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Approaches to Changing Military Compensation

Presentation to the Military Manpower Roundtable

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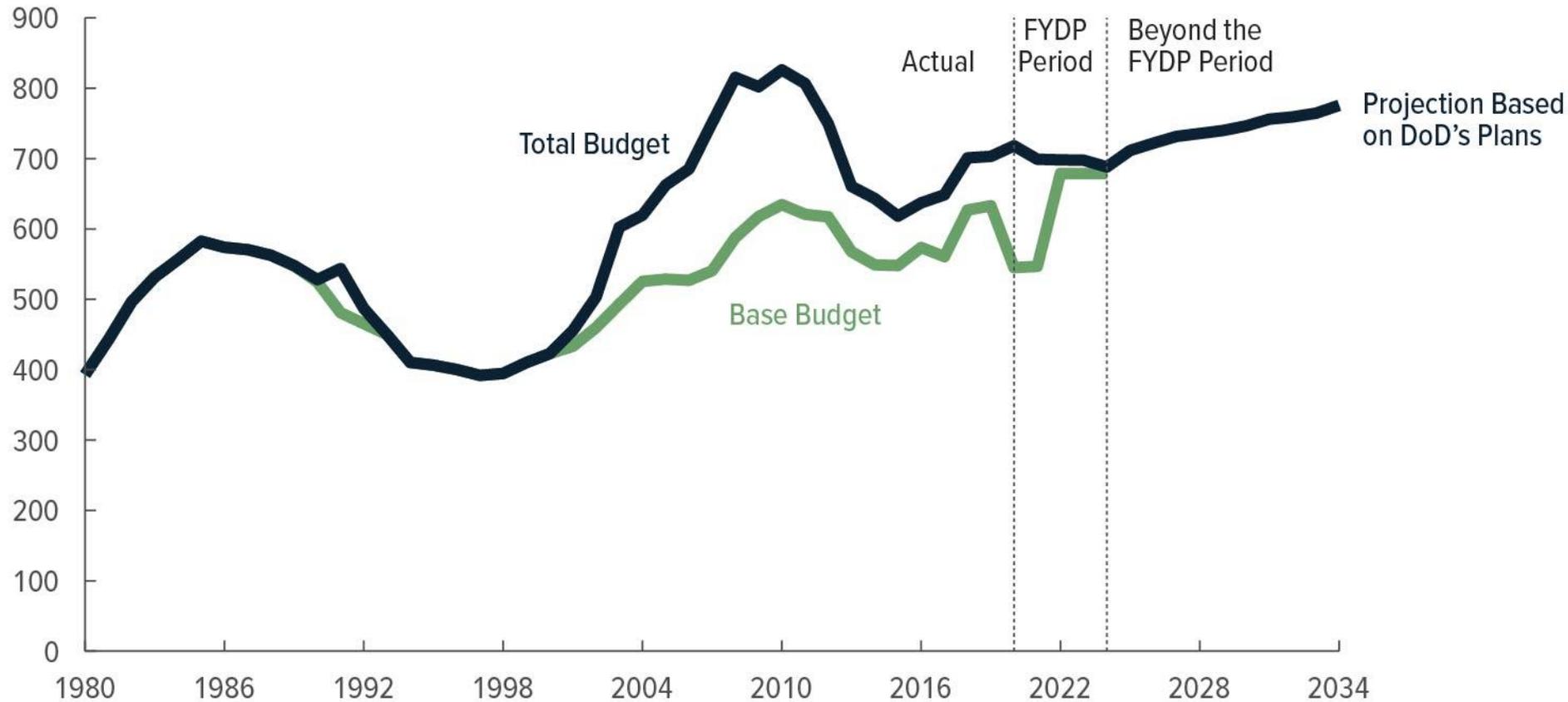
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CBO's Findings

- Cash compensation for military personnel exceeds the 70th percentile of earnings for comparable civilians, often by a significant amount.
- Military compensation is more heavily weighted toward noncash and deferred benefits than civilian compensation is, which further increases its relative value.
- If DoD's overall budget remains flat over the next few years and military end strength adheres to the department's plans, then spending on pay and benefits will reduce DoD's ability to fund other needs, such as modernization or readiness.
- DoD could implement approaches to slow the growth of spending on personnel while still attracting and retaining a high-quality force.

The Costs of DoD's Plans Grow by 13 Percent Between 2020 and 2034 in CBO's Projections

Billions of 2020 Dollars

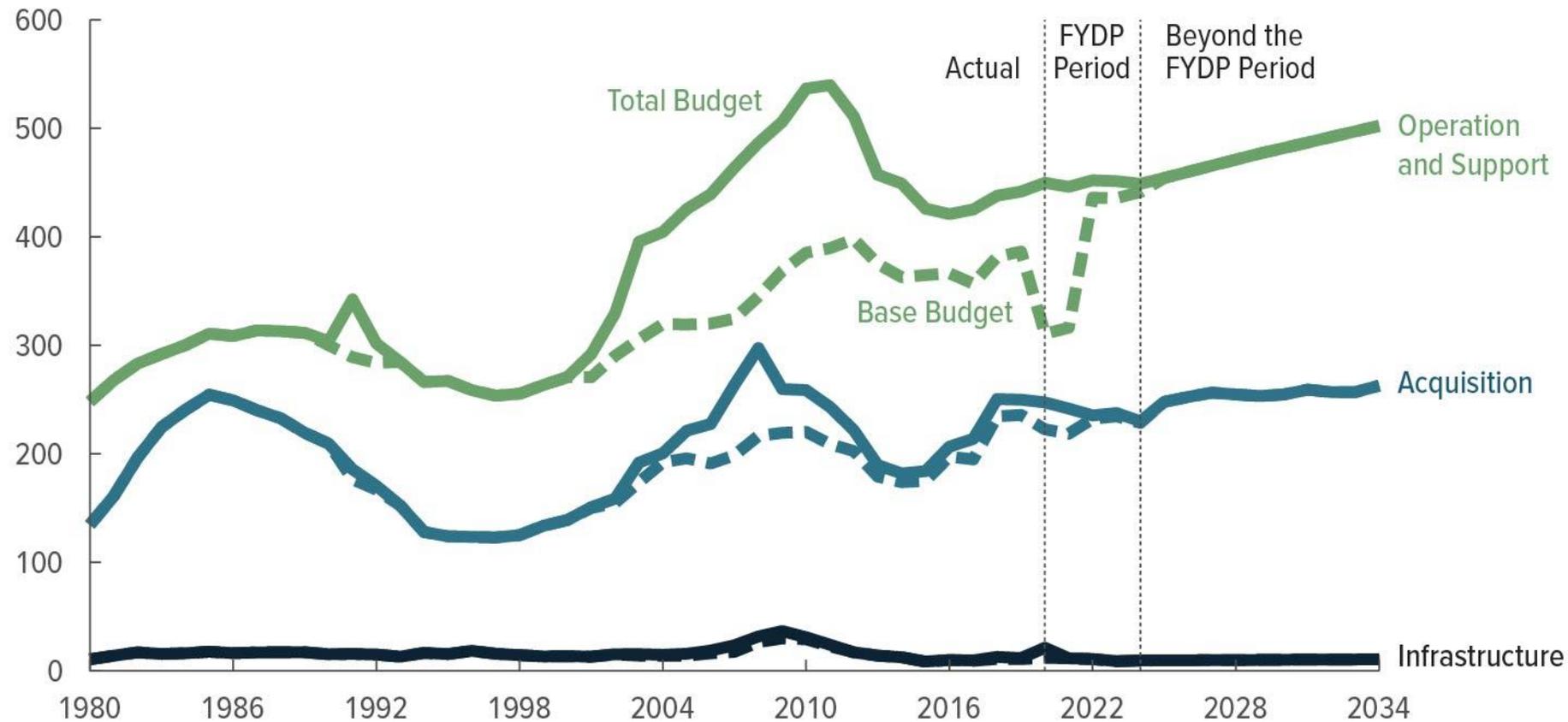


Source: Congressional Budget Office, *Long-Term Implications of the 2020 Future Years Defense Program* (August 2019), www.cbo.gov/publication/55500.

FYDP = Future Years Defense Program.

Most of the Increase in the Costs of DoD's Plans Would Be in Operation and Support

Billions of 2020 Dollars



Source: Congressional Budget Office, *Long-Term Implications of the 2020 Future Years Defense Program*, August 2019, www.cbo.gov/publication/55500.

FYDP = Future Years Defense Program.

Major Elements of Military Compensation and DoD's Current Funding

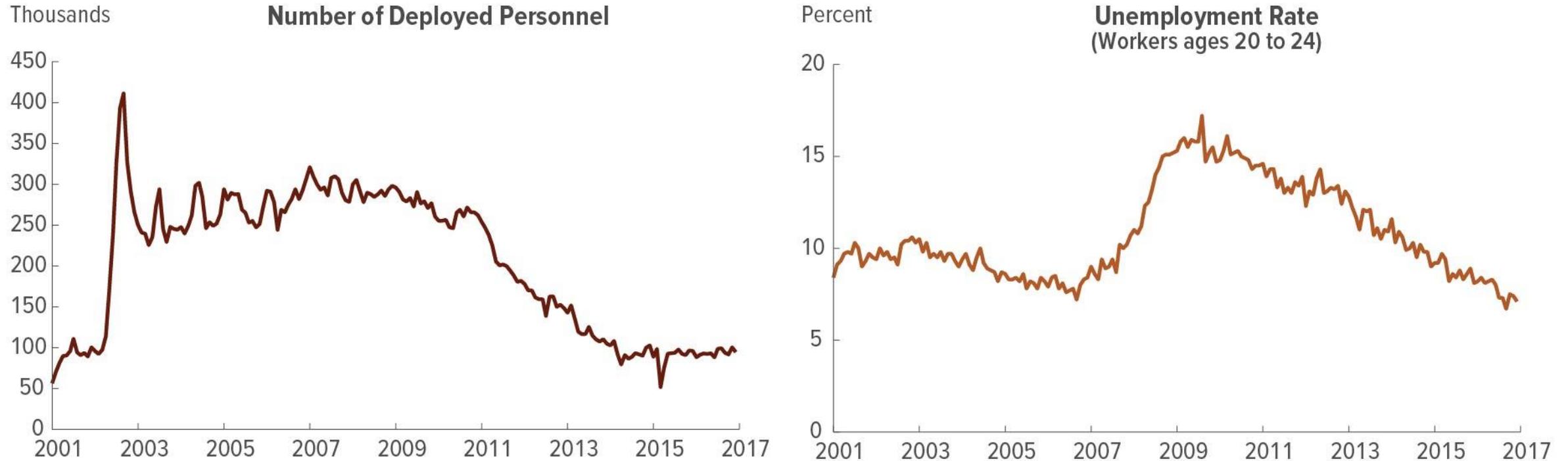
- DoD's funding for military compensation totaled \$170 billion in 2019:
 - \$90 billion for cash compensation;
 - \$44 billion for current noncash benefits, including health care, commissaries, and so forth;
 - \$25 billion for the accrued liability for future retirement benefits; and
 - \$11 billion for health care for current retirees.
- Funding for the Department of Veterans Affairs totaled \$191 billion in 2019 for former service members.
- When deferred compensation is measured on an accrual basis, the average service member's compensation consists of about 55 percent cash and 45 percent noncash and deferred benefits.
 - Estimated total compensation for the median enlisted service member in 2018 was \$112,800.
 - Estimated total compensation for the median officer in 2018 was \$183,100.

The Policy Approaches That CBO Analyzed

- Two approaches that would change cash compensation:
 - Substitute bonuses for a portion of annual increases in basic pay
 - Institute a salary system
- Three approaches that would reduce noncash or deferred compensation:
 - Close selected schools run by DoD and offer cash vouchers instead
 - Eliminate the transferability of Post-9/11 GI Bill benefits
 - Increase the share of health care costs paid by military retirees and their families

Historical Interaction Between Recruitment, Deployment, and the Economy

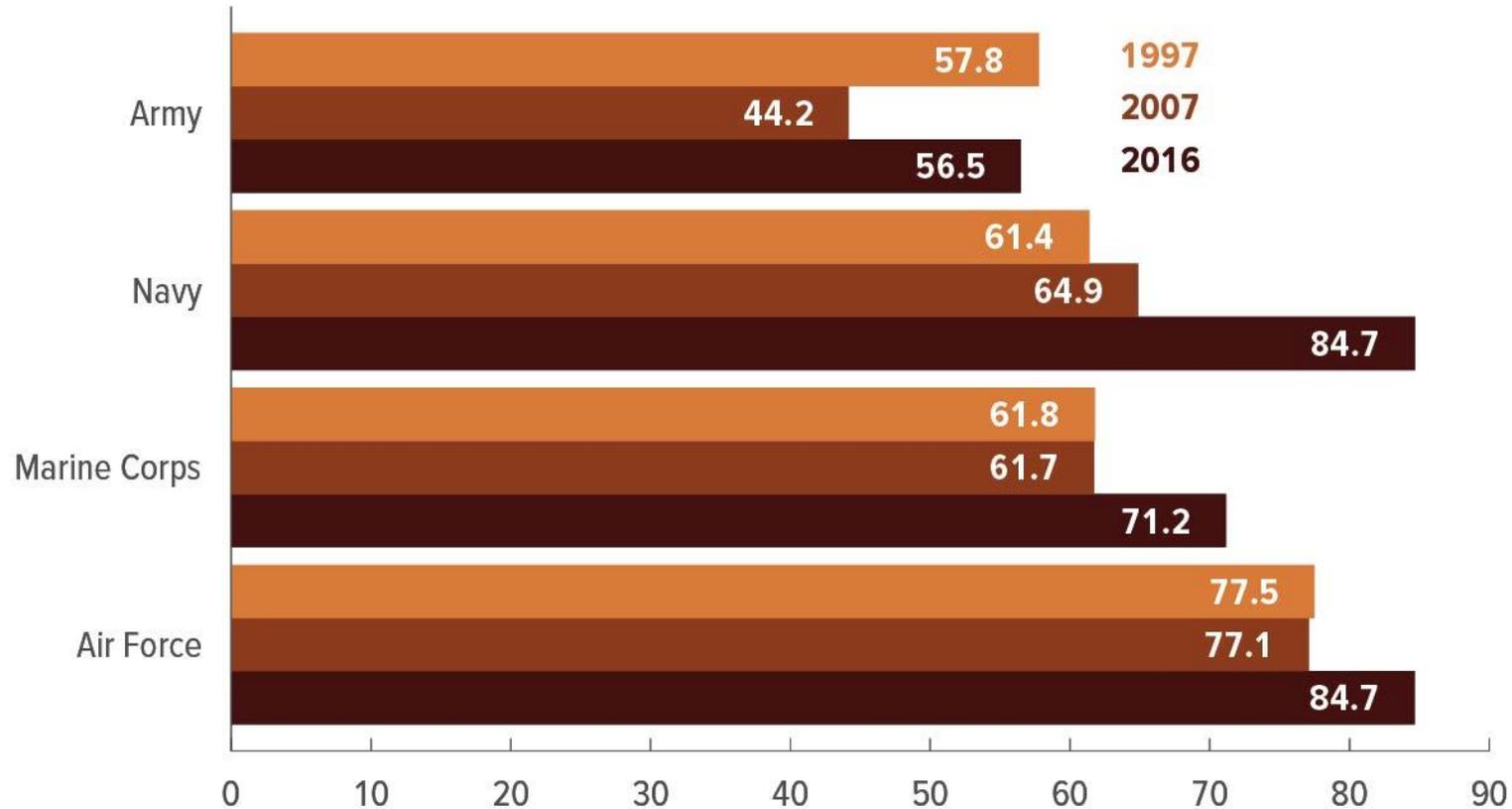
Deployed Personnel and the Unemployment Rate



Force deployments and the economy can interact to make recruiting more challenging. The Department of Defense faced significant challenges between 2004 and 2007.

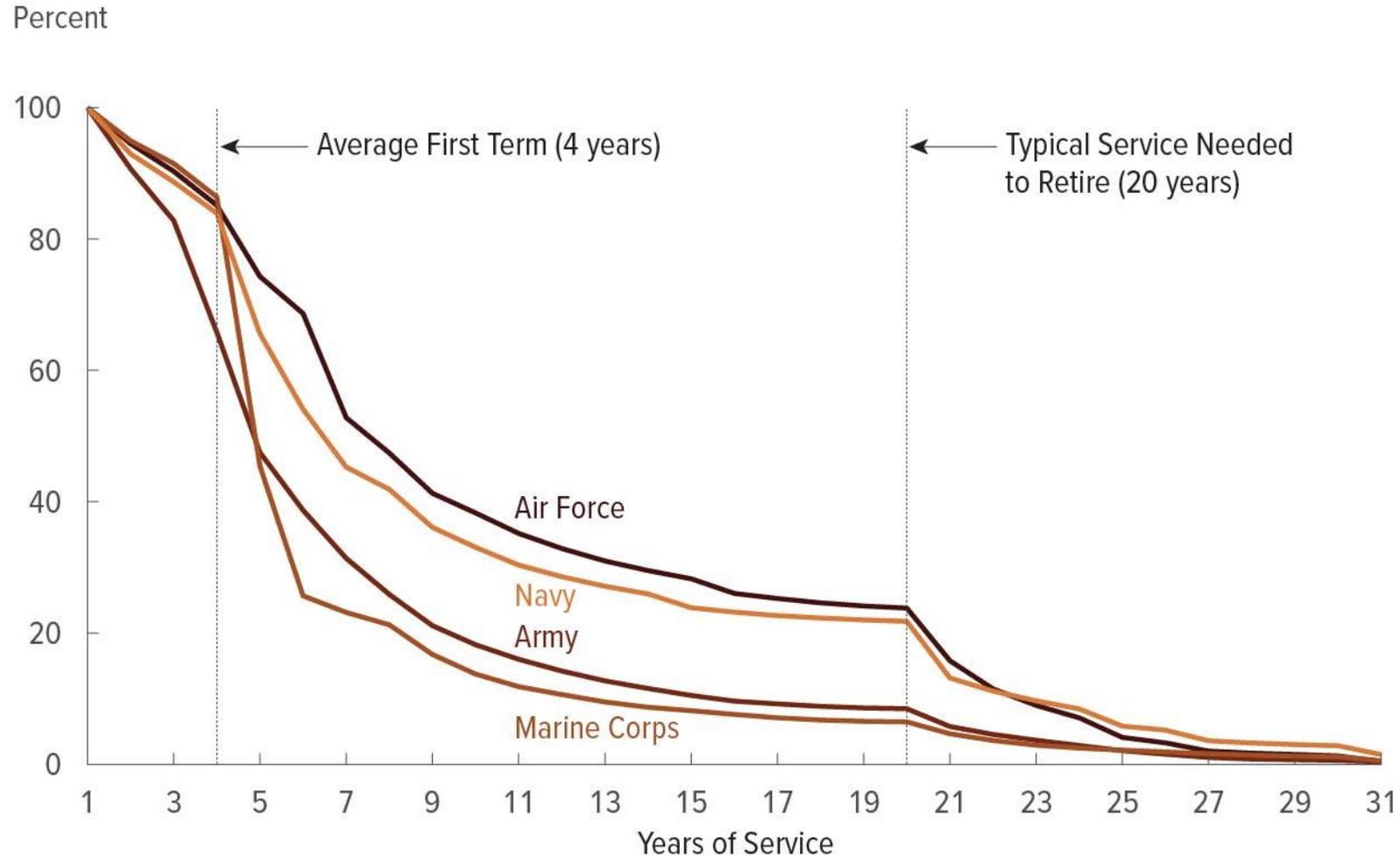
Share of Active-Duty Enlisted Recruits Considered High Quality, Selected Years

Percent



In general, the share of active-duty enlisted recruits who are considered high quality—who have a high school diploma and scored above average on the Armed Forces Qualification Test—has grown over time. The Army saw quality drop substantially in 2007, although it has since rebounded.

Share of Enlisted Personnel Who Remain in the Military, by Years of Service

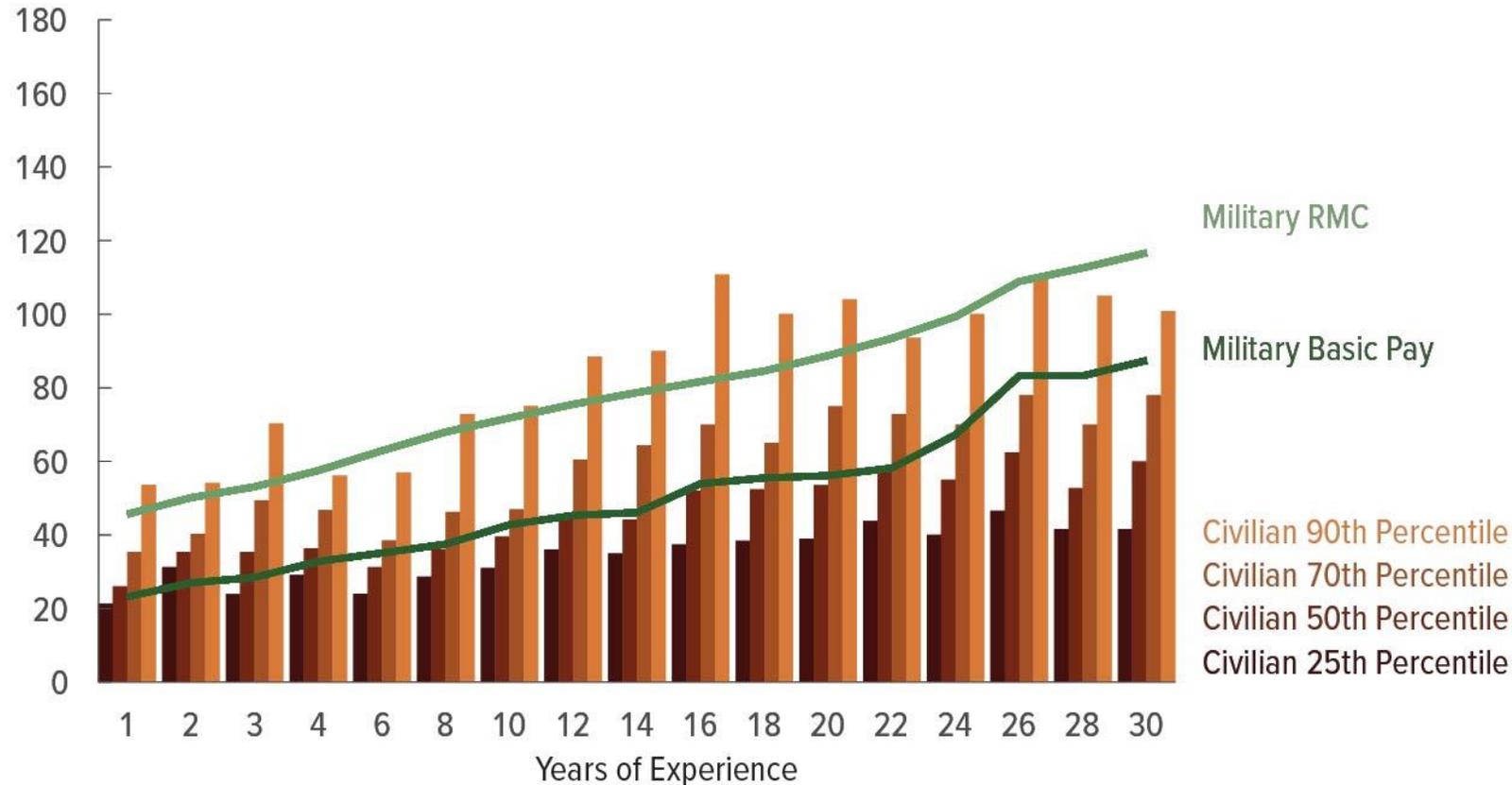


Most enlisted personnel leave active duty after one or two terms of service. An average term lasts about four years but can range from two years to six years.

How Military Cash Compensation Compares With Civilian Earnings

Compensation for Enlisted Personnel Relative to Cash Earnings for Civilians, by Years of Experience, 2018

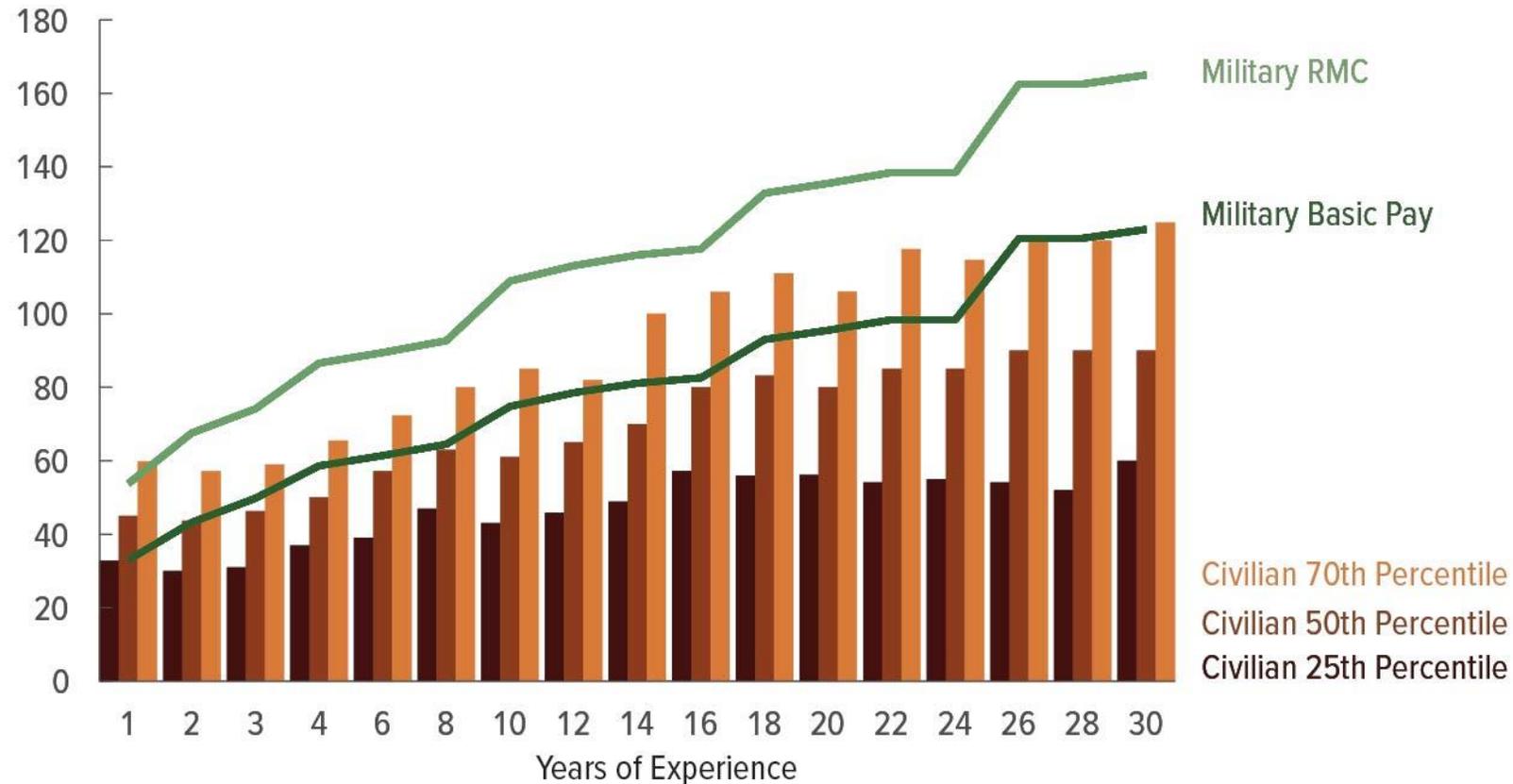
Earnings per Year (Thousands of 2018 dollars)



RMC for enlisted personnel approximates the cash earnings of the 90th percentile of male civilian workers with comparable years of experience and some college education.

Compensation for Commissioned Officers Relative to Cash Earnings for Civilians, by Years of Experience, 2018

Earnings per Year (Thousands of 2018 dollars)

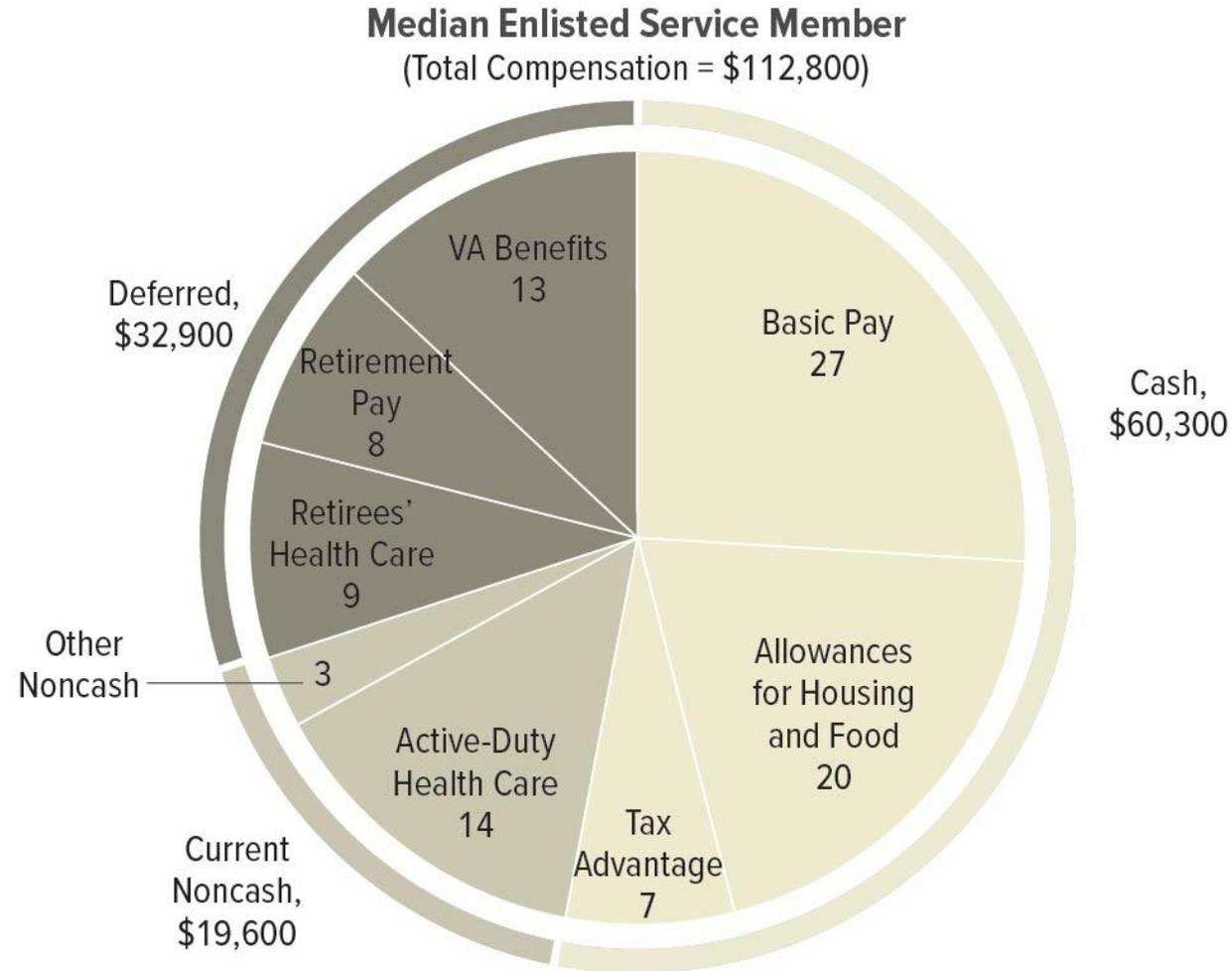


RMC for officers generally exceeds the cash earnings of the 70th percentile of male civilian workers with a bachelor's degree and comparable years of experience.

The Estimated Mix of Cash and Noncash/Deferred Compensation

Estimated Compensation for a Service Member Holding the Rank of E-4, 2018

Percent

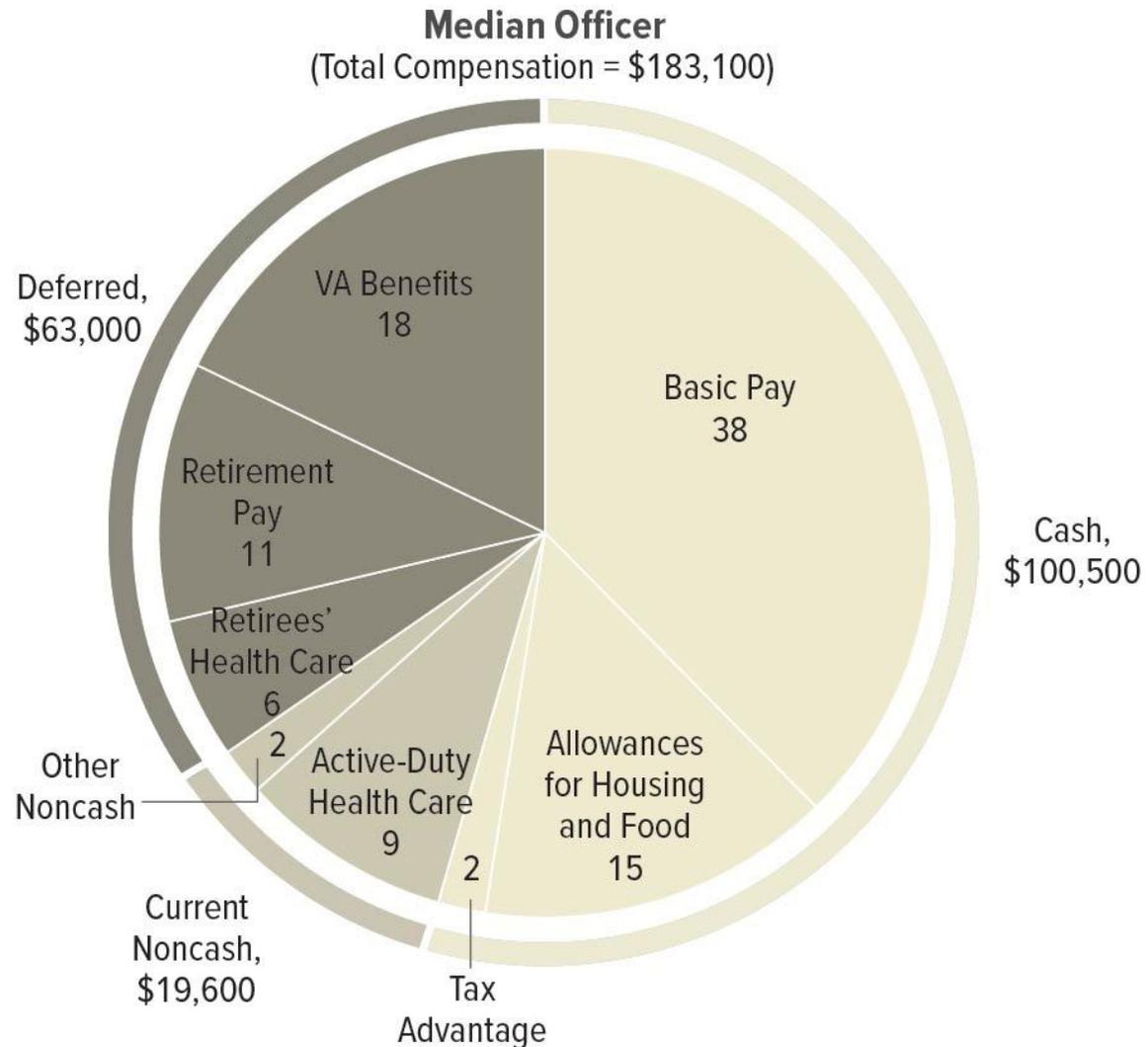


About 47 percent of the estimated value of total compensation for the median enlisted service member is made up of noncash and deferred benefits.

E-4 is the median rank in the enlisted force. "Other Noncash" includes commissaries, child care, and other on-base amenities. Retirement and veterans' benefits are estimated on an accrual basis, incorporating the probability of a service member's reaching retirement.

Estimated Compensation for an Officer Holding the Rank of O-3, 2018

Percent



For the median officer, noncash and deferred benefits constitute 45 percent of total military compensation.

O-3 is the median rank in the commissioned officer corps. "Other Noncash" includes commissaries, child care, and other on-base amenities. Retirement and veterans' benefits are estimated on an accrual basis, incorporating the probability of a service member's reaching retirement.

Advantages and Disadvantages of Changing to a Greater Reliance on Cash Compensation

■ Advantages

- The value of cash benefits is more easily recognized by potential recruits, current service members, and policymakers; reducing the number of types of cash pay would make that recognition even easier.
- Most service members leave after one or two terms and do not receive retirement annuities.
- Greater reliance on cash allows more immediate rewards for good performance.

■ Disadvantages

- Deferred benefits (particularly retirement benefits) encourage people to stay for an entire career.
- An experienced force is more productive, improving military readiness.
- Retaining an experienced, motivated, and more productive force is crucial to military readiness.
- Retention could suffer if service members were expecting those benefits to persist in the future.

Approaches That CBO Examined

Two Approaches That Would Change Cash Compensation

- Substitute bonuses for some of the increases in basic pay
 - Bonuses could be targeted to people in particular ranks or occupations, whereas a pay raise would be received by all.
 - Smaller pay raises would help DoD return to its 70th percentile benchmark.
 - Bonuses would not affect other elements of compensation (like retirement pay), reducing DoD's future funding needs.
 - Smaller pay raises could hamper recruitment and retention unless the bonuses were maintained.
 - Most service members would receive less compensation over time than under the current system.
- Institute a salary system by incorporating housing and food allowances into basic pay
 - A salary system could give service members a more complete view of what they earn and would better link military compensation to job performance.
 - Bonuses could still be used to recruit and retain people with specific skills or occupations.
 - Cash pay would be unaffected by marital status or family size, making it more like civilian packages.
 - Such a system might lead to improved recruitment and retention of people without dependents.
 - DoD's funding for personnel could rise significantly (or not) depending on how the new policy was implemented.

Potential Budgetary Effects of Substituting Bonuses for Some of the Pay Raise

- If future pay raises were capped at the ECI minus 0.5 percentage points for five years, savings would be about \$300 million in the first year and \$4 billion over five years.
- If selective reenlistment bonuses were used to foster retention, one-year savings would be smaller, totaling about \$160 million in the first year. Savings could be greater if DoD could target bonuses more narrowly.

Potential Budgetary Effects of Instituting a Salary System

- If salaries were set to incorporate the housing allowance at the higher “with dependents” rate for all, spending on military compensation would increase by about \$800 million.
 - Compensation would increase by \$9.2 billion in one year, but ...
 - ... charging rent to almost all who live in government-owned housing would allow DoD to recoup \$8.4 billion, making the net cost to the government about \$800 million.
- If the salary was increased by the average value of the federal tax advantage (because all compensation would then be taxable), the net effect on the federal budget would still be about \$800 million.
 - DoD’s funding would increase by another \$5.8 billion, but the Treasury would gain that same amount in tax revenues.

Three Approaches to Changing Noncash or Deferred Compensation

- Close elementary and secondary schools run by DoD in the United States and offer cash vouchers to affected families
 - Initial savings to DoD could be about \$200 million annually
 - Savings to the federal government would be closer to \$180 million after effects on Impact Aid were included.
 - If vouchers were phased out over time, annual savings would rise.

- Eliminate the right to transfer Post-9/11 GI Bill education benefits to spouses and children
 - Savings would depend on whether members used the benefit for themselves instead and whether the reduced benefit reduced retention substantially.
 - Over a range of likely outcomes, CBO estimates that savings would fall between zero and \$1.5 billion.

- Increase the out-of-pocket costs paid by military retirees for their health care.
 - CBO has examined different variations of this option for both older and younger retirees.
 - Estimated savings range from \$2 billion to \$3 billion annually.