

October 18, 1984

MILITARY COMPENSATION: A KEY FACTOR IN AMERICA'S DEFENSE READINESS

INTRODUCTION

From one-fourth to one-third of every Defense dollar is spent on military personnel compensation. It is a complex, interlocked package of pay and benefits that plays a critical role in managing force readiness. The compensation package, after all, is a major factor in persuading servicemen and women to remain in uniform.

Military compensation is not a salary in the classic sense, but a total package of pay, tax-free allowances, and benefits both immediate and deferred. It includes money (or provision in kind, such as housing or subsistence); various services, including medical care; and deferred compensation, such as retirement and survivor benefits. To maintain force readiness, military compensation must provide a level of remuneration to service members that is in line with contemporary standards and perceived as being fair and equitable in light of the hardships and risks incurred.

When highly leveraged benefits--such as dependent medical care, commissaries, and exchanges--are trimmed, each dollar "saved" may result in a loss of several dollars to military families. The impact on recruiting, retention, or morale--all aspects of force readiness--is seldom fully considered. Qualified, trained, and motivated people are the heart and soul of a ready force. Policy makers at all levels need to better understand the role military compensation plays in the management of U.S. force readiness.

This is the 5th in a series of papers prepared for The Heritage Foundation's Defense Assessment Project directed by Senior Fellow Theodore J. Crackel (U.S. Army, Ret.).

THE MILITARY COMPENSATION PACKAGE

Military compensation is a package that includes basic pay, allowances, benefits, and special incentive pays. Military personnel costs in FY 1985 are expected to exceed \$65 billion. A recruit (E-1) now receives about \$575 per month in base pay. An Army Sergeant First Class (E-7) with 18 to 20 years of service makes about \$1,500. The average Captain (O-3) would earn about \$2,200 monthly, a Colonel (O-6) about \$4,100. Special incentive pay (such as flight pay) could add \$100 or more monthly, but only a small proportion receives it. The value of allowances and benefits is more difficult to assess but is typically considered equivalent to a third or more of base pay.

The report of the Fifth Quadrennial Review of Military Compensation (QRMC), 1984, describes three major elements of military compensation:

□ The first, Regular Military Compensation (RMC), is used in reporting the value of military compensation to Congress and in making comparisons with General Schedule salaries. RMC includes: basic pay, which is prescribed uniformly by grade and years of service; housing allowances or the value of actual housing in kind; subsistence or the value of subsistence in kind; and tax advantages, which occur because of tax-exempt allowances.

□ The second element is composed of special pay to provide incentives to volunteer for particularly hazardous or difficult activity, or to fill highly skilled or undermanned positions. The importance of this has increased since the inception of the All-Volunteer Force in 1973. It is used to overcome manpower problems or shortages in such areas as aviation, submarine duty, parachute duty, and professional health services. There also are bonuses for enlistment and selective reenlistment.

□ A third element consists of supplemental benefits including the retirement system. It is this which most often is attacked. These benefits, however, are an inherent part of the military compensation package, highly valued by service personnel. Retired and Retainer Pay is the single largest element; other items include dependent and retiree medical care, government contributions to Social Security, leave and holidays, nondisability separation pay, and commissaries and exchanges.

Other special allowances are awarded for overseas duty, dislocation, family separation, and indemnity and survivor benefits to reimburse individuals for costs incurred as a result of government-ordered actions.

MAINTAINING THE FORCE

The primary purpose of the military compensation system is to support mission readiness by ensuring the overall manning objectives of the armed forces with the numbers and quality of personnel needed to achieve force objectives.

The spread of service personnel by numbers, age, and grade reflects a large input at the bottom with heavy attrition in the early years and continuing attrition. Only a modest percentage remains in uniform long enough to qualify for retirement compensation. It is essentially a closed system in which lateral entry is very limited. The challenge is to maintain the necessary mix by year groups, grade, and skills and to retain the best in each group. The compensation package is an important management tool in the effort to accomplish this.

Because the majority of career service members is married, incentives must be family oriented. Initial entry may be an individual choice, but in deciding to stay, family interests are a serious consideration. Benefits affecting family well-being have a profound effect on retaining the kind of force the U.S. needs.

THE UNIQUE CONDITIONS OF SERVICE

While comparisons with private sector wage scales are useful in a general sense, it is not possible to simply adopt civilian pay models. There are too many important differences in employment conditions, which have required unique approaches to military personnel compensation.

In contrasting military duties with civilian employment, the Fifth Quadrennial Review of Military Compensation described the unique nature of the military force. Its employer, the Executive Branch of the federal government, can:

- o require the force to fight anywhere in the world and punish those who disobey;
- o use the force when and as long as it believes appropriate without regard to the preference of the individuals;
- o dismiss members, despite fully satisfactory performance, in mid-career for any momentary convenience to the government, while not allowing other individuals to leave, even though they may desire to do so; and
- o force individual members to retire without regard to personal preferences, family circumstances, or alternative employment, and at the same time, retain the right to recall them to active duty if the need arises.

Service members forfeit a considerable degree of personal freedom. The system prescribes how often and where the individual service person will serve, whether it will be with or without family, and what other inconveniences may be required in meeting national defense needs. This, of course, is in addition to being subject to high risk situations. In effect, military personnel sign an irrevocable, unlimited liability contract with the government, a situation not duplicated in the civilian sector.

The picture is succinctly portrayed by Norman Augustine, a former Under Secretary of the Army and now President of Martin Marietta Denver Aerospace.

Certainly, I would hate to ever have to defend a notion that the military pay should not be comparable with civilian pay. But, beyond that, the problem I have is that I am not sure what "comparability" means. For example, in my operation we have 16,000 employees performing a variety of important tasks. But I can't quite imagine having recruited them by saying, "Now this job I'd like you to take will require you being on call 24 hours a day, 365 days a year. You will be expected to pick up and move every 3 years to anywhere in the world you are told, and frequently you will be unable to bring your family with you. Often your family will be required to live in substandard 40-year-old temporary housing and, by the way, I can almost guarantee that if you spend your entire career with us you will at some point be placed in a position where you will be shot at by some people intent on terminating your life prematurely...[What would one] consider to be comparable pay for a job like that?"

Yet there also are many advantages to a service career. Were this not so, the All-Volunteer Force would be a failure. The service offers challenges and opportunities like education, travel, and adventure that are not easily matched elsewhere. There is also satisfaction in serving the nation for vital and necessary purposes. Many are attracted to the military environment, the associations, and the way of life. The sense of belonging in the military community is something special and worthwhile. But this sense can be eroded by the perception--often created by tinkering with the compensation/benefits package--that this community is under attack. The compensation system should and does reflect the differences between military and civilian conditions of employment.

BASIC PRINCIPLES

□ The Manpower System. There is an interrelationship between manpower and compensation. Compensation is linked to force structure and force readiness, and in turn, to military plans and mission capability. Contrary to the view of critics who choose to treat it as if it were part of some autonomous labor market operation, compensation must be synchronized with all the other aspects of the manpower system.

□ Effectiveness. Compensation must be adequate, workable, and capable of producing the desired results. Compensation must provide a socially acceptable level of remuneration for the service member and his family. It should include recognition for special circumstances such as location and hazard. Reimbursements, when made, should cover all expenses incurred.

The need is to acquire and retain the right number of people with proper grades and skills to meet overall force needs. In so doing, it must balance (and control) departures along with inputs and retentions. Retired and retainer pay plays a key role in this effort.

The system must accommodate mobilization planning, and must not only operate effectively in peace but be able to phase successfully to mobilization and a war environment.

□ Equity. This connotes fairness and reasonableness, in comparison both with the rest of the American economy and within the services. This is an elusive concept, and thus is highly subjective. There is no objective way to assess the market value of the special hazards, unusual conditions, or the liability to armed combat.

□ Stability and Flexibility. It is necessary for morale, with attendant effects on attraction and retention, for service members to have a reasonable amount of economic stability. They need to be able to plan ahead. That is only possible, however, when military compensation is handled as a single entity. Stability fails when individual elements of the compensation package are singled out for attack.

Flexibility is the ability to recognize and respond to changing needs and conditions. Nothing in the manpower world is static. Changes are inevitable, and the system needs to accommodate in a responsive but controlled manner.

□ Institutional Support. In addition to basic pay and allowances, there is a special aggregation of benefits and programs geared to the support of service members and their families. These include housing, medical care, commissaries, exchanges, morale and recreational activities, family support programs, and survivor programs. With over half of all service members married, these become very important, particularly in the face of frequent moves, separations, and repeated school disruptions for dependent children.

Military commissaries, medical care, and housing have come under repeated attack. Not only are such programs needed in the military environment, they are considered entitlements by most military families--a part of the compensation package. Cuts are viewed as a breach of faith, and in turn, this translates into manpower losses, which lead ultimately to increases in manpower procurement and training costs. These benefits and services, which support service members and families, are a fundamental part of military compensation and must be given due weight in all major decisions involving compensation.

THE RETIREMENT SYSTEM AND ITS CRITICS

The military retirement system is an important and costly piece of the military compensation package. Costs have quadrupled in real terms in the last 20 years, but this cost growth will

slow markedly in the years ahead. Retirement costs reached \$16.5 billion in 1984, but will grow only to \$19.4 billion (in constant dollars) in the year 2000, to \$22.4 billion by 2043, and then level off.

The increase in the retired population--eleven-fold over the past 30 years--stems from the greatly increased size of the active force following World War II and the Korean War. The increase will be much slower in the future, with little retiree bulge resulting from Vietnam. In fact, with smaller force sizes, future retiree population growth will come largely from the Reserve Components and a general increase in life expectancy.

Of all the elements of the compensation system, retired pay has been most subject to scrutiny and criticism as being too costly. The tendency has been to view retirement as a separate entity, rather than part of the total compensation concept. There are often direct comparisons with civilian retirement systems. In fact, the basis and purpose of military retirement differs from the civilian in several important respects.

The present retirement system provides: nondisability retirement benefits for active duty of 20 years or more; a National Guard and Reserve nondisability retirement system for the members of the Reserve Components who qualify; and a disability retirement for those on active duty who are determined to be unfit because of physical disability. At the present time, there is no vesting of retirement benefits for those who do not otherwise meet the requirements for a retirement annuity, but there is a system of providing separation pay for commissioned members who are involuntarily discharged prior to retirement eligibility.

Eligibility for nondisability retirement, subject to agreement by the Secretary of the military department concerned, occurs only after 20 years of service. Payment is determined on 2.5 percent of basic pay for each year of service up to a maximum of 75 percent of basic pay for 30 or more years of service. This depends on the member's final basic pay, or for those entering after September 1980, the average of the high three years. An Army Sergeant First Class (E-7) who retired at 20 years would draw about \$770 per month. A Sergeant Major (E-9) at 30 years would receive over \$1,700; a Lieutenant Colonel (O-5), after 20 years, would receive about \$1,650; a Colonel (O-6) after 30 years, just over \$3,100. While provision is made for inflation adjustment, full adjustment has been delayed since 1982 by congressional action. Social Security benefits derived from member contribution are added to military retired pay.

Military retired compensation has come under repeated attack in efforts to reduce overall costs. Most of the cost reduction schemes relate to one or more of the following: reduce annuities for early (20-year) retirement; reduce adjustments for cost-of-living allowances (COLA); establish a contributory system in which the service member provides some percentage of input; or integrate Social Security benefits in some manner.

The critics who believe that military retired pay is simply too generous need to reexamine their premises--and the facts. While 20-year retirement provides 50 percent of basic pay, basic pay is only about two-thirds of basic military compensation (BMC)--the approximate equivalent of civilian compensation. The annuity, therefore, after 20 years service is now only about 35 percent of basic military compensation. Today, almost two-thirds of all active duty enlisted retirees with a family unit of four (the norm) would be below the poverty level without additional employment. Over three-quarters would qualify for some welfare--including food stamps. Studies show that lucrative jobs after retirement are more the exception than the rule. A 1983 study by the accounting and consulting firm of Coopers & Lybrand for the Defense Department showed that retiring enlisted men earn substantially less than their civilian peers. While certain technical skills are directly transferable to the private sector, many military skills are not. Most retirees find that they must go through a complete career transition. And even after the transition they are behind. Enlisted men's income was still more than \$6,000 below their peers after seven years in the civilian workforce. Officers who retired after 20 years started out more than \$10,000 behind and were still nearly \$2,000 behind at the end of the same seven years. Moreover, the longer they stayed on active duty, the longer it took to catch up.

The major criticism of retirement is aimed at the authority to draw a retirement annuity after 20 years active service. It is criticized both for being too generous (in terms of total lifestream cost) and for providing a disincentive for members to stay beyond the 20th year. A number of proposals aim at reducing the annuity for retirement short of 30 years. Some also propose cutting the cost of living allowance (COLA), a formula that in the recent years of high inflation has driven up retirement costs.

These proposals mean significant reductions in the service person's total lifestream income. One proposal would reduce the COLA increases by half. While this appears to be only a reduction of a few dollars a month, it would reduce the expected lifetime retirement income of a Navy Chief Petty Officer (E-7)--retiring at 20 years--by 36 percent when inflation is assumed to be a constant 5 percent per year. Higher inflation rates would be even more devastating. Even with 30 years of service the loss of lifetime income would be about 24 percent.

The Reagan Administration, in fact, has a better idea for restraining COLA growth: reducing inflation. Today's lower inflation rates already have reduced dramatically COLA costs. It is inflation and the size of the force that have driven retirement costs up--not increased benefits. Many of today's critics were, only recently, champions of the very programs and policies that brought this inflation in their wake.

PERCEPTIONS AND MISPERCEPTIONS

Some of the attacks on the military compensation system spring from misunderstandings and misperceptions.

□ Commissaries and military exchange stores--the PXs, for example--are almost constantly under attack. Yet they are essential at many posts, and "stretch" military and retired pay everywhere far more than they cost. Abolishing these without compensating those who use them would have the effect of cutting military pay. They are, in fact, a bargain for the taxpayer--high value, low cost.

□ Dependent medical care is another benefit frequently targeted by the cost conscious. There was a time when such benefits were unique; they have roots in necessity at isolated military posts. Today, however, medical plans offered by most industries are as generous and often more generous than those available to service families. Dental care, for example, is routinely provided in company medical plans but unavailable to most military dependents.

□ Some believe that there is current pay comparability with the civilian sector. This is becoming increasingly the exception as the economy improves. Teenage unemployment is typically the last to improve, but there is strong evidence already that, as it does, the wages paid the military will not be competitive.

□ Some assert that retired pay is unaffordable. Yet dedication alone will not prompt a prudent person to seek a career in an organization that terminates many in their forties and even the most successful shortly after reaching age fifty. Retirement pay partially compensates for opportunities--in income, stability, and investment--forgone by those who choose a life of military service.

□ Retired pay is overly generous, argue others. Yet it has been driven up by inflation, not largesse, and would still place many below the poverty level. It provides few with more than is needed to purchase the house their civilian counterparts bought years before and have already paid off.

□ Twenty-year retirement is a particular target. Yet many service persons are involuntarily terminated short of 30 years service. More than half the officers reaching 20 years service will be forced to retire before they reach 30 years service. The fact is that retirement at 20 years is not as attractive as it is sometimes made to seem. Contrary to popular wisdom, the earlier the retirement, the less the total lifetime retired pay will be. The advantages to staying on are increased dramatically if even one promotion in the last ten years is assumed.

These perceptions demonstrate a lack of appreciation of the unique condition of military service or understanding of the role played by compensation in the management of the Armed Forces.

CONCLUSION

Military members and their families know that their jobs are different from those of the average job holder. They are sensitive to this relationship of commitment and good faith. Career personnel have developed a set of values that center on a willingness to subordinate self and accept the risks and burdens of service. They feel that they deserve some guarantees in return:

family support, care, and protection; stability in compensation, support, and benefits; institutional support (commissaries, exchanges, morale and recreational benefits, and medical care); and the retirement benefits they were promised and that they fully and properly earned.

Nothing is more corrosive to good morale than the perception of a continual erosion of benefits. The perception, unfortunately, is ubiquitous. Service oriented publications typically build their circulation around reports on two annual campaigns: first, headlining the attacks on benefits; and second, recounting the threats to the next, inflation prompted, pay hike. Unfortunately, these campaigns are based more on fact than fiction.

Those who must work with the issues of military compensation need a new and comprehensive perspective for understanding and assessing this complex area. The underlying purpose of the compensation system is to manage the force and support the needs of national security. Human resources are the most important, and the most expensive, part of the nation's investment in defense, and the compensation system has a profound long-term impact on providing an adequate number of people with proper skills and leadership ability to meet defense needs and ensure the desired composition and configuration of the force.

Military compensation is not and never will be a mirror image of that in the civilian sector. The structure, objectives, and conditions of service are extremely different. The unilateral contract and the unique risks and conditions of service mean that the service person is different than the purely economic-man model. Career members need and expect a special kind of institutional support not common in a civilian work environment. That is why the compensation philosophy must be more than an economic wage for services rendered. The benefits and privileges are especially important, and the retirement system and survivor benefits are vital ingredients. They have immediate and lasting impacts on military force readiness--and U.S. security.

Prepared for The Heritage Foundation by
Lt. Gen. Richard L. West (U.S. Army-Ret.),
Senior Associate
Association of the U.S. Army

Defense Assessment Project Studies:

- No. 1. Theodore J. Crackel, "Reforming 'Military Reform'", Heritage Back-grounder No. 313, December 12, 1983.
- No. 2. Robert K. Griffith, "Keeping the All-Volunteer Force Healthy," Heritage Backgrounder No. 353, May 18, 1984.
- No. 3. J. A. Stockfisch, "Removing the Pentagon's Perverse Budget Incentives," Heritage Backgrounder No. 360, June 19, 1984.
- No. 4. Mackubin Thomas Owens, "The Utility of Force," Heritage Backgrounder No. 370, August 1, 1984.

KEY REFERENCES

Department of Defense, Fifth Quadrennial Review of Military Compensation, January 1984.

Congressional Budget Office, Modifying Military Retirement: Alternative Approaches, April 1984.

Report of the President's Commission on Military Compensation, April 1978.

Department of Defense, Military Compensation Background Papers, Second Edition, July 1982.

Statement of Dr. Lawrence J. Korb, Assistant Secretary of Defense, before a combined session of two Senate subcommittees, "Comparison Studies are Inadequate," reprinted in Sergeants, Air Force Sergeants Association, February 1984.

Thomas M. Hale, Captain U.S. Navy, "Military Retirement Pay: A Time of Crisis," U.S. Naval Institute Proceedings, April 1983.

Tom Philpott, "Research of Pentagon Pay Study Panel Proving Two Retirement Beliefs False," Navy Times, March 21, 1983.

Peter K. Ogloblin, Office of the Deputy Assistant Secretary of Defense for Military Personnel and Force Management, Principles of Military Compensation (unpublished paper), February 16, 1983.

Associates of Military Leadership, Department of Behavior Sciences and Leadership, United State Military Academy, Military Retirement and Dissatisfaction: Is This a Calling or a Job?, n.d.

Thomas M. Hale, Captain USN (Ret.), "Reserve Retirement: A Bumpy Road Ahead," National Guard, April 1984.

Richard V. L. Cooper, et al., "Military Retirees, Separates, and Post-Service Earnings," Coopers & Lybrand, January 1984.