of rising DoD health care costs and increased reliance on TRICARE. Health care benefits for servicemembers, retirees and their dependents grew by 69 percent (from \$13.8 billion to \$23.3 billion) between Fiscal Year (FY) 2000 and FY 2004.⁶ Increases in demand and continuing inflation place pressures on access, cost and quality of the military health care system. Future cost growth is a concern, and any adjustments will be made with the goal of modifying cost sharing. Among benefit changes being considered by the DAMC are:

- increased premiums for TRICARE, increased copays at Military Treatment Facilities and increased pharmacy copays to shift some of the health care costs to beneficiaries; and
- new benefit options intended to make the use of employer-provided health insurance more attractive.

S&I pays create flexibility, allowing the armed forces to provide to servicemembers incentives other than promotion. DoD offers more than 60 different types of S&I pay, including hazardous duty pay, reenlistment bonuses and incentive pay for choosing critical skill sets and assignments. To increase equity and manageability in S&I pays, the DAMC is considering:

- consolidation of S&I pays to create a simpler system;
- modification of the system to reward performance; and

⁶ Government Accountability Office, *DoD Needs to Improve the Transparency and Reassess the Reasonableness, Appropriateness, Affordability, and Sustainability of Its Military Compensation System* (Washington, D.C.: July 2005).

- establishment of rules for setting pay levels and development of rules for adjusting the S&I budget to become more adjustable to changes in market conditions.

Quality-of-life compensation is meant to mitigate the challenges of military life for servicemembers and their families. Recreation, family and community support programs are used to maintain morale, increase retention rates and improve troop readiness. In making changes to quality-of-life programs, the emphasis will be on providing choices. Recommendations may include creating more flexibility in allowing servicemembers to choose assignments, geographic locations and benefits.

Assessment of reserve component pay comes as the Global War on Terrorism creates a shift in perception within the reserve component from that of a part-time obligation (strategic reserve) to the specter of more frequent mobilization and deployment (operational force). New duties demand more time from reserve component members, thus affecting their civilian career earnings. The DACMC may recommend more flexibility within the compensation system to provide incentives and rewards for staffing and varying levels of participation in training. Subsidies to cover civilian health insurance when a reserve component member is activated may induce those members to keep their civilian health insurance and improve the continuity of their health care.

As the DACMC reviews the current military compensation system and formulates recommendations, the panel strives to achieve a level of fairness. The system must be deemed both fair to the current force and able to provide the incentive structure to meet the readiness goals of an all-volunteer force. **Modifications to the current system will have to be resource-neutral, requiring no changes in the cost to DoD.** Recommendations must be fashioned to make the current system of compensation more reasonable, appropriate, affordable and sustainable.

Conclusion

Secretary Rumsfeld chartered the DACMC to provide advice on how compensation can help sustain a cost-effective and ready military force. The panel will submit its recommendations to the Tenth QRMC for consideration early in 2006. The pay studies performed by the DACMC and Tenth QRMC will strive to create a balance between cash compensation and deferred benefits while improving the current system's equity and competitiveness with the civilian sector. The goal of these pay studies is to curb rising costs while appropriately compensating those who volunteer to serve in the armed forces.

Future changes to the system must not preclude any benefits already guaranteed to current servicemembers and must be deemed fair. Proposed increases in costs to TRICARE beneficiaries—those currently serving and retired enrollees—erode servicemembers' retirement stipends and do not withstand the challenge of fairness. The erosion of health care may also have a trickle-down effect that negatively impacts recruitment and reenlistment. DoD must expand its effort to reduce costs by eliminating inefficiencies in administration, contracting and procurement rather than cost-shifting to beneficiaries. Further financial burdens on military beneficiaries—active duty, Guard and Reserve, and retired—are not compatible with the tenets of military compensation as fair, flexible and effective. The unique demands and sacrifices inherent in a military career far surpass the demands made on civilian workers, and military compensation must reflect this, especially when the nation is at war.