

PREPARED STATEMENT
OF
THE HONORABLE CHRISTINE H. FOX
ACTING DEPUTY SECRETARY OF DEFENSE
AND
ADMIRAL JAMES A. WINNEFELD, JR, USN
VICE CHAIRMAN OF THE JOINT CHIEFS OF STAFF
BEFORE THE
SENATE ARMED SERVICES COMMITTEE

JANUARY 28, 2014

Chairman Levin, Senator Inhofe, and distinguished members of the Committee, we appreciate the opportunity to appear before you to discuss the state of military compensation and retirement benefits in the context of the current fiscal environment. Let us begin, on behalf of Secretary of Defense Chuck Hagel, Chairman of the Joint Chiefs of Staff General Martin Dempsey, and the men and women in uniform we serve, by offering our appreciation for the support of this Committee in once again enacting a National Defense Authorization Act (NDAA). As Acting Deputy Secretary Fox was recently able to discuss with both the Chairman and Ranking Member, this Committee's dedication to getting the NDAA passed means the Department has the authorities it needs to accomplish the incredible array of missions we undertake around the world each and every day, as well as those that support our number one asset: our people.

BUDGET ENVIRONMENT

We in the Department are likewise appreciative of the full year appropriations bill that the Congress recently enacted, which funds the Department of Defense for the remainder of fiscal year (FY) 2014, and also for the budget agreement reached under the Bipartisan Budget Act (BBA) of 2013, which provides the Department with much-needed certainty over our budget for FY 2014 and FY 2015, and partially addresses some of the significant budgetary challenges imposed by the Budget Control Act (BCA) of 2011.

The Department fully supports the goal of deficit reduction in the context of maintaining adequate funding to preserve a strong national defense in a rapidly shifting and highly complex global security environment. The President's budget submission for FY 2014 reflected our commitment to achieving this goal. While fully resourcing the President's strategy as described in the Defense Strategic Guidance, the proposed budget (PB) for FY 2013 trimmed the Department's budget by \$487 billion over 10 years, as required under the BCA. This nearly half-trillion-dollar reduction dovetailed with efforts undertaken by Secretaries Gates and Panetta to improve departmental efficiencies and eliminate unnecessary or underperforming acquisition programs. It was followed by additional cuts in PB14 in support of the President's proposal to replace sequestration.

Once triggered, the BCA's sequestration mechanism reduced the Department's FY 2013 budget by \$37 billion, and threatened the Department with an additional \$52 billion in cuts in this fiscal year. In response to these realities, last summer Secretary Hagel directed that the Department be prepared to operate with significantly fewer resources than those envisioned in our FY14 request. The resulting Strategic Choices and Management Review (SCMR) responded to the Secretary's direction, and clearly demonstrated two points worth noting in the context of today's discussion.

First, the SCMR showed us that in addition to delivering a force that could not fully support the Defense Strategic Guidance in the mid-term, sequester-level cuts under the BCA severely limited the ability of our fighting forces to be ready in the near-term.

Second, it showed that while savings from increased efficiencies, reduced overhead, and reduced military and civilian pay and benefits would not come close to closing the funding gap created by the BCA, every dollar saved in these areas could contribute to maintaining the readiness, capacity, and capability impaired by sequestration-level cuts. That's in part why last summer Secretary Hagel announced another round of management reforms, most notably a 20 percent cut in the Department's major headquarters, staff directorates, and support agencies.

The BBA's increased funding for DoD partially mitigates the worst of the Department's readiness problems in FY 2014, adding about \$21 billion above sequestration-level funding. At only about \$9 billion above sequestration-level funding in FY15, it will do less to help next year. In FY 2016 and beyond, the full BCA sequestration-level cuts remain the law of the land, and will lead to a force that is too small, and takes on too much risk, to fully defend the nation's interests. That is why the Department continues to call for a change in the law, even as we plan for a future at sequestration levels.

REQUIREMENT FOR SLOWING THE RATE OF GROWTH IN MILITARY COMPENSATION

Mindful of this context, Secretary Hagel, the Joint Chiefs, and the Service Secretaries agree that we cannot afford to sustain the rate of growth in military compensation that we've experienced over the last decade.

The rate of growth in pay and benefits to our military members since the early 2000s reflects the convergence of multiple motivations, all of them well-intentioned. These include making-up for previous shortfalls between military and private-sector compensation, expressing the nation's gratitude for the sacrifices required by many service members and their families as a result of the wars in Iraq and Afghanistan, and assisting some services—primarily the Army—in recruiting and retaining a top-notch force during the height of last decade's fighting.

As a result of a series of increases to pay and benefits motivated by these interests—and sometimes in excess of those requested by the Department—since 2001, inflation-adjusted pay and benefit costs for service members have risen by about 40%. Defense health-care costs alone have grown at an unparalleled rate—from less than \$20 billion in 2001 to over \$48 billion in 2013. Payments for housing costs have also increased faster than inflation.

As we have witnessed recently with respect to the consumer price index (CPI)-minus-one provision included in the BBA, which will be discussed in greater depth below, any discussion of compensation for our uniformed personnel is both emotional and fraught with tough decisions about what the Department, and ultimately the American people, promise our men and women when they put on the uniform.

Here we would like to reiterate a point made by several members of the Joint Chiefs. From talking to our sailors, soldiers, airmen, and Marines, the sense of the Department's leadership is that given current rates of compensation, our military work force feels, in general, that their quality of life is quite high. Conversely, the Chiefs and service leaders are also told that one effect of sequestration is a marked decrease in what they term quality of service, defined as the satisfaction a service member feels at knowing they have what they need to do their job, whether that's well-maintained equipment or adequate training.

Our men and women recognize that if they are well paid, but the Department does not have money to maintain their equipment, or supply them with the latest technology, or send them to get the training they need, then we have not done them a service, but rather a disservice. And when we send them into harm's way, this disservice can quickly transition into a breach of trust. That is because America makes a two-fold sacred contract with its military.

The first aspect of our obligation is to properly compensate and care for our service personnel and their families, both during and after their service. But the second part of the contract is equally important: that we provide our troops the finest training and equipment possible, so they can deploy to combat prepared to accomplish their mission and safely return to their families.

As the Department's overall budget declines, we must confront the balance between this two-fold commitment head-on, just as we are confronting the need to balance force size with readiness and modernization.

WORK TO DATE

Against this backdrop, the Department has done a significant amount of work to explore how we slow the rate of compensation growth responsibly, fairly, and effectively.

In so doing, we have followed several key principles.

First, we have endeavored to ensure that pay and benefits remain at levels that would permit us to attract and retain a high-quality all-volunteer force.

Second, all adjustments made would serve simply to slow the rate of growth. No service member would experience a cut in pay.

And third, we've stated that savings accrued through changes to compensation should be invested in war-fighting capability and personnel readiness. Since every 1% we save in military pay and benefits equates to almost \$2 billion, our ability to reallocate these savings translates into the potential for substantial additional combat power.

In line with these principles, the Department has provided several proposals in recent years seeking to slow the rate of growth in compensation costs, some of which have been accepted by the Congress. For example, Congress has modestly increased TRICARE enrollment fees and indexed them to inflation. Congress has also permitted increases in pharmacy co-pays that are structured to provide incentives to use generic drugs ordered by mail. In fact, Congress piloted a program to require the use of mail order for many prescriptions. Just this year, Congress accepted a 1% basic pay raise, even though the Employment Cost Index called for an

increase of 1.8%. We are currently reviewing all military pays and benefits and may offer further proposals in the future.

CPI-MINUS-ONE ADJUSTMENT

Recently, Congress enacted and the President signed a change in military retirement. The so-called “CPI-minus-one” provision included as part of the BBA reduces cost of living adjustments to military retirees to one percentage point below the CPI, until the retiree reaches age 62. At that point, the retiree’s annuity is recomputed based on full past CPI increases, and all increases after age 62 are based on the full CPI.

While no DoD officials, to our knowledge, were consulted on the details of the BBA, including the CPI-minus-one provision, DoD fully supported the provisions in the FY14 Omnibus Appropriation that modified the CPI-minus-one provision to exempt military disability retirements, payments under Combat-Related Specialty Compensation (CRSC) and Concurrent Receipt and Disability Pay (CRDP), survivors of those who died while on active duty, and survivors of disability retired members. These modifications provide critical financial support to those members and their families who have given our country the best years of their lives.

The CPI-minus-one provision does not take effect until December 1, 2015. It would save the Department roughly \$500 million a year in reduced retirement accrual payments. It would not, however, fundamentally reform or modernize the military compensation system, and does not provide for “grandfathering.” A repeal of the provision would eliminate approximately \$6 billion in mandatory savings that would need to be offset.

The Department supports a comprehensive review of the CPI-minus-one provision, including its effect on retirees not exempted by the FY14 Omnibus Appropriations Bill. Examples of issues to examine include whether to repeal the provision entirely, or to include it in an overarching restructuring of the military retirement system.

If the Congress decides to retain the CPI-minus-one approach, we strongly recommend it be modified to include grandfathering, the approach the Department supports for any changes affecting military retirement. While we do not support retention of a non-grandfathered CPI-minus-one approach, because the provision does not take effect until

December 2015, it appears that the Congress could wait to modify or repeal it until the Military Compensation and Retirement Modernization (MCRM) Commission presents its final report in February 2015. Because of the complex nature of military retirement benefits, we in the Department recommend that the Congress not make any additional changes in this area until the Commission provides its report.

Let us finish by sharing our views on the Commission.

MILITARY COMPENSATION AND RETIREMENT MODERNIZATION COMMISSION

The leadership of the Department of Defense share the goals of the MCRM Commission: to ensure that now and in the future, the military compensation system recognizes the sacrifices of those who are serving and have served in uniform and their families; to ensure military compensation remains competitive with the private sector so we can attract and retain the quality and large number of personnel needed; to ensure compensation is structured to sustain the All-Volunteer Force (AVF); to ensure the military compensation system is flexible enough to assist military personnel managers in shaping the force; and to ensure the system delivers an AVF at the best value to the American taxpayer.

The MCRM commissioners have been given an extraordinarily important and complex task, and the Department welcomes their report. Acting Deputy Secretary Fox recently met with Commission Chairman Alphonso Maldon, and discussed with him the many challenges ahead. The Department has itself reviewed military pay and benefits thoroughly, and we believe that we have the necessary information to make judgments about potential changes in most types of pay and benefits. We have presented proposals in the past, and, if we make further proposals in the future, we hope Congress will act on them. However, because of the complexity of retirement issues, we would respectfully ask that the Congress not make any more changes until the Commission completes its work. As we noted above, this includes waiting to make any changes in the CPI-minus-one provision.

From the very outset of the MCRM Commission's work, the Department has cooperated fully and collaborated closely with the commissioners and their staff. In addition to meeting with Acting Deputy Secretary Fox, Chairman Maldon met with Acting Under Secretary of

Defense for Personnel and Readiness Jessica Wright and many members of her staff, as have many other commissioners and Commission-staff members. Additionally, the Department has responded to numerous data requests from the Commission. During their meeting, Acting Deputy Secretary Fox personally assured Chairman Maldon that such engagements and data sharing will continue for as long as the Commission requires, and Chairman Maldon expressed his appreciation for the Department's ongoing support.

The law that established the MCRM Commission also required the Secretary of Defense to transmit his recommendations for modernizing the military compensation and retirement systems to the Commission and the Congress by November 1, 2013. As that date approached, the Department was still in the process of arriving at options in these areas, and was unable to share details beyond those contained in our FY14 budget request. Since then, we have done more work, and, once completed, the details will be fully reflected in the President's FY 2015 Budget. Acting Deputy Secretary Fox assured Chairman Maldon that the Department's senior leaders will make every effort to explain our proposals to Commission members as well as to members of Congress. We expect that we will be able to discuss a range of reform options with you and members of the Commission by no later than the end of February, and that these options will be fully informed by commitments made to our service members and recent retirees.

We look forward to continuing the Department's close cooperation with the MCRM Commission throughout the coming year.

CONCLUSION

Since 2001 and until last year, the Department of Defense benefitted from increasing budgets as we fielded a necessarily larger force to answer the nation's commitments at home and abroad. Today, as our combat mission in Afghanistan abates, we must responsibly return to a more routine footing, all the while contending with a rapidly evolving and dangerous security environment. We must do so while at the same time facing a changing—and challenging—fiscal environment.

Slowing the growth rate of compensation must be one element in a larger approach to preparing a future force that is balanced, and ready to meet challenges seen and unforeseen. Yet pay and benefits are an area where we must be particularly thoughtful, as we weigh commitments made, ensure we are able to recruit and retain the force needed for tomorrow, and make certain those we send into harm's way have all they need to accomplish their mission.

We appreciate the support of this Committee, and look forward to working with you to achieve this balance.