

**SETTING MILITARY COMPENSATION:
PAY COMPARISONS AND OTHER APPROACHES**

**Statement of
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**Before the
Subcommittee on Civil Service, Post Office, and General Services
Committee on Governmental Affairs**

**and the
Subcommittee on Defense
Committee on Appropriations**

United States Senate

November 30, 1983

Mr. Chairman, I appreciate the opportunity to testify on military compensation issues. At your request, my testimony begins by comparing the pay of military personnel and federal civilians. That analysis suggests that, at pay grades compared in a Defense Department study, military personnel have higher take-home pay than federal civilians. Because of the many limitations on these comparisons, however, they should at most be used as one guide to deciding military compensation issues. Decisions should be based primarily on the ability of the military to recruit and retain the personnel that it needs.

In recent years, recruiting and retention have been at or near historically high levels in all the services. CBO expects that recruiting and retention will continue to be very good for the next few years. In light of these results and the need for fiscal restraint, the Congress may explore alternative approaches to limit the growth in military compensation. My testimony concludes by discussing two such approaches: limits on pay raises and changes in military retirement.

COMPARISONS OF MILITARY AND FEDERAL CIVILIAN TAKE-HOME PAY

At the request of the House Budget Committee and others, CBO estimated the cash take-home pay for military and federal civilian employees at different pay grades. We assumed the pay rates and laws in effect today, before any of the pay changes that take place in January.

After presenting the results, I want to emphasize the many assumptions and limitations on these results.

Take-Home Pay Often Higher for Military

CBO's estimates show that, at pay grades that are commonly compared, military personnel take home more cash pay than do federal civilians (see Table I at the end of my testimony for all the estimates). For example, a typical military person in the Washington, DC, area serving in pay grade O-5 (an Army lieutenant colonel or Navy commander) with 20 years of service takes home roughly \$37,400 a year. A typical GS-14 at pay step 4 takes home roughly \$29,500 a year. A typical E-7 (an Army sergeant or Navy chief) with 14 years of service takes home approximately \$22,000 compared to \$16,000 for a GS-9 at pay step 4.

The validity of these comparisons depends, of course, on correct linkages between military and civilian pay grades. The ones I have used are roughly consistent with linkages suggested in a study by Hay Associates for the Department of Defense's Third Quadrennial Review of Military Compensation in 1976. Such studies typically identify common occupational elements such as supervisory responsibilities, job content, and level of skill or education required. They then quantify these factors and develop aggregate measures that allow comparisons between wholly different jobs such as cooks and secretaries.

Needless to say, linking military and civilian jobs requires numerous judgments and assumptions that make such linkages rough guides at best.

Indeed, these linkages are only one of the assumptions and fundamental problems that limit the usefulness of these pay comparisons.

Assumptions Mean Estimates May Not Apply to Any Individual

CBO estimated cash take-home pay under a set of simplifying assumptions. Inevitably, these assumptions mean the estimates may not apply to any particular employee. The number and difficulty of the assumptions also emphasize the problems of comparing two very different pay systems.

For example, CBO's estimates exclude special and incentive pays because they vary so widely from individual to individual. Thus the table understates military income by excluding reenlistment bonuses, aviation career incentive pay, sea pay, and others. Special pays for federal civilians, while smaller, are also excluded.

CBO's estimates also exclude out-of-pocket costs that could reduce cash take-home pay. For example, the government may not always fully compensate military personnel for moving expenses. Thus, in years when persons move, our estimates could overstate military take-home pay. We may also overstate federal civilian pay to the extent that there are unreimbursed expenses related to their work.

Calculations of take-home pay also require assumptions about the amount of federal, state, and local taxes. In calculating taxes, we have assumed that military and federal civilian personnel have the typical federal tax deductions for a family of four. In practice, many taxpayers, especially

homeowners, claim deductions substantially larger than the rule-of-thumb estimate of 23 percent of taxable income. In addition, we have assumed that all personnel pay state and local income taxes, although some military personnel do not even though they live in states that have an income tax.

Nor is take-home pay the only measure of compensation. While it recognizes the employee contributions for fringe benefits, take-home pay excludes the value of the fringe benefits. Many of these fringe benefits—especially retirement and health care—are more generous for military than for civilian personnel.

I have mentioned only a few of the many assumptions in our estimates; all are detailed in the notes to Table 1 at the end of my testimony. Some of these problems could be resolved with a more sophisticated approach, but many are the result of trying to compare two very different pay systems. Moreover, there are more fundamental limitations that restrict the usefulness of these comparisons.

Fundamental Limitations Restrict Usefulness of Comparisons

Many military jobs have no counterparts in the private sector, let alone in the federal civilian work force. There are few sonar technicians or combat soldiers anywhere except in the military. Thus comparisons of military and federal civilian pay give only a hint about the willingness of persons to serve in these jobs.

Simple comparisons of military and federal civilian pay also ignore many factors that must be considered in assessing the adequacy of pay.

Military personnel may be subject to more risk, given the possibility of combat, than are most other federal civilians and private-sector workers. They also serve under a separate set of laws that sometimes limits their personal freedom. Moreover, working conditions and a broad spectrum of quality-of-life issues distinguish military service from federal civilian service.

Finally, comparisons of pay completely ignore the number of personnel that are required. If the military or the federal civil service is to grow, they will generally have to pay more per person to attract and retain extra personnel; the converse is true in periods of contraction. But simple comparisons of pay make no allowance for this fundamental point.

ADEQUACY OF PAY FOR MILITARY RECRUITING AND RETENTION

In light of the many problems inherent in pay comparisons, the best measure of the adequacy of military pay is the ability of the military to attract and retain needed personnel. Let me turn briefly to recruiting and retention results, focusing now on enlisted personnel in the uniformed military.

Military pay in recent years has followed an up-and-down course. The pay raises of 1977-1980 were below those in the private sector; these limited increases were followed by raises in excess of private-sector increases in 1981-1982. The 1983 pay raise was again below private-sector increases. For fiscal year 1984, the Congress agreed to a pay raise slightly

below likely private-sector increases along with a deferral of the raise until January 1984.

This history, along with important shifts in the economy and other factors, has been reflected in the achievement of military manpower goals. Between 1976 and 1980, large numbers of senior personnel decided to leave military service, and all the services experienced difficulty in recruiting. Since 1981, the combination of large pay raises, a slack economy, and management emphasis has resulted in sharp improvements in recruiting and retention. Our forecasts suggest that success in recruiting and retention should continue for the next few years, as the discussion below suggests.

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 of recruit quality. The Army traditionally has had the most difficult recruiting problem. In fiscal year 1983, however, nearly 90 percent of Army recruits held high school diplomas. Not only is this the highest level since the All-Volunteer Force began in 1973, but it is better than the Army's draft-era experience, when about 70 percent of recruits held high school diplomas. It is also much better than the 65 percent minimum required by law. The other services experienced similar success in 1983.

CBO projects that, in the next few years, recruiting will continue to meet numerical goals while also greatly exceeding minimum quality

requirements set by the Congress. Our projections are shown in Table 2, at the end of this statement. These estimates are based on the military end strengths set forth in the 1984 defense authorization bill. We have also assumed a 4 percent pay raise in 1984 followed by raises equal to those in the private sector in later years. Finally, the projections assume CBO's latest economic forecast, which shows unemployment declining to 7.5 percent in 1986. Should unemployment fall more quickly, recruiting could be modestly worse than our current forecasts.

Retention

Retention similarly is at historical highs in all the services. Enlisted retention is often measured by the number of personnel with more than four years of active service. That total should be about 900,000 by the end of fiscal 1984, up 43,000 or 5 percent over a year earlier. Reenlistment rates are up in all services, although pockets of shortages still remain in particular skill or experience groups.

Under the same assumptions discussed above for recruiting, CBO expects further increases in the size of the enlisted career force. If the services do not limit reenlistments, career force size could grow by nearly 50,000 between 1984 and 1986. Table 3 at the end of my statement shows our forecasts. Most of the increase would be concentrated in the Navy and Air Force, the services with the greatest requirements for senior enlisted personnel.

OPTIONS FOR REDUCING MILITARY PERSONNEL COSTS

This favorable outlook indicates that, at least for the next few years, military pay is adequate in terms of its effects on recruiting and retention. Indeed, there may be possibilities for the Congress to reduce personnel costs modestly without severely impairing the ability of the military services to meet manpower goals, and I will discuss two such approaches. I should caution, however, that in the long run military pay will probably have to keep pace with increases in the private sector or recruiting and retention will suffer. Thus the Congress should not look for dramatic, long-term reductions in pay costs unless it is willing to accept a smaller or less experienced military force.

Limit Military Pay Raises

The Congress cannot consistently hold down pay raises while meeting current goals for active-duty service personnel. But, at least for the next few years, it may be able to achieve these goals at less cost by limiting future pay raises and, if selected manpower shortages develop, increasing bonuses or other special pays.

For example, the Congress could limit the annual military pay raise to 4 percent for the next several years. The Congress has done so for the past two years and indicated a plan to continue 4 percent raises in the first budget resolution. The Administration, on the other hand, may well recommend military pay raises that are larger than 4 percent. For every one percentage point that the Congress holds the pay raise below the

Administration's request, annual military pay costs are reduced by almost \$400 million. Moreover, future retirement costs are also held down. Under the new accrual accounting procedures that will be in effect starting in 1985—procedures that recognize costs of future retirement liabilities in today's defense budget—the defense budget will be reduced by a total of about \$500 million for every reduction of one percentage point in the pay raise.

The Congress might have to couple limits on pay raises with selected increases in other pays. Four percent pay raises may well be less than pay increases in the private sector. Thus, as the economy recovers, shortages could develop in selected military skills, even though most skills would remain fully manned. In that case, increased use of bonuses or special pays for shortage skills would be a cheaper pay policy because it would focus added pay on the skills where recruiting and retention are most difficult.

Restructure 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 outlays for those on the retirement rolls will be about \$16.8 billion. Accrual costs will be over 50 percent of basic pay, which means that an amount equal to more than half of current basic pay for members on active duty will need to be set aside to fund their future retirement benefits fully.

There has been no lack of proposals for changing the military retirement system. Since 1969 seven major studies have proposed changes, and another, the Fifth Quadrennial Review of Military Compensation, is reported to be working on a proposal. Increasing incentives for longer careers was one theme common to all these seven studies. Each made proposals that would reduce benefits for those who leave after just 20 years of service and so would provide less incentive to leave immediately. Increasing incentives to stay past the first term of service was another theme. Every study recommended providing some nondisability benefits to those who leave with more than about 10 but fewer than 20 years of service. Today they receive nothing, and so retirement plays little role in reenlistment decisions that occur after the first few years of service.

CBO's preliminary analysis suggests that restructuring military retirement could reduce costs but would also alter the willingness of people to remain in the military. For example, the Congress could permanently grant military retirees under age 62 just half the normal cost-of-living allowance (COLA). Under current law, retirees under age 62 will--through 1986--receive COLA increases that were specified in the law at levels intended to provide one-half the normal COLA. Because of sharply reduced inflation since the law was passed in 1982, these raises will be substantially more than one-half of full cost-of-living increases.

CBO estimates that a provision that provided half the actual COLA on a permanent basis would eventually reduce retirement costs substantially. Because of accrual accounting, these long-run reductions would show up

immediately in the defense budget. Assuming inflation of 4 percent a year, the defense budget would fall by about \$3 billion in the first year. Reductions in federal outlays would occur more slowly as retirees gradually came under the provisions of half-COLA. There would also be some offsetting increases in recruiting and training costs, though they would be small relative to the retirement savings.

Half-COLA would, however, also change the willingness of people to stay in the military. More persons would probably leave before completing 20 years of service, because the incentives to stay for 20 years would be less. But more of those who complete 20 years of service would want to continue in the military in order to get full pay raises rather than half the cost-of-living allowance. On balance, CBO estimates that the size of the enlisted career force—that is, the number of personnel with four or more years' service—would eventually be reduced by about 5 percent.

The Congress will, of course, want to wait to receive recommendations on military retirement from the Department of Defense. But these findings suggest that restructuring military retirement could cut costs while reducing modestly the numbers of career personnel.

SUMMARY

In sum, analysis suggests that, at pay grades linked by a Defense Department study, military personnel receive more cash take-home pay than federal civilians. But these comparisons provide at most only a guide to the fundamental criterion for setting military compensation. That criterion is

whether military compensation is adequate to attract and retain the needed number of qualified men and women to meet military manpower goals.

Our analysis suggests that military pay is currently adequate in these terms. Moreover, military recruiting and retention should remain good at least for the next few years.

Thus the Congress might be able to limit the growth in military personnel costs by restructuring military compensation. Among the policies the Congress might consider are changes in retirement and limits on pay raises coupled with more bonuses and special pays to correct any spot shortages that develop. In the short run, these alternatives offer the prospect of reducing personnel costs without serious adverse effects on recruiting or retention.

TABLE 1. COMPONENTS OF MILITARY AND CIVILIAN TAKE-HOME PAY, BASED ON OCTOBER 1982 PAY RATES
(As of February 1, 1983)

	Basic Pay	BAS <u>a</u> /	BAQ <u>b</u> /	VHA <u>c</u> /	Gross Income	Federal Income Tax <u>d</u> /	State Income Tax <u>e</u> /	FICA Tax <u>f</u> /	Retire- ment <u>g</u> /	Health <u>h</u> / Insurance	Net Income
Military Officers (Pay grade/years of service)											
O-10/ 26	63,800	1,178	7,636	2,214	77,028 <u>i</u> /	15,855	3,196	2,392	0	0	55,585
O-8/ 26	62,878	1,178	7,636	2,214	73,906	15,490	3,142	2,392	0	0	52,882
O-7/ 26	54,670	1,178	7,636	2,214	65,698	12,240	2,671	2,392	0	0	48,396
O-6/ 26	48,035	1,178	6,682	2,472	58,367	9,689	2,289	2,392	0	0	43,997
O-6/22	44,291	1,178	6,682	2,472	54,623	8,372	2,074	2,392	0	0	41,785
O-5/20	37,868	1,178	6,080	2,554	47,680	6,197	1,704	2,392	0	0	37,386
O-4/16	31,892	1,178	5,425	2,658	41,153	4,488	1,361	2,137	0	0	33,167
O-3/6	24,138	1,178	4,878	2,244	32,438	2,629	915	1,617	0	0	27,277
O-1/2	13,727	1,178	3,488	2,023	20,416	797	336	920	0	0	18,363
Military Enlisted											
E-9/26	26,582	1,708	4,601	2,622	35,513	3,178	1,055	1,781	0	0	29,499
E-8/20	20,174	1,708	4,248	2,719	28,849	1,847	687	1,352	0	0	24,963
E-7/14	16,621	1,708	3,953	2,530	24,812	1,235	483	1,114	0	0	21,980
E-6/8	13,234	1,708	3,640	2,257	20,839	725	312	867	0	0	18,935
E-5/6	11,581	1,708	3,344	1,839	18,472	489	242	776	0	0	16,965
E-4/4	10,256	1,708	2,938	1,586	16,488	325	186	687	0	0	15,290
E-3/2	8,456	1,708	2,563	1,794	14,521	116	114	567	0	0	13,724
E-1/1	6,883	1,708	2,563	1,384	12,538	0	74	461	0	0	12,003
E-1/1	6,883	0	0	0	6,883	(391)	74	461	0	0	6,739 <u>j</u> /
Federal Executives											
Level 1	--	--	--	--	80,100	23,035	4,133	348	5,607	1,417	45,560
Level 2	--	--	--	--	69,800	18,492	3,541	348	4,886	1,417	41,116
Level 5	--	--	--	--	63,800	15,855	3,196	348	4,446	1,417	38,518

(Continued)

	Basic Pay	BAS <u>a</u> /	BAQ <u>b</u> /	VHA <u>c</u> /	Gross Income	Federal Income Tax <u>d</u> /	State Income Tax <u>e</u> /	FICA Tax <u>f</u> /	Retire- ment <u>g</u> /	Health <u>h</u> / Insurance	Net Income
Senior Executive Service											
ES-6	--	--	--	--	67,200	17,346	3,391	348	4,704	1,417	39,994
ES-3	--	--	--	--	61,515	14,950	3,064	348	4,306	1,417	37,430
ES-2	--	--	--	--	59,230	14,046	2,933	348	4,146	1,417	36,340
ES-1	--	--	--	--	56,945	13,141	2,801	348	3,986	1,417	35,252
General Schedule (Grade/step)											
GS-15/4	--	--	--	--	53,407	11,747	2,598	348	3,738	1,417	33,559
GS-15/1	--	--	--	--	48,553	9,881	2,319	348	3,339	1,417	31,189
GS-14/4	--	--	--	--	45,405	8,776	2,138	348	3,178	1,417	29,548
GS-12/4	--	--	--	--	32,311	4,605	1,385	315	2,262	1,417	22,327
GS-11/4	--	--	--	--	26,959	3,268	1,077	263	1,887	1,417	19,047
GS-9/4	--	--	--	--	22,281	2,263	808	217	1,560	1,417	16,016
GS-7/4	--	--	--	--	18,215	1,508	574	178	1,275	1,417	13,263
GS-5/4	--	--	--	--	14,707	941	385	143	1,029	1,417	10,792
GS1/1	--	--	--	--	8,676	(28)	119	85	607	1,417	6,476

- a/ Basic Allowance for Subsistence. For enlisted personnel, at the rate applicable when on leave or authorized to mess separately.
- b/ Basic Allowance for Quarters, at the With Dependent rate.
- c/ Variable Housing Allowance, 1983 rates for members with dependents, Washington, D.C., Metropolitan Area.
- d/ Assumes four personal exemptions, joint return, and standard deduction, and an earned income credit for those earning under \$10,000. Figures based on 1982 tax tables or schedules, but deflated 10 percent to account roughly for the July 1983 tax rate reduction. These assumptions may not represent typical military members, federal executives, or workers.
- e/ Based on Virginia 1982 income tax rates, assuming four personal exemptions, joint return, and standard deductions.
- f/ FICA tax for military members: 6.7 percent of first \$35,700. Medicare tax for federal civilian employees: 1.3 percent of first \$35,700 and prorated to reflect fact that payments began in January 1983.
- g/ 7 percent of gross pay for federal executives and workers.
- h/ Based on Blue Cross/Blue Shield High Option, 1982 family rates.
- i/ O-10 gross income includes a \$2,200 personal money allowance.
- j/ Relatively few E-1s receive cash allowances (roughly 11 percent in fiscal year 1983).

TABLE 2. PROJECTIONS OF HIGH SCHOOL GRADUATE PERCENTAGES BY SERVICE (By fiscal year)

	1984	1985	1986	1987	1988
Army	88	70	73	70	68
Navy	87	79	82	82	79
Air Force	88	87	88	88	88
Marine Corps	86	84	82	79	83

NOTES: Projections assume the following:

End strengths after 1984 increase at the relatively high rate planned for in the President's budget for fiscal year 1984.

No change in recruitment of women or people with previous military service through 1988 (that is, Army enlists 19,000 women and 10,000 recruits with previous military service).

Army restricts recruits in category IV to the Congressional requirement; Navy, to 11 percent; Marine Corps, to 8 percent; and Air Force to 5 percent. Also, the Army recruits no women who score in category IV.

A pay raise of 4 percent in 1984, except no raise for personnel in pay grade E-1 with fewer than four months of service; pay comparability thereafter. Unemployment declines gradually to 6.9 percent by 1988.

TABLE 3. PROJECTIONS OF ENLISTED PERSONNEL IN THE CAREER FORCE (By fiscal year, in thousands)

	1984	1985	1986	1987	1988	1989
Army	324	326	326	327	326	326
Navy	234	244	248	255	257	264
Air Force	280	297	307	311	313	321
Marine Corps	65	67	69	71	72	73
DoD	903	934	950	964	968	984

NOTES: Same assumptions as in Table 2, and the following:

Naval strengths do not include the several thousand full-time reservists (TARS) in the career force.

Services continue present policies on reenlistment, and so do not restrict the career force's growth.