

# Statement Prepared for the Senate Armed Services Committee

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David S.C. Chu

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Mr. Chairman and Members of the Committee: It is a privilege to participate in your panel on military compensation. I should stress that the views I express are entirely my own, based on my previous experience, and do not necessarily reflect research by the Institute for Defense Analyses, nor the views of the Department of Defense.

You asked that I especially address the evolution of military compensation since 2001. In my judgment, three important forces explain its present level and composition: the longer history of military pay and benefits, with its significant utilization of payments in kind, often deferred, and sometimes a function of family status; the nation's desire to recognize and reward those who have already served; and the need to sustain the all-volunteer force that has served us so well, competing against others for the best talent in our society. Compensation decisions that respond to one of these forces will not necessarily serve the others.

Let me begin with the last: Sustaining the all-volunteer force. Based on concern with the quality of military recruits in the 1970s, Congress raised military "base pay" substantially and mandated minimum quality standards. In the 1990s, relying on a review by the National Academy of Sciences of the experience with varying quality levels, the Department of Defense adopted the higher quality goals that endure to this day: 90 percent of non-prior service enlistees should be High School Diploma Graduates, and 60 percent should score above average on the Armed Forces Qualification Test, with no more than four percent coming from the 10<sup>th</sup> to 30<sup>th</sup> percentile of that distribution

(Mental Category IV). To meet that standard, and to sustain preferred retention patterns, the Ninth Quadrennial Review of Military Compensation recommended that “Regular Military Compensation” (base pay plus the taxable equivalent value of housing and subsistence allowances) be set at the 70<sup>th</sup> percentile of civilian earnings for those with comparable education and experience levels. Thanks to the Congress adopting a series of targeted pay increases at the beginning of the last decade, and decisions on the housing allowance, Regular Military Compensation reached and now exceeds that level.

Ultimately, of course, the appropriate level of military compensation is determined by results in recruiting and retention. During the course of the conflicts in Iraq and Afghanistan, the Department expanded use of the authority Congress gave it much earlier to pay recruiting and retention bonuses, and Congress provided the Department with additional flexibility through Assignment Incentive Pay and the opportunity to revamp special pays and allowances. As the burden of those conflicts declined, the Department reduced the extent to which it uses these authorities, illustrating the value of their flexibility.

Taken collectively, the measures I’ve described allowed the United States to pursue its operations overseas for almost 15 years with an all-volunteer force of high quality, whose performance the country as a whole deeply admires, whatever the differing views of its citizens about the conflicts themselves. Quality standards for those joining the military were largely met, and retention both active and reserve paralleled peacetime outcomes. The

professional performance of the American military sets an international standard—and even earlier its excellence convinced a number of nations that had traditionally relied on conscription to adopt the all-volunteer model. There are clearly elements of the current compensation system that have worked well, or that have been adapted effectively.

You asked in your letter of invitation, however, about the need for reform of that system. I believe the country has a special opportunity to consider reform, in the appropriate holistic manner, with the Military Compensation and Retirement Modernization Commission you created. Permit me to reiterate and expand briefly upon the testimony I offered the Commission, and in so doing to comment implicitly on the other two forces shaping the level and composition of military compensation: That is, the history of military pay and benefits, and the desire to recognize and reward those who have already served.

Perhaps most important, I believe that any changes to the military compensation system should derive from the desired shape and characteristics of the future military force. That force may share some of the characteristics of today's military, but it may also differ in important respects. It may place more emphasis on what some like to call "Phase 0" (shaping) and "Phase 4" (post-major conflict), with their attendant needs for greater linguistic and cultural knowledge. It may have more communities that overlap with skills best developed in the civil sector—think cyber. It may want a different experience profile from that created by the current retirement system's incentives, and the "norm" of a 20-year active duty

career. It may be a force with very different needs for entering credentials and experience profiles, across skill and warfare communities: Today we implicitly assume that all will be the same, and thus all should have, in broad terms, approximately the same compensation. It may even be a force in which some individuals move back and forth between active military service and civil life—what would compensation need to look like to achieve that objective?

The society from which military personnel are drawn is also changing. Expectations about, interest in, and attitudes toward military service are different from those of earlier periods. (That is true, I expect, for parents and other “influencers”, too.) Likewise, the outlook on career choices—even the notion of a career—clearly differs from an earlier generation. And our society now offers much improved opportunity for women and minorities than pertained in the mid-20<sup>th</sup> century, when so many of our military personnel policies were formed. There will likely be further important social changes in the years ahead, to which the military compensation system must be prepared to respond.

Perhaps the most important success of the current system was recognizing that in an all-volunteer force (presumptively still our national goal) the military compensation “package” must remain competitive for talent with what the civil sector offers. Since we anticipate real compensation in the civil sector will grow over time, so will military compensation. Those joining the military need to know that the political system will act consistently with that reality (for example, sustaining the competitive standard set out by the

Ninth Quadrennial Review of Military Compensation), and forbear from making what appear to be arbitrary changes to the trajectory of military compensation as a source of near-term budget savings. Instead, “bending the cost curve” needs to look to the efficient use of personnel, and to how we best use our several personnel communities (active, reserve, federal civilians, contractors) to keep military operating costs affordable. Managing the “demand side” well is just as important to compensation success, I would argue, as attending to issues on the “supply side”.

It is nonetheless fair to ask whether the currently constituted military compensation package is best suited to the needs of the 21<sup>st</sup> century force at which we’re aiming, particularly because its structure is so much shaped by the longer history of military pay and benefits, and because much of the total expense is driven by the desire to recognize and reward those who have already served (vice recruit and retain for today’s force). There are at least seven major practices that might be re-examined:

- Should so much of the package be in deferred compensation—i.e., pay and benefits provided after military service concludes, whether after a relatively brief period (VA benefits, etc.) or after a career (retirement, etc.)? As the Congressional Budget Office has pointed out, this is a very different balance from that in the civil sector. The behavior of the force would argue it is not optimal—and, as others have pointed out, there are distinct elements of unfairness in the way some parts of the package are conferred (e.g., the cliff vesting of retirement at 20 years of active service).

- Should so much of the package be in kind versus in cash or allowances? A well-established economic principle argues that you're usually better off providing cash that the individual can use at his or her discretion rather than trying to "guess" at what might be preferred. As one of my colleagues some years ago giped about military compensation: "It's a system composed of what 40-year olds believe 20-year olds should want."
- To the extent that benefits are provided in kind, should the government be the provider? The Department has already moved away from this traditional model for residential construction, empowered and encouraged by the Congress.
- Should so much of the package be determined by one's family status rather than one's contribution to the mission? This is particularly an issue for junior personnel.
- Should we move even further away from the theory that "one size fits all" (i.e., that pay and allowances are importantly determined by grade and years of service)? Bonuses, special and incentive pays, gate pay and Assignment Incentive Pay already acknowledge that the package must differ by skill area and assignment.
- Should our approach to compensation take greater cognizance of individual preferences, capitalizing on self-selection? Implicit in the current approach, I fear, is still much of the directive management

philosophy from the draft era. Could we channel the desires of individual military personnel in ways that better satisfy them, while meeting—perhaps in improved fashion—the needs of the institution? The Navy’s use of Assignment Incentive Pay, the Army’s pilot effort with “Green Pages”, the Reserve Components’ use of volunteers for deployment, as well as earlier initiatives, point to how “all volunteer” might be even more ambitious than present policy.

- Should the mechanisms to compensate for risk be reconsidered, given that they may not be accomplishing their objectives well (e.g., the heavy reliance on the tax code to recognize those exposed to combat situations)?

Permit me to offer seven observations that may affect deliberations about these practices:

First, as my reference to VA already implies, parts of military compensation are paid by agencies other than DoD. The VA contribution, in particular, is very significant; it is also worth noting that military personnel have been part of the Social Security System since 1957. Further, military service may be counted toward federal civil service retirement. Decisions about the use of military personnel and the compensation package should recognize its full range, not just those elements provided explicitly by DoD. Present practices do not meet this visibility standard. This contributes further to the repeated finding that military personnel underestimate, sometimes



significantly, the full value of their compensation. And it obscures the full cost from decisionmakers.

Second, while much of the public discussion of military compensation focuses on the active duty force, I believe it is equally important to consider whether Reserve Component compensation meets the country's force needs efficiently, especially if the Reserve Components are to play as significant a role in the years ahead as they played in the first decade of the 21<sup>st</sup> century. Again, it is important to keep in mind that part of RC compensation comes from sources outside DoD—e.g., for the National Guard especially, from the states.

Third, since a military career imposes burdens on family members that are often quite different from those borne by other Americans, some attention to the family income situation is appropriate, especially the “tax” on spouses that is levied by frequent moves, resulting in lower lifetime earnings for those spouses who pursue work and careers. Nor should the disruption to the children's education be neglected.

Fourth, as I know you and your staff are aware, there is considerable empirical material with which to analyze some of the personnel supply issues any reform debate will want to consider, resident in the surveys conducted by the Department. Those data have been extensively used to answer some questions, but less so for others.

Fifth, important insights on the needs for personnel—the demand side—may also come from the Combatant Commands. My hazard is that their views will be much more variegated than those of the Service headquarters, and will underscore the value of flexibility in compensation mechanisms, to meet needs efficiently.

Sixth, as I suggested earlier, setting and honoring the expectations of those contemplating military service will be key to successful change. There is considerable evidence that unfulfilled expectations—which would result if the guideposts are set improperly or changed capriciously—can doom both policies and institutions.

Seventh, to the extent change is contemplated, consistent with the importance of expectations, attention to the transition mechanisms may be just as important as crafting the optimal course ahead. As I'm confident you'll recall, the change to the retirement program Congress enacted in the 1980s foundered on just this challenge.

I do hope that any debate of change can begin by outlining what the issues are, and what the nation can gain if it deals well with those issues—and the price it will pay if it does not. This hearing certainly contributes to that objective. For me, apart from the specific points I've raised, the most important issue is the ability of the compensation system to provide the military force American needs—a force that may be importantly different in its shape and variety from the force we've needed in the past, or the magnificent force that we enjoy today.