

MILITARY COMPENSATION ISSUES

Statement of

Robert F. Hale, Assistant Director for
National Security and International Affairs Division
Congressional Budget Office

Before the

Subcommittee on Military Personnel and Compensation
Committee on Armed Services
U.S. House of Representatives

April 26, 1983

Mr. Chairman, I appreciate the opportunity to testify on military compensation issues. In this and the next several years, the Subcommittee faces difficult decisions about a wide variety of compensation issues that will affect defense spending. My testimony today will focus on three issues of particular interest to this Subcommittee: military pay raises, accrual accounting for military retirement, and reimbursement of members for permanent change of station moves. I will assess the effects of alternative pay raises on costs and on the ability to recruit and retain needed military personnel. Your decisions will also have important effects on morale and equity, which I realize you must weigh along with the cost and manning implications.

DETERMINING THE MILITARY PAY RAISE

1984 Raise

In 1984, even with a pay freeze, all the services should do well in recruiting. Success in recruiting personnel into active military service is often measured by the percentage of recruits who hold high school diplomas, which is one criterion for recruit quality. CBO calculates this percentage assuming that numerical requirements are met and that recruits satisfy the test-score limits imposed by the Congress. In the Army, which traditionally has the most difficult recruiting problem, we expect that about 84 percent of all male recruits without previous military service will hold high school

diplomas in 1984. (Table 1 at the end of my testimony shows details for the Army and the other services.) Not only is this near the highest level since the All-Volunteer Force began; it is better than the Army's draft-era experience, when about 70 percent of recruits held high school diplomas.

Similarly, even with a pay freeze in 1984, retention should be up. Retention is often measured by the number of personnel with more than four years of service who remain on active duty. That total should be about 900,000 by the end of 1984, up 43,000 or 5 percent over projected levels at the end of 1983. (Table 2 shows details.)

A 1984 pay freeze, however, would dim recruiting and retention prospects beyond 1984. If pay raises beyond 1984 kept pace with those in the private sector, but there was no catch-up raise later, our projections show that by 1988 only about 61 percent of all male Army recruits would hold high school diplomas, well below today's level and also below the 65 percent minimum set by the Congress for the Army in 1983. Moreover, by 1988 the services would have about 961,000 career personnel. This would be considerably more than today but about 31,000 or 3 percent less than if a 4 percent raise had been given in 1984.

These projections assume the increases in strength levels and other changes in personnel policies recently proposed by the Administration. In some cases the latest Administration policies—which feature increases in Air Force end strengths and decreases in numbers of Army recruits who

have prior military service--have substantially altered earlier CBO forecasts that were supplied to the Subcommittee. For example, earlier forecasts based on last year's plans showed that, without a catch-up raise, about 70 percent of all male Army recruits might hold high school diplomas in 1988, compared to 61 percent under current plans. Total numbers in the 1988 career force of all the services would be 983,000 under last year's plans, compared to 961,000 under current plans.

The sensitivity of these results to manpower policy changes illustrates the need to evaluate military compensation in a broader context. Decisions about major defense commitments or programs--such as expansion of the Navy or strategic modernization--can lead to substantial changes in the size and composition of military manpower requirements. For example, as the above numbers suggest, the need for a military pay raise in 1984 depends partly on decisions about the proposed increase in Air Force end strengths and the Army's intention to cut back on prior-service recruiting. The Congress could improve its ability to review manpower policy in a broader context if it were to obtain from each service a comprehensive five-year manpower plan, something the services prepare for internal use but do not currently provide to the Congress.

The projections cited above use CBO's unemployment forecast that shows unemployment at about 10 percent in 1984 and still around 7.5 percent by 1988. With a brisker recovery, the 1984 recruiting and retention

results would not change much, but the 1988 results would be less positive (see Tables 1 and 2).

In light of the effects of a pay freeze on recruiting and retention, especially beyond 1984, the Congress might opt for a steadier pay policy that grants some pay raise in 1984. It could, for example, grant a 4 percent increase in basic pay, which would increase personnel costs by about \$1.6 billion in 1984. But recruiting and retention results would also be better. The percentage of Army recruits holding high school diplomas in 1984 might reach over 90 percent, compared to 84 percent under the pay freeze. And there would be about 909,000, or 1 percent more, career personnel in 1984. More important, the percentage of Army recruits with high school diplomas in 1988 would be 71 percent rather than the 61 percent projected under a 1984 pay freeze followed by comparability raises. And the size of the career force in 1988 would be about 31,000, or over 3 percent, larger than if there were a pay freeze in 1984.

The Administration has recognized its potentially damaging effect on recruiting and retention and has tentatively promised service members a 10.9 percent "catch-up" raise in 1985, to be followed in later years by comparability. While the Administration's policy would avoid additional expenses for pay and benefits in 1984, it would lead to higher total costs. Over the five-year period through 1988, the "freeze and catch-up" approach would increase manpower costs by \$32.3 billion, compared to \$30.5 billion

under a 4 percent pay raise in 1984 followed by comparability increases in later years.

The higher costs of the "catch-up" proposal, however, would not yield significant further benefits in force manning. The percentage of Army recruits with high school diplomas, projected to be 71 percent in 1988 assuming a 4 percent raise followed by comparability, would also be 71 percent under the "catch-up" approach. The size of the career force would be approximately 999,000 under the "catch-up," only 6,500 or 0.6 percentage points larger than with a 4 percent raise in 1984. Moreover, the improved near-term retention under the 4 percent raise means that the total number of career man-years between 1984 and 1988 would actually be greater than under the more costly "catch-up" approach.

Holding Down Future Pay Costs

While it may be possible to freeze pay in 1984 and still meet goals for recruiting and retention, the Congress cannot consistently hold down pay raises and still meet these goals. It could, however, achieve these goals at less cost by occasionally limiting future pay raises and substituting higher bonuses or other special pays. This would be a cheaper pay policy because it would focus added pay on the skills where recruiting and retention are most difficult. In some military skills recruiting and retention are chronic problems, but in others the goals are routinely exceeded.

ACCRUAL ACCOUNTING FOR MILITARY RETIREMENT

The Administration has proposed major changes in the way the federal budget accounts for military retirement. The "accrual accounting" changes require legislation, which the Administration has sent to the Congress. The Subcommittee also has before it a separate piece of accrual accounting legislation (H.R. 1160). The two bills are similar, and I will discuss them together.

Both bills would simply adjust accounting procedures. They would not affect the amount of retirement benefits paid to any retiree; nor would they affect federal costs. Both would make four major changes in accounting procedures:

- o The Defense Retired Pay appropriation would be transferred out of the defense function and absorbed into a trust fund discussed below.
- o An "accrual" charge for retirement costs for today's military personnel would be added to the defense budget function. The charge would equal the amount actuaries estimate would fully fund the retirement benefits earned each year by today's military members. The charge would take into account expected future prices, wages, and interest rates.
- o A trust fund would be created to pay annual retirement benefits out of accumulated accrual charges and interest earned on them.

The trust fund would also receive annual appropriations from the defense function or some other budget category to pay retirement benefits earned before the initiation of accrual accounting.

- o An independent board of actuaries would be created to ensure that all technical calculations are made on actuarial grounds.

These changes are desirable because the present budgeting method for military retirement fails to reflect the retirement costs of current military manpower. Instead, today's defense budget reflects only the retirement costs of those already retired and their survivors. Conversion to an accrual cost approach in the current budget would explicitly recognize the future retirement liability being built up by today's military personnel. Thus, accrual accounting would improve manpower management by making retired pay costs part of today's budgetary process and force structure decisions.

Let me illustrate this key point with an example. Under today's budgetary procedures, the addition of 100,000 soldiers to defense's manpower pool would not change nondisability retirement costs for 20 years; thus these costs are likely to be ignored. Under accrual accounting, costs would go up immediately, ensuring full visibility.

Nor is this cost visibility the only benefit. Accrual accounting could assist the Congress in assessing the long-run budgetary effects of changes in the military retirement system, since any such revisions would immediately be reflected in the size of the accrual charge.

Because of these important benefits, CBO recommends that the federal budget reflect accrual accounting for military retirement. Accrual accounting has also been recommended by GAO.

Accrual accounting would affect the size of the national defense function (function 050). Should accrual accounting be implemented in 1984, this function would initially decrease by \$16.8 billion because the retired pay appropriation would be taken out. The exact size of the accrual charge that would then be added to function 050 would depend on the economic assumptions used. Using the Administration's assumptions (0.5 percent annual real wage growth and 1.0 percent real interest), the accrual charge for military retirement would be \$15.0 billion in 1984. Thus, on balance, function 050 could decrease by almost \$2 billion.

In a period of intense concern over the size of the defense budget, it may be undesirable to make a substantial change in this function that is due merely to new accounting procedures rather than to any real shift in defense activity. Thus, if the Congress enacts accrual accounting legislation now, it may wish to postpone implementing the changes until fiscal year 1985 to avoid any confusion during this year's debate. The delay would also allow time to make the needed technical calculations. Alternatively, the Congress could add an appropriation to function 050 in addition to the accrual charge. This appropriation—which would equal the difference between actual payments to retirees and the accrual charge plus interest—would

ensure that function 050 remained unchanged in 1984 and would also ensure the solvency of the trust fund.

In addition to changes in function 050, accrual accounting would affect numerous other budget functions, principally the income security function that would house the new trust fund. Overall, these accounting changes might increase federal budget authority by about \$6 billion as the budget begins fully recognizing future retirement costs. But total outlays would not change because actual payments to retirees would remain unchanged.

In sum, accrual accounting represents a complex set of changes that promise to improve defense management. Given the current, intense scrutiny of defense spending for efficiencies, it may be a particularly appropriate time to consider these changes.

PERMANENT CHANGE OF STATION COSTS

CBO has been asked by the Committee to address the issue of PCS move costs and ways to reduce them. We have analyzed the Administration's request for 1984, and will supply that analysis for the record. Analysis shows that 63 percent of the nearly \$3 billion requested for PCS moves in 1984 will pay for moves from one job to another within the United States ("operational" moves) or to or from a job overseas ("rotational" moves).

If the Congress wishes to save money on PCS moves in 1984, one approach would be to require a temporary extension of tour lengths. If, for

example, tour lengths for active-duty personnel in the United States and overseas were extended two to three months, then savings in operational and rotational moves would amount to about \$0.4 billion in 1984. The services have extended tour lengths in the past to meet dollar constraints.

These temporary extensions, however, clearly disrupt personal plans of service members and so adversely affect morale. Thus it may be desirable to reassess this problem on a permanent rather than an ad hoc basis. CBO cannot, however, assess the effects of large permanent changes in the number of PCS moves. Such changes could affect operational commitments (such as the numbers of persons who could be stationed overseas) or personnel policies (such as the relationship between initial Army tours). CBO does not have the analytic tools to assess the effects of major changes in numbers of moves on these variables and hence on military readiness. Indeed, such an analysis, even if we could do it, would involve the Congress in many detailed personnel and operational decisions.

I would like to suggest an alternative approach to handling the PCS issue. The Congress could set a limit on total PCS funds, which in this difficult budget season might have to be below the Administration's request. Within that limit, the Congress could allow the Department of Defense either to allocate more to increasing the rates of reimbursement per move (thereby paying more of the member's costs, as the services often want to do) or to allocate more to the number of moves (thereby keeping up the

frequency of rotation). This approach might encourage DoD to improve its management of the PCS account and would avoid Congressional involvement in many detailed decisions.

Mr. Chairman, I have addressed several compensation issues of immediate interest to the Subcommittee. CBO has also analyzed the effects of alternative GI bills and of changes in military retirement benefits, both issues that could be debated this year. I would be glad to answer questions on these topics. Many of these compensation changes offer an opportunity for substantial budget savings, which guarantees them some popularity during this difficult budget season. But changes in military compensation must also be assessed in light of their effects on recruiting and retention, lest we revisit in the next few years the major manning problems of recent years.

TABLE 1. PROJECTIONS OF MALE NON-PRIOR-SERVICE ACCESSIONS WITH HIGH SCHOOL DIPLOMAS UNDER ALTERNATIVE PAY RAISES (By fiscal year, in percent) a/

		1984	1985	1986	1987	1988	1988 <u>b/</u>
No Raise <u>c/</u>	Army	84	69	67	63	61	57
	Navy	82	77	76	74	65	59
	Air Force	87	87	87	87	85	76
	Marine Corps	82	81	77	75	76	70
"Catch-Up" Raise in 1985 <u>d/</u>	Army	86	82	79	75	71	63
	Navy	84	85	83	82	74	66
	Air Force	87	87	87	87	87	85
	Marine Corps	82	86	81	79	81	74
4 Percent Raise <u>e/</u>	Army	97	81	78	74	71	61
	Navy	91	85	83	82	74	66
	Air Force	87	87	87	87	87	82
	Marine Corps	87	85	81	79	81	72

- a. Projections assume the Administration's proposed strength levels and personnel policies (such as numbers of prior-service personnel). High school graduates who score in Category IV on the Armed Forces Qualification Test are assumed to constitute 20 percent of the Army's non-prior-service accessions, 11 percent of the Navy's, 8 percent of the Marine Corps', and 5 percent of the Air Force's accessions. Except as noted, projections use CBO economic assumptions which show unemployment declining from 10.1 percent in 1984 to 7.6 percent in 1988. All options assume that raises beyond 1984 keep pace with those in the private sector.
- b. This column assumes faster recovery, producing unemployment of 6.0 percent by 1988. Pay raises that keep pace with the private sector would also be higher.
- c. This option assumes no pay raise in 1984.
- d. This option assumes no pay raise in 1984 and a 10.9 percent raise across-the-board in 1985, as set forth in the Administration's defense program.
- e. This option assumes a 4 percent increase in basic and other pays, effective October 1, 1983, for all personnel.

TABLE 2. PROJECTED NUMBER OF ENLISTED PERSONNEL IN THE CAREER FORCE (YOS 5 TO 30) UNDER ALTERNATIVE PAY RAISES (By fiscal year, in thousands) a/

		1984	1985	1986	1987	1988	1988 <u>b/</u>
No Raise <u>c/</u>	Army	322.8	323.4	321.4	320.0	317.2	305.0
	Navy <u>f/</u>	235.1	246.2	251.0	256.9	260.6	254.3
	Air Force	277.9	293.2	301.7	305.2	313.3	304.7
	Marine Corps	64.2	66.6	67.9	68.6	69.8	68.2
	DoD	900.0	929.4	942.0	950.7	960.9	932.2
"Catch-Up" Raise in 1985 <u>d/</u>	Army	322.7	327.2	330.0	332.9	333.8	320.0
	Navy <u>f/</u>	234.9	248.9	255.2	264.4	270.2	263.1
	Air Force	277.8	295.3	305.8	311.3	321.4	311.8
	Marine Corps	64.2	67.6	69.8	71.4	73.3	71.5
	DoD	899.6	939.0	961.8	980.0	998.7	966.4
4 Percent Raise <u>e/</u>	Army	326.8	331.1	332.6	333.9	332.2	319.4
	Navy <u>f/</u>	237.4	250.4	256.8	264.1	268.1	261.5
	Air Force	279.5	296.3	206.0	310.7	319.2	310.3
	Marine Corps	65.2	68.2	70.1	71.3	72.7	71.0
	DoD	908.9	946.0	965.5	980.0	992.2	962.2

a.-e. For notes a. to e., see Table 1.

f. The Navy projections exclude the several thousand full-time reservists (TARS) with more than four years of service.