MILITARY COMPENSATION ISSUES

Statement of

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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 key issues: military pay raises, educational benefits, and military retirement. I will assess the effects of alternative decisions 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.

SUMMARY OF FINDINGS

One key decision regards future pay raises. Our analysis suggests that, even with the 1984 pay freeze recommended by the Administration, recruiting and retention in 1984 would remain at or near historical highs in all the services. But a pay freeze would dim the outlook for recruiting and retention beyond 1984. Thus, the Congress could decide on a steadier pay raise policy and grant a raise in 1984, though at added cost. The raise proposed in the Tower-Jepsen legislation would cost $600 million more in 1984 than would the freeze but would improve recruiting and retention.

In the longer run, the Congress cannot regularly hold pay raises below those in the private sector and still meet manning goals. Key goals could be met at lower costs, however, if the Congress limited some raises but increased bonuses or other special pays.

The Congress may also be faced with a decision about improving military educational benefits. With recruiting at record levels, no added incentives are needed now to meet manning goals. If recruiting problems develop in the future, the Congress should be aware that broad, noncontributory educational benefit programs, while they would improve recruiting, could eventually cost $1 billion or more a year and $200,000 for every added high-quality recruit. More narrowly focused improvements would still cost about $100,000 per added high-quality recruit. By contrast, targeted enlistment bonuses or more recruiters could attract additional high-quality recruits at a cost of $20,000 to $40,000 each.

Finally, the Congress may face decisions about military retirement. Our preliminary analysis of a retirement proposal the Administration may submit suggests that, relative to current law, it would eventually cut costs. In today's dollars, savings could amount to $2 billion to $3 billion a year by the year 2000, or about 10 to 15 percent of nondisability retirement costs. The proposal would also reduce career retention by about 5 percent in the mid-1990s and alter the pattern of retention. The Congress may wish to consider alternatives in this complex and emotional area, and there are many available.

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 would, however, 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 the pay raise proposed in the Tower-Jepsen bill. This would mean a 4 percent increase in basic pay, beginning in April 1984, for all but junior personnel (those in pay grades E-1, E-2, and O-1). This legislation would increase personnel costs by about $600 million in 1984. But

recruiting and retention results would also be better. The percentage of Army recruits holding high school diplomas in 1984 might reach about 88 percent, compared to 84 percent under the pay freeze. And there would be 901,300 or 0.1 percent more career personnel in 1984.

Alternatives to the Tower-Jepsen proposal could produce even more favorable results, but at higher cost. For example, last year's budget resolution assumed a 4 percent pay raise for all personnel, beginning in October 1983. Such a pay raise would add $1.6 billion to personnel costs in 1984 but would result in better recruiting and retention than would Tower-Jepsen (see Tables 1 and 2).

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.

IMPROVING MILITARY EDUCATIONAL BENEFITS

Another key choice that the Congress may face concerns military educational benefits. As the above results suggest, military recruiting and retention are currently at historical highs and are likely to remain high for the next several years. Thus, for the next few years, there is no apparent need for new incentives in the form of improved educational benefits. If problems develop in future years,

and the Congress considers meeting them with improved educational benefits, it should weigh the costs of these proposals against costs of other ways to improve recruiting.

Analysis done last year by CBO suggested that broad-based educational programs--those that require no contribution and provide benefits to most or all personnel--are expensive, both in terms of budget costs and costs per added recruit. For example, one alternative analyzed last year by CBO provided benefits of $225 a month for up to 36 months, with higher benefits for those who remain on active duty beyond the first term. Such a plan could eventually increase personnel costs by about $1 billion a year in today's dollars. Recruiting would improve, but retention would deteriorate as individuals leave the military to take advantage of their educational benefits. The cost for every high-quality recruit added to the military would be about $200,000, which is substantially higher than the costs of other alternatives discussed below. ("High-quality" recruits are those who hold high school diplomas and score in the upper half on entrance examinations given to all entering recruits.)

These general results should apply, though only in part, to broad-based programs such as the one proposed by Senators Cohen, Armstrong, and others (S. 691). The Cohen-Armstrong proposal features a freeze on pay for E-1 personnel that would hold down costs but would also reduce recruiting success. The Cohen-Armstrong bill also features a complex proposal designed to reduce the incentive to leave the military in order to take advantage of educational benefits. CBO has not fully analyzed this last feature, and thus we do not have cost estimates for the entire bill. But the costs per added recruit are likely to be substantial.

More narrowly focused improvements in educational benefits, such as those proposed by Senator Simpson (S. 667), would be less expensive. The Simpson bill would improve the existing Veterans' Educational Assistance Program (VEAP) by increasing the amount the government contributes (from $2 to $3 for every $1 contributed by a service member) and by paying interest on member contributions while they are held by the government. The legislation would also eliminate the termination date, currently specified as December 31, 1989, for benefits earned under the old Vietnam-era GI Bill. By 1990, when full costs would be apparent, added spending under this legislation would equal about $210 million a year in today's dollars. The cost per additional recruit associated with the improvements in VEAP would be about $100,000. This would be lower than the cost of broad-based programs, but higher than the cost of using bonuses (about $35,000 per recruit) or more recruiters (about $22,000 per recruit).

Improved educational benefits might, of course, serve purposes other than recruiting. They might induce more of our citizens to attend college. They might also be seen as a readjustment benefit for those whose careers are interrupted by military service. Finally, educational benefits might appeal to a different category of youth than would bonuses or recruiters, inducing more of the college-bound to join the military. An estimate of how many college-bound youth would be induced by educational benefits to interrupt their plans and join the military, especially in the hard-to-fill combat arms skills, is, however, difficult to make. So too is a judgment as to the appropriateness and efficacy of using military educational benefits to achieve these non-military purposes.

RESTRUCTURING MILITARY RETIREMENT

Another key choice facing the Congress could involve military retirement. For many years, concern has been voiced about the costs of the retirement system. In 1984 costs for those on the retired rolls will be about $16.7 billion. For those on active duty, costs equivalent to about 50 percent of annual basic pay would have to be set aside to fund future retirement costs fully. There has also been concern about the retention incentives provided by the current system. Critics note that the system provides little incentive to reenlist in the military after just a few years of service, because no nondisability benefits at all are paid to those who leave with fewer than 20 years' service. But the system provides a strong incentive to leave after exactly 20 years of service when benefits become available.

There has been no lack of proposals for changing the retirement system. Since 1969, five major studies have proposed changes and another study, the Fifth Quadrennial Review of Military Compensation, is underway right now. Some important changes have already been enacted. In 1980 the Congress provided that, for those entering the military after September 1980, retirement benefits will be computed based on the three years when pay is highest rather than on pay at the time of separation. In 1981 the Congress substituted an annual cost-of-living allowance (COLA) for the semiannual raise in benefits. In 1982 the Congress delayed the dates when COLAs are granted and, more importantly, provided that in 1983, 1984, and 1985 retirees under age 62 will receive only half the normal COLA, subject to certain minimum raises.

In this year's budget, the Administration proposes to make this so-called "half-COLA" provision permanent. It has not yet submitted the actual legislation, but CBO has done a preliminary analysis assuming a permanent half-COLA, no

minimum raises, and long-term growth in the Consumer Price Index of 4 percent a year.

Under these assumptions, the half-COLA option would save money. Relative to current law--which CBO assumes means half-COLAs in 1984 and 1985 but full COLAs thereafter--savings in today's dollars would total about $2 billion in 1984-1988, or about 3 percent of nondisability retirement costs. By the year 2000, annual savings might be $2 billion to $3 billion in today's dollars, or about 10 to 15 percent of nondisability retirement costs. Savings would continue to grow beyond the year 2000.

There would also be a shift in the pattern and level of retention. Because of reduced benefits, a higher fraction of persons would leave the military after about 10 years of service than would be the case under a system featuring full COLAs. But a higher fraction of those who do remain for 20 years would want to remain past 20 years, in order to minimize the number of years spent receiving half-COLAs. On balance, the total size of the career force in the mid-1990s would be about 5 percent smaller under a permanent half-COLA provision than with full COLAs.

Many studies have suggested that the shifts in the pattern of retention created by the half-COLA raises would be desirable. If the Congress wanted these shifts but also wanted to hold down reductions in total numbers of career personnel, it could consider coupling the half-COLA provisions with a "catch-up" raise at ages 62 or 65. A catch-up raise would bring the retired pay of older retirees back to levels that would been reached under full COLAs. Thus it would add to the costs of a half-COLA option but should also minimize the loss of career personnel. It might also be viewed as an equitable treatment of older retirees.

The Congress might also consider providing some benefits to those who leave with fewer than 20 years of service. This "early vesting," which has been recommended by every major study of military retirement, would add to costs but could also substantially improve retention by increasing the incentive to remain in the military after the first term of service.

The half-COLA provision, and variants of it, have the inherent disadvantage that retirement earnings are determined by fluctuations in future prices; the greater the rate of inflation, the smaller the pension in real terms. Similar effects on costs and retention could be achieved by changing the fraction of basic pay that persons receive after completing careers of varying lengths. Past studies have provided numerous examples of changes of this type.

As this discussion suggests, restructuring military retirement would affect not only costs but also the pattern of career retention and the numbers of career personnel. Thus any decision to alter retirement should weigh both the costs and the effects. Unfortunately, it is not easy to foresee all the possible effects of such changes, especially for alternatives much different from the current system. Far-reaching changes in military retirement may therefore result in unanticipated changes in costs or retention.

KEY ACCOUNTING CHANGES

The Administration has also proposed important changes in the way the federal budget accounts for military retirement. Currently, the defense budget only reflects payments to those already retired. The Administration would change the accounting procedure to reflect liabilities being incurred today to pay future retirement costs. By making future manpower costs fully visible in the budget,

these accounting changes should help in the effort to economize on expensive manpower resources and thus improve management. For this reason, the principles of "accrual accounting" have been endorsed by many studies and are recommended by CBO.

The Congress should also consider requiring accrual funding of any proposed improvements in educational benefits, in order to make their full costs visible in the federal budget.

In sum, Mr. Chairman, a wide array of key compensation issues is before the Congress. Some of the proposals 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 b/
No Raise c/	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
Tower-Jepsen d/	Army	88	73	70	66	64	61
	Navy	85	80	79	77	68	62
	Air Force	87	87	87	87	87	81
	Marine Corps	83	82	78	76	77	73
4 Percent Raise e/	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 by 1988. All options assume that raises beyond 1984 keep pace with those in the private sector.

b. Faster recovery would produce unemployment of 6.0 percent by 1988. Pay raises that keep pace with the private sector are also higher.

c. This option assumes no pay raise in 1984.

d. This option assumes a 4 percent increase in basic pay only, beginning on April 1, 1984, except for those in pay grades E-1, E-2, and O-1 who receive no 1984 pay raise.

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 b/
No Raise c/	Army	322.8	323.4	321.4	320.0	317.2	305.0
	Navy f/	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
Tower-Jepsen d/	Army	323.4	324.6	323.1	322.0	319.5	307.2
	Navy f/	235.4	246.9	252.0	258.1	261.9	255.5
	Air Force	278.1	293.7	302.3	306.0	314.2	305.5
	Marine Corps	64.4	66.8	68.2	69.0	70.2	68.6
	DoD	901.3	932.0	945.6	955.1	965.8	936.8
4 Percent Raise e/	Army	326.8	331.1	332.6	333.9	332.2	319.4
	Navy f/	237.4	250.4	256.8	264.1	268.1	261.5
	Air Force	279.5	296.3	306.0	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.