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Earned Deferred Compensation

Proposed military earnings reforms do more harm than good

by Nicholas R. Krueger

Key Points

- No amount of reform to military earnings—even comprehensive, systemic reform—could ever make more than a symbolic dent in the nation's budget and debt crises.
- Proposed fee hikes or access restrictions for TRICARE are only temporary half-measures that do not address the root causes of cost growth and do not meaningfully "stabilize" account growth.
- The main purpose of the military compensation system is to help guarantee military readiness. It is worth paying a premium to ensure that the expertise and professionalism of the force endures.
- It is unfair to make drastic reforms to military earnings (or to make evolutionary reforms that have a drastic impact over time) that have a substantially negative impact on real people but have a comparatively tiny positive impact toward their intended aims.

Introduction

No one deserves a paycheck more than American Soldiers deserve theirs. Whether a Soldier answers duty's call today in Afghanistan or answered earlier in Iraq, Vietnam, Korea or one (or more) of dozens of other countries, every servicemember makes unique sacrifices that are fundamentally unlike the demands of civilian employment. **Precisely because of the singular nature of the military profession's demands—and, more explicitly, because of the strategic necessity of guaranteeing that U.S. forces are always available and ready—the armed services have provided their personnel for decades with a wide range of compensation that is not always similar to the types of compensation packages with which civilian employees are familiar.** Despite this, proposals that effectively "civilianize" military compensation reemerge time and again.

At present, the rationale attached to such proposals falls almost wholly into three main categories. The arguments suggest that military compensation policies must be modified to *save taxpayer money* to help resolve the federal budget and national debt crises; to *stabilize Department of Defense (DoD) account growth* because personnel costs generally (and health care costs in particular) threaten to increase as a share of the total DoD budget; or to *make the system more fair* to those who serve and to all Americans who foot the bill. The various policy proposals and

think tank studies—whose supporters almost unanimously agree that any military compensation reform must be undertaken comprehensively—often attempt to offer cost savings in all three categories simultaneously; by doing so, they sometimes seem to imply that the quantity of objectives aimed at is more important than the depth of impact achieved in each category. In other words, they imply that any time a plan can be shown to make improvements (however slight) in any or all of the three categories, it simply *must be* preferable to the status quo.

Such an implication is too simple. In the real world, personnel policy changes sometimes achieve only modest improvements toward their objectives while effecting a disproportionately negative impact on real people—thus yielding questionable value. What is more, in military and strategic reality, it is sometimes more important to be effectively ready than to attempt to satisfy every conceivable metric of fairness.

A more appropriate method of evaluating military compensation policy is to assess whether any given proposal makes a meaningful difference in the cost both to military readiness and to the servicemembers for whom the system is supposed to provide. It is not sufficient to merely consider whether a proposed change might do some good. Much more nuanced factors—such as *how much* impact a new policy will have toward an intended goal; whether a new policy addresses *root causes* of challenges or merely delays difficult decisions; and *to what extent* a new policy breaks faith with the expectations of people who volunteered their service for their country—are always relevant criteria when considering military compensation reform. When current proposals to amend the military compensation system are weighed on this scale, the outcomes buck the existing conventional wisdom.

Three Straw Men

Is it useful to seek federal budget/national debt relief through military earnings reform?

It is worth comparing a few simple statistics to gain perspective about whether military earnings reform should play a central role in addressing the national debt crisis. Consider the following estimates:

- 2012 military health care budget: $51 billion[1]
- 2012 DoD personnel budget: $153 billion[2]
- 2012 total DoD budget: $646 billion[3]
- 2012 total federal discretionary spending: $1.30 trillion[4]
- 2012 total federal spending: $3.63 trillion[5]
- 2012 federal budget deficit: $1.17 trillion[6]
- Total national debt as of July 2012: $15.9 trillion[7]

A few facts are especially noteworthy. For instance, the whole military health care budget is equivalent to only 4.4 percent of this year's budget deficit, 1.4 percent of this year's total spending and 0.3 percent of the total national debt. Hypothetically, Congress could cut the full military health care budget more than 20 times over and still not close *this year's* budget shortfall. Even if the entire DoD personnel budget were cut to zero, almost 90 percent of this year's shortfall would still exist. Even if DoD did not exist—if the United States did not spend a single dime on national defense—the country would still add to its national debt because of its mandatory spending programs. Plainly, no amount of TRICARE fee increases, reformed military retired pay or revised active duty pay structure could ever take more than a symbolic bite out of this year's budget deficit, much less the entire national debt.

However, there is a much more subtle federal budget problem lurking beneath the obvious one. The Budget Control Act of 2011 required substantial cuts to congressional discretionary spending, and military compensation (especially military retiree health care expenditures) is seen by some as an ideal target for meeting difficult goals. But the law is widely misunderstood in an important respect—there is considerable maneuvering room for Congress and the executive branch to abide by the law without affecting military compensation—and even in this more limited budget context, the potential savings to be gleaned from reform are only a tiny fraction of what is required.

It has been widely reported that the first phase of the Budget Control Act "required" DoD to cut $487 billion from its projected spending over 10 years. This is inaccurate and misleading. The only years for which the law

specified an annual cap were Fiscal Year (FY) 2012 and FY 2013; thereafter, the law merely requires that the sum of all discretionary spending through FY 2021 (in all categories, not just defense) total at least $917 billion less than the sum projected at the time the law was passed. The number $487 billion does not appear in the text of the law; this is merely the approximation that the Office of Management and Budget has used in budget proposals to suggest how much of the $917 billion might come from defense accounts.

In plain language, this means that during the relevant span, Congress was expected to spend approximately $11 trillion across all its discretionary accounts and will now have to cut something on the order of 9 percent of it[8]—but Congress has flexibility to craft the cuts across every account for which it is responsible. Congress and the administration have already demonstrated their willingness to exempt certain categories—such as the Department of Veterans Affairs (VA) budget—from the cuts on the principle that military personnel have already paid their fair share and that the potential savings to be realized through military compensation reform proposals are the equivalent of only a small fraction of such exemptions. For example, DoD estimates that the vast and disproportionate TRICARE fee hikes it has proposed for military retirees would raise a little more than $2.5 billion per year[9]—an annual amount that is less than 0.3 percent of the $917 billion sum required over 10 years.[10] Contrast $2.5 billion with the $64 billion discretionary portion of the total $140 billion budget request of the VA for FY 2013 that will be (rightly) exempted from Budget Control Act cuts. It is illogical to believe that the $64 billion should be exempted from cuts (because Soldiers have already sacrificed enough) while simultaneously believing that other former Soldiers should be expected to pay more for their own earned deferred compensation even after they have already held up their end of the bargain (because Soldiers have not yet sacrificed enough).

The point is this: regardless of whether one takes a short view or a long view of the federal budget situation, military compensation expenses are an insignificant fraction. Even the most radical reform proposals would make only the most minor contributions to resolving the debt crisis or effecting the cuts required by the Budget Control Act.

Is it useful to try to "stabilize" DoD account growth through military earnings reform?

Another enduring argument that is frequently used by advocates of military compensation overhaul is that change is necessary because the cost to DoD of military earnings is growing too rapidly—leading to "unsustainable" growth—and crowding out other parts of the budget such as operation and maintenance and procurement. Every dollar spent on paying or caring for a Soldier, the theory implies, is a dollar that could have been spent on new equipment or training. A corollary to this argument is that the rapid growth of military earnings expenditures since the late 1990s must have been excessive and that Soldiers today are effectively overpaid—which situation ought to be corrected by underpaying them in the future.

This line of reasoning falls short on several counts. Taking inflation into account, it is true that the combined cost of military earnings has increased by 30 percent since 2001.[11] But during that same span, other forces were at work that largely account for the growth. First, active duty endstrength increased by several percentage points, partly explaining the cost growth. Second, DoD changed its accounting methods in 2003, beginning the practice known as health care accrual budgeting. Under this practice, DoD began paying into a fund (known as the Medicare-Eligible Retiree Health Care Fund) that effectively covers upfront the estimated health care costs for future Medicare-eligible retirees—a move that made the consequences of policy decisions more immediately transparent but also added almost $10 billion to DoD personnel costs all at once. (In the past, health care had been paid for in the year in which services were actually delivered, making budgeting difficult.)[12] Most significant, however, was the series of servicemember pay raises enacted by Congress throughout the 2000s. These were necessary—indeed, long overdue—to close a double-digit pay gap between military and civilian earnings to ensure that the armed services continued to attract high-quality recruits and retained its experienced Soldiers during more than a decade of war. Given all of these challenges (especially considering the parallel private-sector health care cost inflation that occurred simultaneously), it is actually remarkable that DoD held personnel cost growth down as much as it did. Proposals exist today that would reverse much progress by holding military pay raises *under* the rate of inflation—budget gimmicks that would effectively penalize Soldiers for continuing their service in the future and that are similar to the policies that created the intolerable pay gap in the first place.

Still, health care costs are one area in which DoD accounts are held hostage. In 2000, DoD spent $17.7 billion to provide health care to the force; by 2012, that amount had ballooned to $51 billion;[13] by 2030, the Congressional Budget Office estimates that the cost could reach $95 billion, citing probable cost growth during that span in the areas of direct care and administration, purchased care and contracts and pharmaceuticals of between 3 and 6 percent annually.[14] However, it does not make sense to civilianize military health care by compelling retirees and their families to foot ever more of the bill because such a move can never be more than a minor postponement to finding a lasting solution.

The TRICARE system—as well as the CHAMPUS system that existed before TRICARE—has always been intended to be the heavily subsidized means of providing earned, long-term compensation to servicemembers. Even when TRICARE was first instituted in the 1990s, the portion of total health care costs borne by servicemembers was only about 27 percent.[15] The government never intended to share health care costs evenly among servicemembers; TRICARE's purpose always was to provide earned compensation and to protect retirees from the risks of future cost growth.

Even if retirees' fees were raised exorbitantly so that retirees again paid about 27 percent of the cost of their care—and even if those fees were indexed to keep the cost share at 27 percent—the government would still be responsible for the vast majority (the remaining 73 percent) of the cost and would still face the same steady inflation that is already unsustainable. In other words, DoD is merely a victim of the same medical cost growth that plagues the entire United States. Even the most extreme proposals to charge retirees more for their care or restrict them from accessing their earned compensation would only delay—not stabilize—cost growth for a short time before the same underlying causes of the rising cost of care struck again.

However, the entire premise that action must be taken to control military compensation cost growth so as not to encroach on other DoD accounts flounders on another point. Simply, it does not matter what percentage of the overall DoD budget happens to be occupied by health care, personnel or any other category. Hypothetically, if personnel costs represented 98 percent of the budget and operation and maintenance and procurement each represented only 1 percent, it would not matter *so long as* each category received sufficient means to execute its requirements. Sufficient means are measured in buying power, not budget share. There is no evidence that Congress would penalize DoD procurement accounts, for example, solely because the personnel budget grew simultaneously. And as described above, the Budget Control Act does not actually limit Congress to a predetermined size of DoD budget pie in any year.

There are many other, much more substantial steps that have not received as much attention as they now warrant—and unlike temporary half-measures such as fee hikes for servicemembers, some of these actually do address root causes of DoD health care cost growth. For example, there still does not exist a unified military medical command that could extensively streamline the provision of service and which would certainly consolidate and trim redundant bureaucracy. As another example, a chronic shortage of permanent military medical force structure before and after 9/11 has forced DoD to turn increasingly to expensive private contractors to deliver care to active duty families and retirees. Better force structure investment and planning to meet wartime medical requirements—and to transition more effectively between peacetime and wartime—could do much to alter the underlying conditions that have driven up DoD costs most rapidly in the area of delivery of care over the past decade.

But many proposals put forward today that claim to try to "stabilize" DoD account growth are puzzling. Military health care cost growth cannot be cured or even meaningfully aided with simple expedients such as fee increases on servicemembers because the root causes are nationwide issues that require nationwide solutions. Further, the widely repeated assertion that personnel costs eat funds that would otherwise be available to other DoD budget categories is simply baseless. **Billions of dollars in efficiencies already trimmed by DoD in the past several years have not been reinvested into its own accounts.** There is no reason to believe that personnel cost savings achieved through compensation reform would receive a different fate.

Is it useful to try to make the military compensation system fairer?

Yet another common appeal made by critics of the traditional military compensation model is to Americans' sense of justice. Countless writings attempt to compare the incomparable profession of arms to civilian employment,

military pensions to civilian investments, TRICARE coverage to private health insurance or military service to civilian skills. Others question the fairness of longstanding requirements for Soldiers to make lasting commitments to service before they become eligible to access their earned long-term compensation.

DoD, the Army and Congress have done much to make military compensation more equitable and more flexible. The United States has come a long way in guaranteeing the rights of servicemembers and their families. There are many good ideas being explored even now that could permit Soldiers and families to access the full value of their investments such as the Survivor Benefit Plan more easily or to choose from a much wider array of earnings options that they could tailor to their individual needs. These ought to be explored so long as the ultimate goal is to provide servicemembers with better and more valuable earnings. One sure measure of improvement to the fairness of the compensation system is that Soldiers are receiving the squarest deal that can be had.

However, some reform proposals whose intent is to save budget dollars or improve flexibility unintentionally create unfair compensation conditions. For example, ideas to civilianize the military retirement system by transforming the existing defined-benefit pension to a more flexible defined-contribution investment account—the main aim being budget savings for DoD—create major dilemmas. On one hand, many current and future career Soldiers stand to lose large sums of total value if they are forced to switch to a different retired pay structure; further, any Soldier who is denied the opportunity for a defined-benefit pension is forced to assume his own investment risk. Defined-contribution plans create the surety that some career Soldiers will fail in their investments and end up with no retirement savings at all. On the other hand, attempting to phase in any new retirement system by "grandfathering" current Soldiers creates an unnecessary double standard for compensating equally dedicated service. **It is an unjust irony indeed that millions of American civilians receive unearned benefits under the protection of "mandatory" legislative funding while the earned retirement and medical compensation of the nation's small percentage of Soldier-citizens and their families is more vulnerable to the shifting of Washington's winds as "discretionary" funding. Paying Soldiers the full value of their earned deferred compensation is mandatory.**

But the real purpose of all the unique structures of the tried-and-true military compensation system has nothing at all to do with fairness and everything to do with readiness. The system in place today has successfully recruited and retained successive generations of professional, expert Soldiers who are the backbone of the force and the cornerstone of military readiness. Especially today, when many of the Army's mid-career professionals are skilled, tech-savvy, proven leaders who possess highly marketable leadership skills, the Army desperately needs a financial mechanism that motivates the cream of its crop to complete full careers so that the Army's institutional excellence and preparedness endures. For example, it normally takes approximately five to eight years to develop a Soldier into a noncommissioned officer. The civilian economy is sure to rebound, and when it does, the military needs to continue to attract and retain skilled servicemembers by compensating them well for the additional hardships their service entails—a challenge that the vast majority of private-sector employers do not face. Neither cost-effectiveness nor equity is the only measure of sound personnel policy. The world's premier all-volunteer force must be resourced sufficiently to attract the finest talent, and because it is fundamentally unlike civilian institutions, it should come as no surprise that some of its effective retention practices appear foreign to civilian eyes.

DoD and the Army would be wise to look for opportunities to improve the value of the compensation they provide. However, the most important intangible value of the unique military compensation package—even more important than fairness, flexibility, transferability or convenience—is its contribution to the readiness and enduring professionalism of the force. These strategically vital characteristics are worth paying a premium to obtain. Proposals to revamp the structure of military earnings for fiscal or other reasons ignore their effects on force readiness only at their peril and can introduce an unacceptable level of risk.

The Human Factor

The military compensation system in place today, for all its real or perceived complications, has successfully sustained the all-volunteer force since its inception and served as a cornerstone of American military readiness for decades before that. It has been fine-tuned constantly over the years. It hardly comes as a surprise that the most recent period of difficulty in the history of Army recruitment and retention occurred during the 1990s after Congress

attempted some cost-saving measures in 1986 via the so-called "REDUX" retired pay system that effectively cut the quality of earnings.[16] To their credit, Congress soon realized that the all-volunteer force is worth its cost and reinstated the full value of servicemembers' earnings.

Soldiers faithfully execute their duties and trust that the nation will uphold its end of the bargain and keep its promise to deliver earned compensation. Yet Soldiers and retirees have already seen their earnings eroded one by one. The retirement pay system has been adjusted in the government's favor over time by altering the methods by which retirees' baseline pay is calculated. Cost-of-living increases have not always kept up with the government's promises. TRICARE Prime premiums and pharmacy fees have already begun increasing.[17] Older retirees are subject to volatile means-tested Medicare Part B premium increases, and they are faced with ever weaker availability of quality care as military facilities consolidate and private physicians increasingly refuse to accept new Medicare patients.[18] Because the Medicare and TRICARE systems within the government are linked, the absence of a long-term legislative solution to scheduled Medicare cuts in payments to health care providers means that doctors treat military retiree patients only reluctantly—out of fear that they may never be fully paid by the government.

But now servicemembers are facing the most draconian changes yet. Proposed TRICARE premium increases and new access fees are unprecedented—potentially tripling or quadrupling for many servicemembers. Persistent calls for comprehensive review and overhaul of the retired pay structure threaten to severely cut the earned deferred compensation of those who did their duty the longest and to dump all the risk onto those servicemembers who have already risked the most. The proposals even threaten to affect those still serving on active duty by allowing their annual pay raises to fall behind yet again. What is most intolerable, as this paper has demonstrated, is that Soldiers and families are being asked to go along with these ideas *even though* most proposed compensation reform measures are, at best, half-steps and temporary fixes to enduring challenges of national breadth.

Soldiers' careers are dangerous. They labor in extreme environments that often create long-term professional and wellness challenges; some of those challenges, such as Soldiers' mental health, are only beginning to be understood. Soldiers appreciate it when their civilian supporters welcome them home from overseas, send care packages or shake their hands on the street. But what they want most is for their nation to follow through with their spoken appreciation by delivering upon the Soldiers' promised **earnings** for their sacrifices. *That* is fairness. The United States absolutely can afford to take care of the few who volunteer to accept deferred compensation tomorrow in return for service on war-torn battlefields around the world today. It absolutely must commit to the strongest defense possible by adequately resourcing the world's premier all-volunteer force—but there is no need to redefine the meaning of *fairness.*

Endnotes

[1] Vice Admiral Matthew Nathan, Navy Surgeon General, testimony before the Subcommittee on Defense of the Senate Committee on Appropriations, 28 March 2012.

[2] "Overview: Fiscal Year 2013 Budget Request," Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer, February 2012, pp. 8-1 and 8-2.

[3] *Ibid*.

[4] "Updated Budget Projections: Fiscal Years 2012 to 2022," Congressional Budget Office, March 2012, http://www.cbo.gov/sites/default/files/cbofiles/attachments/March2012Baseline.pdf.

[5] *Ibid*.

[6] *Ibid*.

[7] U.S. Treasury Department, Bureau of the Public Debt, http://www.treasurydirect.gov/NP/BPDLogin?application=np.

[8] "Discretionary Spending Under the Budget Control Act of 2011," Congressional Budget Office, 8 August 2011, http://www.cbo.gov/publication/42214.

[9] Jonathan Woodson, Assistant Secretary of Defense (Health Affairs) and Director of TRICARE Management Activity, testimony before the Military Personnel Subcommittee of the House Armed Services Committee, 21 March 2012.

[10] The cumulative budget impact of DoD's TRICARE fee proposals remains unclear. If implemented evenly over 10 years, the $25 billion in new revenue could total about 3 percent of the sum required by the Budget Control Act.

[11] Robert F. Hale, Undersecretary of Defense (Comptroller), testimony before the Subcommittee on Personnel of the Senate Armed Services Committee, 28 March 2012.

[12] Maren Leed and Brittany Gregerson, "Keeping Faith: Charting a Sustainable Path for Military Compensation," October 2011, Center for Strategic and International Studies, p. 17.

[13] Nathan, 28 March 2012.

[14] "Long-Term Implications of the 2013 Future Years Defense Program," Congressional Budget Office, July 2012, p. 20. http://www.cbo.gov/sites/default/files/cbofiles/attachments/07-11-12-FYDP_forPosting.pdf.

[15] Jonathan Woodson, Assistant Secretary of Defense (Health Affairs) and Director of TRICARE Management Activity, testimony before the Subcommittee on Personnel of the Senate Armed Services Committee, 28 March 2012.

[16] See AUSA Torchbearer Alert "U.S. Army Retirees: Retired Pay and Health Care at Risk," September 2011, http://www.ausa.org/publications/ilw/Documents/TB_Alert_Retirement_web.pdf.

[17] See AUSA Torchbearer Alert "Breaking the Faith," February 2012, http://www.ausa.org/publications/torchbearercampaign/torchbeareralerts/Documents/TB_Alert_Breaking_Faith_web.pdf.

[18] See AUSA Torchbearer Issue Paper "Military Retiree Health Care Faces a Triple Whammy," November 2011, http://www.ausa.org/publications/torchbearercampaign/torchbearerissuepapers/Documents/TBIP_Retirees_web.pdf.

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