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Report of the Seventh Quadrennial Review of Military Compensation

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The report presents the results of the two-year study performed by the presidentially chartered Seventh Quadrennial Review of Military Compensation (7th QRMC). The 7th QRMC conducted a fundamental review of the compensation system of the seven uniformed services, evaluating basic pay, allowances, special pays and bonus programs, and the mechanisms for their periodic adjustment. The 7th QRMC found that the current compensation system is viable; however, existing deficiencies and inconsistencies must be addressed to ensure continued success. The QRMC's recommendations include changes to the basic pay table; changes to the basic allowances for subsistance and housing; creation of a CONUS cost-of-living allowance; improved management of special and incentive pays; an annual pay adjustment mechanism linking RMC growth to the employment cost index; and a timetable for implementation.

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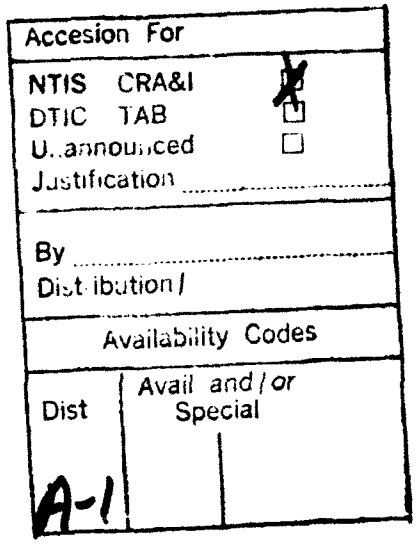

Report of the Seventh Quadrennial Review of Military Compensation

August 21, 1992

Whenever the President considers it appropriate, but in no event later than January 1, 1967, and not less than once each four years thereafter, he shall direct a complete review of the principles and concepts of the compensation systems for members of the uniformed services. Upon completion of such review he shall submit a detailed report to Congress summarizing the results of such review together with any recommendations he may have proposing changes in the statutory salary system and other elements of the compensation structure provided members of the uniformed services.

———37 U.S.C. § 1008(b)

The Report of the Seventh Quadrennial Review of Military Compensation
August 21, 1992

Office of the Assistant Secretary of Defense
(Force Management and Personnel)
The Pentagon, Room 3E764
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THE WHITE HOUSE

WASHINGTON

November 6, 1990

MEMORANDUM FOR THE SECRETARY OF DEFENSE

SUBJECT: The Seventh Quadrennial Review of Military Compensation (QRMC)

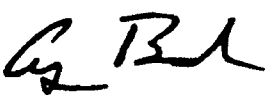
Under the provisions of 37 U.S.C. 1008(b), I am required, beginning not later than January 1, 1991, to direct a complete review of the principles and concepts of the compensation system for members of the uniformed services. You will be my Executive Agent for this review, consulting with me as the occasion requires.

During the past decade our military compensation system has been highly competitive, enabling us to attract and retain enough dedicated and talented men and women to achieve the highest quality Armed Forces in the Nation's history. As we restructure our military forces over the coming decade of change, it is important that we maintain a competitive and flexible compensation system. The system must enable us to continue to attract and retain high-quality individuals equitably and efficiently in the stringent fiscal environment of the 1990s.

Therefore, the Seventh Quadrennial Review of Military Compensation should conduct a fundamental review of the overall compensation system to assess its ability to enable us to continue to achieve these important goals. In particular, your review should evaluate basic pay, allowances, special pays and bonus programs, and periodic adjustments in these compensation elements, to ensure their effectiveness in meeting new requirements.

As Executive Agent, you should ensure that representatives of other executive branch agencies participate in this review as appropriate. Please report to me with your recommendations in time to reflect any necessary changes in my 1993 budget and legislative programs.

I will be looking forward to your progress in this review.



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7th QRMC STAFF ANALYSES

The full set of the 7th QRMC study documentation includes this report and the 7th QRMC Staff Analyses, which form a series of stand-alone reports. The reports in the Staff Analyses provide detailed facts and logic of interest to the small audience of staff specialists who may require a more complete understanding of the findings and recommendations in our official report.

There are two types of documents in the Staff Analyses: Major Topical Summaries (MTSs) and Global Subject Papers (GSPs). MTSs cover primary areas of investigation, such as basic pay and allowances, while GSPs cover either theoretical considerations, such as the principles of compensation, or special research subjects, such as foreign military compensation systems. All other QRMC staff documents are internal working papers that do not necessarily represent the official views of the QRMC. The Staff Analyses consist of the following documents:

MAJOR TOPICAL SUMMARIES (MTSs)

GLOBAL SUBJECT PAPERS (GSPs)

Chapter 1
Executive Summary

EXECUTIVE SUMMARY

INTRODUCTION

Against the backdrop of Desert Shield and a thaw in the cold war, President Bush chartered the Seventh Quadrennial Review of Military Compensation (7th QRMC) to:

- Conduct a fundamental review of the overall compensation system and assess its ability to continue to attract and retain high-quality men and women through the 1990s and beyond.
- In particular, evaluate basic pay, allowances, special pays and bonus programs, and the mechanisms for their periodic adjustment.

The President's charge was to reexamine the basic elements of military compensation to insure that its current structure and composition are sufficient to meet the manning challenges of the post-cold war era. We pursued this charter by focusing on both the overall military compensation structure and on its individual major elements—basic pay, allowances, special and incentive pays, and the annual pay adjustment mechanism.[1] The overarching question was whether the current system of pay and allowances will continue to adequately support our national defense requirements in the future.

In keeping with the President's charter we concentrated on the structure, rather than the level of military compensation, and on current cash, rather than deferred and noncash compensation (retirement, medical, and other benefits). However, recognizing the importance retired pay and benefits play in the total compensation system, we did analyze how these elements would affect and be affected by our recommendations.

THE CHANGING ENVIRONMENT

The fundamental question facing the 7th QRMC was whether the current military compensation structure is an adequate framework to support tomorrow's uniformed services. Key to the answer is the environment, both internal and external, in which tomorrow's force and its supporting compensation system will operate. The existing pay and allowances structure has evolved and endured because it has helped build and maintain a robust military force. However, dramatic changes have occurred since its last major revision at the end of World War II. Furthermore, the pace of change is accelerating and will continue to do so in the future. Conscription has ended, and the military population has already substantially changed demographically, institutionally, and qualitatively. Added to this, the force reductions now under way will streamline the military and increase the need for high-technology skills and talented, experienced members.

External factors also dictate a fresh look at the structure of military compensation. Budgetary pressures cannot be expected to be relaxed in the foreseeable future. Moreover, growing competition with the civilian sector over a limited pool of young, educated people will make recruiting a challenge, even at reduced accession rates. Finally, the evidence available suggests that regional disparities in the cost of living are growing.

The evolving nature of war and its technology, the move from a conscripted to a volunteer force, and changes in social attitudes and values regarding military service have led to a significantly different force in substantially different circumstances. Members today are better educated and more experienced than their predecessors. Many of them are women. The force contains growing numbers of single parents and members married to other members. The high quality apparent in the current force, recently validated in the Persian Gulf, implies that future military members will enjoy even more attractive civilian employment alternatives than those of their predecessors.

Recent events have also called into question the compensation system's effectiveness as a fair reflection of its population's needs. For example, during the 1991 deployment to the Persian Gulf, enlisted members lost their subsistence allowances. Many of them (and their families) viewed this as a significant income loss. In fact, Congress has subsequently directed the Department of Defense to reevaluate that allowance. Other complications in managing allowances are emerging as food and housing provided in kind become the exception rather than the norm. Regional price variations, which evidence suggests are increasing, strain the existing pay and allowances structure. Growing disparities in cost-of-living elements call into question whether cost-based provisions are needed beyond those currently provided by the variable housing allowance (VHA).

It is reasonable to ask whether a compensation system that matured in the middle of the twentieth century for a largely conscripted force will remain viable into the twenty-first. In short, if attainable, a simpler pay and allowances system with a more direct method of managing military compensation might be superior to the current structure of pays and allowances with its growing patchwork of ad hoc changes. Indeed, three other major English-speaking countries with volunteer forces (Australia, Canada, and the United Kingdom) have dramatically streamlined their compensation systems within the past two decades.

ADEQUACY OF THE CURRENT SYSTEM

Our most significant finding is that the current compensation system *can* support the force structure of the twenty-first century. However, deficiencies and inconsistencies do exist and must be addressed to ensure continued success. It is a structure that works, that has stood the test of time, and that will continue, with careful modifications, to attract and retain military personnel of the needed number and quality.

The current pay and allowances structure works because it provides individual building blocks that can be arranged flexibly, within a framework of centralized policy making and fiscal control. These blocks allow compensation to be related to productivity and to be structured as effective incentives for recruiting, retention, and performance.

Compensation differentials among members are the key to an effective, affordable system. There are properly three major military pay determinants:

- *Status* (rank and longevity). Status incorporates a great deal of information about an individual's performance in the past and potential for the future. Both for officers and for NCOs, maturation as a military leader or as a managing technician is required for advancement. Status is appropriately the predominant pay determinant.

- *Skill* (or specialty). Pays based on military specialties (the special and incentive pays, including bonuses) provide economical means to meet outside competition for high-value skills, hold valuable experience, reduce training costs, and encourage particularly talented individuals to pursue demanding career fields.

- *Locality* (cost of living). Locality-based allowances help the member cope with geographic variations in the cost of living. A compensation system, no matter how well designed for one location, can be undermined by variations in the prices of housing and other elements of household expenditure.

VISION FOR THE FUTURE

As discussed in detail in Chapter 2, there are benefits to be gained by system simplification, particularly with respect to the major allowances. The current allowances generally serve two purposes: to reimburse members for out-of-pocket expenses usually provided in kind, and to offset extraordinary variations in prices. Unless there is a compelling reason for providing an element of compensation in kind, cash provision is generally advantageous, both to the member and to the government.

The need for an allowance as a separate element is reduced when all the members of a given status receive the same cash allowance. Once the allowance is the norm rather than the exception, it no longer serves as a useful differentiation of pay between members. This has arguably become the case with the basic allowance for subsistence (BAS), which is now paid to all officers and most career enlisted members. Over time, service members and the government stand to gain from merging this allowance with basic pay. Consideration should be given to moving its cash equivalent into basic pay.

Taken to its limit, this move toward simplification would imply eliminating BAS and the basic allowance for quarters (BAQ) as allowances and moving their imputed cash value, including tax advantage, into basic pay. The result would be a much simplified pay and allowances system—a system with basic pay to reflect status, special and incentive pays to cover skill differentials, and a single locality-based cost-of-living allowance to prevent regional price variations from undermining system function. However, our study suggests that such a fundamental structural overhaul would cause turbulence and raise short-term costs. In fact, there are major hurdles to overcome before such a transition would be possible. They include modification of the existing links between retired pay and basic pay, and resolution of the proper balance between current and deferred income. While a simplified pay and allowances system can be envisioned for the future and should be pursued, the QRMC recommends evolutionary rather than revolutionary change at this time. Transition costs combined with the underlying utility of the existing system suggest that there is no urgent need for major change.

The 7th QRMC recommends:

- ***A near-term policy of continuing the present system of pay and allowances. However, realistic pricing of existing subsistence and housing allowances and an internal restructuring of basic pay are needed to fulfill the objectives of the system.***

- ***Deliberate pursuit of a simpler, more functional pay and allowance system that will better support the future force. The compensation linkages that currently thwart structural change should be reviewed.***

Within the structural framework outlined above, consider now the individual major components of military compensation. Consistent with the organization of this report, we will discuss basic pay, the allowances, and the special and incentive pays in order. This will be followed by a summary of our analyses of military pay adjustment; integration and transition options for implementing our recommendations; and a look to the future, which addresses areas that should be studied by future groups.

BASIC PAY

Basic pay is the principal vehicle for linking compensation to military performance measured by rank. However, ad hoc changes over the past forty years have distorted this linkage so that years of service weigh more heavily than promotion as a determinant of pay. As a result, the distinction between pays of different grades at similar years of service is, in some cases, too small to provide a clear reward for promotion.

There are also significant inconsistencies in the current pay tables. Promotion-triggered pay raises range from 2.8 to 38.2 percent, and longevity raises from 1.3 to 21.8 percent; often there are no apparent reasons for the differences.

The 7th QRMC's proposed pay tables, discussed and displayed in Chapter 3, relieve pay compression between grades by restoring significance to every promotion pay raise and eliminating inconsistencies in the current pay tables. By shifting the emphasis toward promotion while retaining meaningful and consistent longevity raises, these proposals would maintain the high quality of the force by encouraging continuation of top performers. Specifically, in the proposed pay tables:

- The member promoted at average or faster timing is better off than under the current table.
- The member promoted at slower than average timing is not as well off as under the current table.
- Retention of average and faster promotees is improved while overall retention is sustained.
- Longevity differentials for average promotees are more uniform.
- Promotion differentials for typical members increase with rank and exceed longevity differentials.
- Instances and magnitudes of pay inversions are reduced from the current pay table.

The 7th QRMC recommends that its proposed time-in-service pay tables be implemented to achieve a consistent and appropriately weighted promotion and longevity structure across all grades, and that future changes adhere to the structure and principles underlying the proposed table.

BASIC ALLOWANCE FOR SUBSISTENCE

The BAS and the administrative system governing its operation are today unnecessarily complex, often misunderstood, and often perceived as inequitable. If anything, today's BAS system tends to undermine members' confidence in the pay and allowances system. This disfunction was underscored during Operations Desert Shield and Desert Storm. During that deployment, BAS was terminated and rations were provided to many members. Replacement of the allowance with rations reduced family income for enlisted members significantly below the food costs the allowance was designed to defray. Moreover, the administrative task of running a large, joint operation was burdened by service variations in procedures for managing the allowance.

Mispricing of the allowance is a major part of the problem. All officers receive BAS at one rate that is less than the cost of food. Eligible enlisted members receive BAS at one of six rates, and each of these rates exceeds reasonable measures of the cost of food, including the amount charged in military dining facilities. Because BAS exceeds food costs, enlisted members who receive it have, in effect, greater income than those who are subsisted in kind.

Simply put, BAS is *broken* and should be either eliminated as an allowance or repriced to improve its function. To repair BAS as an allowance consistent with its role in today's compensation system, it should be set equal to a member's cost of procuring food on the economy as measured by United States Department of Agriculture (USDA) standards for nutritional requirements and costing. Administrative procedures should be standardized for all grades and services based on practices now applied to officers.

Finally, the QRMC reviewed the dining hall surcharge levied on some members. While the purpose of the surcharge is to recoup operating costs, less than 3 percent of the $1.5 billion dining hall operating expenses is collected. Furthermore, the surcharge has actually had the perverse effect of discouraging supervisory personnel from using the dining hall.

The 7th QRMC recommends:

- ***Establishing a single BAS rate for all members, officer and enlisted; basing the rate on and indexing it to food costs calculated under the USDA Moderate Food Plan; and adjusting basic pay in all cases to preserve the present value of cash compensation.***
- ***Standardizing dining facility and BAS administrative policies by applying the current officer procedures to all members.***
- ***Eliminating the surcharge for all members except those in a temporary duty (TDY) status.***

HOUSING ALLOWANCES

Each member receives either an allowance to defray the costs of obtaining housing or housing in kind. Largely due to regional price disparities, the housing allowance has come to present the Department of Defense with one of its greatest, most persistent compensation challenges. The total housing allowance for members assigned within the United States consists of two parts: BAQ and a variable housing allowance (VHA). BAQ varies by rank and dependency status while VHA varies by rank, dependency status, and location. Adjustment of these allowances also differs. BAQ is increased annually at the rate of the military pay raise, regardless of housing prices, while VHA is determined centrally based on an annual internal member survey of housing expenses.[2]

The 7th QRMC has found that a successful housing allowance must satisfy two major objectives:

- The housing allowance should be sufficient to procure adequate housing commensurate with that occupied by civilians at similar income levels.
- A service member should be unaffected by the housing price variations between locations.

There are inherent weaknesses in setting housing allowances from a survey of member expenditures rather than from actual prices in the housing market. Because spending patterns are responsive to prices—people tend to upscale their housing in lower-cost areas and vice versa—use of expenditure data has tended to support higher housing standards in low-cost areas and undermine standards in high-cost areas. Even if the problems with expenditure data could be overcome, there are difficulties in designing an effective member survey; e.g., in some areas the military population is simply not large enough to provide a reliable sample.

The 7th QRMC concluded that external housing price data should be established as the basis for setting the housing allowance. Weaknesses in the current rate-setting methodology particularly disadvantage junior enlisted members and members assigned to isolated, high-cost areas. Until DoD fully implements a housing allowance system based on external price data, a *minimum adequacy floor* is necessary to provide some near-term relief to these members.

Finally, the government recoups half of that portion of a member's VHA not spent on housing. This policy, known as the *50-percent offset*, is poor compensation practice and questionable public finance.

The 7th QRMC recommends:

- ***Establishing a single housing allowance based on local housing costs, as determined by an external survey of housing price data.***
- ***Implementing the following protective measures until a new rate-setting methodology is adopted:***
  - ***Creating a housing allowance floor to assure that junior enlisted members can afford adequate housing and basing the floor on an external survey of housing costs at the $20,000 annual income level.***
  - ***Using external housing price data to establish rates in resort areas and other duty locations where the current allowances are clearly inadequate.***
- ***Eliminating the 50-percent housing allowance offset.***
- ***Studying housing allowance entitlements for Reserve members on active duty for periods of less than 20 weeks.***

CONTINENTAL U.S. COST-OF-LIVING ALLOWANCE (CONUS COLA)

Other than the VHA, the current compensation system has no provision for geographic variation in

prices within the CONUS. Our research reveals that costs of living not covered by allowances or in-kind provisions vary from 5 percent below to 19 percent above the national average, even taking into account the ameliorative effects of commissary, exchange, and medical benefits. The available evidence suggests that the disparity in living costs between high-cost and low-cost areas continues to grow. A member can be reassigned from a low-cost to high-cost area and suffer a loss in real income equal to or greater than a reduction in rank of a full grade. In fact, some members elect to leave the service rather than move to high-cost areas.

The 7th QRMC finds that cost-of-living variations not covered by VHA are significant enough to warrant a CONUS COLA in high-cost areas after taking into account availability of commissary, exchange, and health care facilities. The QRMC recommends that a CONUS COLA be paid to members whose nonhousing costs of living are more than 5 percent above the national average. A CONUS COLA will not only ensure that members assigned to high-cost areas are not burdened by extreme price variations but, in fact, will protect the compensation system from being undermined by accelerating regional price differences.

The 7th QRMC recommends establishing a CONUS cost-of-living allowance payable to members in locations where the cost of living not defrayed by other allowances, in-kind provisions, or military support facilities is more than 5 percent above the national average.

OTHER ALLOWANCES

There are 31 other allowances provided to recognize the special conditions or requirements of military service. The 7th QRMC briefly reviewed these other allowances and identified several needed procedural corrections.

In particular, most other allowances are paid at a fixed rate prescribed in law, with no mechanism for periodic review or adjustment short of a change in the law. Consequently, they are typically allowed to drift far away from actual costs before the law is changed to update them. Consideration should be given to eliminating partial BAQ, which is paid to members without dependents who live in unaccompanied personnel housing. Unchanged since 1977, it serves no useful purpose today as a separate allowance and is an unnecessary complication in the compensation system. Finally, if BAQ and VHA are combined into a single allowance, a new basis will therefore be needed to compute those allowances now referenced to BAQ.

The 7th QRMC recommends:

- ***Reviewing and periodically adjusting fixed-rate allowances.***
- ***Phasing out partial BAQ.***
- ***Establishing a new rate basis for BAQ drag-alongs when a single housing allowance is adopted.***

SPECIAL AND INCENTIVE PAYS

Special and incentive (S&I) pays principally function to redress skill and manning imbalances and are high-leverage pays critical to tomorrow's compensation system. However, S&I pays are currently disorganized and managed on an ad hoc basis with little coordinated oversight by OSD and the services. The lengthy process required to update any one of these pays tends to undermine its function. The rate-setting process is unstructured and agonizing, and it varies from pay to pay. With the exception of the selective reenlistment bonus program, no standard review and adjustment methodology exists. For S&I pays to be effective, OSD and the services should have more flexibility to adjust pay levels and pay policy in response to short-term manning requirements. We recommend development of a more cohesive management method within DoD.

Finally, while the President's charter did not call for the case-by-case evaluation of individual

pays, three pays obviously require attention. Two are unnecessary; the third needs restructuring to improve its efficiency. These are addressed specifically in the recommendations below.

The 7th QRMC recommends:

- ***Amending title 37 of the United States Code to organize the 55 special and incentive pays into three explicit categories for more efficient management:***
  - ***Career Incentive Pay—monthly cash payments paid on a long-term basis to attract members to certain career fields, duty positions, or locations.***
  - ***Skill Incentive Pays—lump-sum or annual cash bonuses paid to attract and retain qualified members to perform in a critical skill area for a specific term of service.***
  - ***Hazardous Duty Pays—monthly cash payments paid to recognize members who perform hazardous duties.***
- ***Using the Selective Reenlistment Bonus (SRB) Program as a model to develop an officer continuation bonus for nonmedical specialties.***
- ***Developing cost-benefit models to assist management decisions on the adjustment of incentive pays.***
- ***Establishing an Incentive Pay Review Committee to perform an annual review of incentive pays, promote cost-benefit modeling, and ensure consistency and timeliness of compensation adjustments.***
- ***Restoring the value of hazardous duty pay by setting the monthly payment at $150 and reviewing the hazardous duty pay rate every four years.***
- ***Repealing provisions for special pay for members assigned to international military headquarters and for nuclear-trained and qualified enlisted members, and restructuring certain places pay.***

ANNUAL PAY ADJUSTMENT

The purpose of the annual pay raise is to adjust military pay, in light of civilian wage growth, to ensure that entering into or continuing a military career remains attractive. Maintaining competitive pay has been an explicit objective of Federal compensation management, both for the military and the civil service, since 1967. In fact, in that year legislation outlining mechanisms for keeping civil service pay competitive included provisions linking military pay raises to general schedule civilian pay raises.

To keep military pay abreast of civilian peer earnings, three tasks have to be performed: identify those peers, measure their pay increases, and apply a like increase to military pay. Career continuation decisions are heavily influenced by income comparisons; therefore, referencing the pay raise to those of career force contemporaries is a principal objective. These contemporaries, for compensation purposes, are people of like age and education, and of similar occupation.

A focused measure of the earnings growth experienced by young high school and college graduates—the peers of most military entrants—is not readily available from existing published data. The Employment Cost Index (ECI) is the best existing measure of overall wage growth; it was selected in the Federal Employees Pay Comparability Act (FEPCA) of 1990 as the reference point for setting civil service pay increases. However, it is industrially and occupationally oriented and cannot be disaggregated for evaluation of civilians whose demographics mirror those of the military population. An alternative measure, developed by RAND and the QRMC, is the Defense Employment Cost Index (DECI). It offers the potential for disaggregated measures of pay growth experienced by service members' peers, both as an eventual indicator for setting the

military's annual pay raises and as a tool for managing other elements of the compensation system (e.g., establishing enlistment and selective reenlistment bonuses). However, the DECI is still in the development phase. Questions yet to be fully addressed include determining an appropriate weighting and aggregation scheme to arrive at a single pay adjustment rate, implementation and DECI stewardship issues, and the index's year-to-year sensitivity across the business cycle. The QRMC recommends use of the ECI pending completion of DECI development.

Regular military compensation (RMC), which includes basic pay and the subsistence and housing allowances, is the measure of military pay that corresponds closest to civilian salaries.[3] Increasing RMC annually by the same amount as average civilian pay growth would preserve the same income relationship. Indeed, since 1974 the annual raise has been applied that way, most often proportionately across all elements.

RMC should continue to increase abreast of civilian earnings. However, if the allowances are set and adjusted properly based on costs of food and housing, then changes must be made to the way the pay raise is applied. The QRMC believes that, after the allowances have been updated based on prices, basic pay should be increased at the same rate for all members by the amount needed to achieve an increase in average total RMC equal to the change in ECI.

Finally, while the Federal policy of increasing both civil service and military pay apace with private sector wage growth is generally sound, the specific provisions of FEPCA indicate that the formal pay linkages in law since 1967 should be changed. FEPCA provides for referencing general schedule pay to local wage measures with the result being incorporated into the annual pay raise on a regional basis. Because there is no such provision for military pay, nor does the QRMC recommend one, it is time to link military pay raises directly to private sector pay increases. Again, the QRMC recommends that the ECI be the reference point for measuring civilian pay increases, pending maturation of the DECI.

The 7th QRMC recommends:

- ***Continuing to use full ECI as the target amount of the annual military pay adjustment. The Office of the Secretary of Defense should underwrite further development of the DECI as a personnel management tool and as a candidate index for future use in the pay adjustment process.***

- ***Applying the military pay raise (full ECI) to average total RMC when price-based allowance adjustments are fully implemented.***

INTEGRATION AND TRANSITION

Although the QRMC's recommendations will generate significant changes to individual elements of the compensation system, they are designed to result in career earnings similar to today's. The principal differences lie in *when, how much,* and *for what reason* a member receives an increase in pay. Because each recommendation affects the others, we advise jointly implementing our core structural recommendations: to revise the basic pay table, establish a housing floor, and tie the BAS to food costs.

The 7th QRMC recommends using a one-year transition to implement our near-term proposals.

OTHER CONSIDERATIONS

During the course of our study, we came to recognize other compensation issues that, while not within the resource constraints or scope of our charter, need immediate attention or analysis. As discussed in Chapter 8, the QRMC sees the following specific issues worthy of further study:

- Pay Linkages: The linkage between basic pay and other parts of the military compensation system, particularly retired and drill pay, impede even the simplest, though important,

changes to the current system. DoD should carefully evaluate ways to relax the constraints on the elements of cash compensation structure that these linkages impose.

- Implications of a Smaller Force Structure: Should military compensation remain at current levels in light of a sustained force drawdown? We briefly reviewed this question from a force readiness perspective, first looking at pay for career members then at pay for new recruits. Two conclusions emerged: (1) a post-drawdown career force that mirrors the quality and experience mix of today's force implies no relaxation in the level or growth of pay; and (2) while, on theoretical grounds only, there may be some justification to consider reducing recruit entry-level pay or incentives, the impacts of such a move are unclear and depend on a number of external factors.

- REDUX Retirement Program: Force structure consequences of recent changes in the retirement system merit careful evaluation. Significant reduction in retirement benefits, effective for members entering on or after August 1, 1986, can contribute to reduced midcareer retention in the mid-1990s, and may be of particular importance following our major force reduction.

Finally, the 7th QRMC would emphasize that compensation review is properly a continuous process. We recommend that DoD initiate a formal program to maintain and enhance the analytic capabilities developed during this study. Additionally, consideration should be given to improving the continuity of compensation policy development. This should include, in particular, a review of the standing support and timing of future QRMC studies.

SERVICE PERSPECTIVES

Throughout the study period, the QRMC benefited from the counsel of the Coordination Council and the Advisory Panel, and from an arm's length liaison with the service staffs. Their insights and comments were helpful at every stage of the process, particularly during the review of an earlier draft of this report. Inasmuch as the QRMC is an independent body, this report does not necessarily reflect the views of the services. Appendix B contains a synopsis of their opinions, and GSP H contains a summary and the full text of service and other Coordination Council member comments.

NOTES

1. The principles that guided the review are presented in Appendix A—Principles of Military Compensation.

2. Overseas members currently are entitled to the overseas housing allowance (OHA), which is based on their actual rent up to a ceiling set at the 80th percentile of the reported rents of members with the same grade and dependency status.

3. By law, 37 U.S.C. § 101, RMC includes ". . . basic pay, basic allowance for quarters (including any variable housing allowance or station allowance), basic allowance for subsistence, and Federal tax advantage accruing to the aforementioned allowances because they are not subject to Federal income tax."

Chapter 2
The Structure of Military Compensation

THE STRUCTURE OF MILITARY COMPENSATION

INTRODUCTION

The fundamental question facing the Seventh Quadrennial Review of Military Compensation was whether the current military compensation structure is an adequate framework to support tomorrow's uniformed services. The existing system of pay and allowances has evolved and endured because it has helped build and maintain a robust military force.

In its earliest days, the compensation system reflected the demographic profile of the forces it paid and the geographic requirements of a frontier lifestyle. Military members, mostly young and single, lived in military quarters and ate in military dining halls. Generally, quarters were available on post to accommodate families of married members. Members who acquired their own housing or food were the exception, and were dealt with as exceptions; they were paid allowances to secure the food and housing not provided by the government. This *needs-based* allowance system matured over the course of the nineteenth and early twentieth centuries to suit the situation. The structure of compensation, with major allowances paid to cover members' food and housing, supported unique military career requirements and reinforced the notion that the military *takes care of its own.*

Much has changed. Over time, the evolving nature of war and its technology, the move from a conscripted to a volunteer force, and changes in social attitudes and values regarding military service have produced a significantly different force in substantially different circumstances. Members today are better educated and more experienced than their predecessors. Many of them are women. The force contains growing numbers of single parents and members married to other members. The high quality apparent in the current force, recently validated in the Persian Gulf, implies that future members may enjoy more attractive employment alternatives than those of their predecessors.

The pace of change is accelerating. The force reductions now under way promise not only to streamline the military but also to increase both the need for high-technology skills and the value of talented, experienced members. External factors also dictate a fresh look at the structure of military compensation. Budgetary pressures cannot be expected to abate, even when the current recession ends. Moreover, competition with the civilian sector over the limited pool of young, educated people will continue to make recruiting a challenge, even at reduced accession rates. It is therefore reasonable to ask whether a compensation system that solidified in the middle of the twentieth century will remain viable into the twenty-first.

Recent events have called into question the compensation system's effectiveness as a fair reflection of its population's needs. For example, during the recent deployment to the Persian Gulf, enlisted members lost their subsistence allowances. Many of them (and their families) viewed this as a significant income loss. In fact, Congress has subsequently directed the Department of Defense to reevaluate that allowance.[1] Other complications of managing allowances are emerging as food and housing provided in kind become the exception rather than the norm[2]. Regional price variations, which evidence suggests are increasing, strain the existing pay and allowances structure. Growing disparities in cost-of-living elements call into question whether cost-based provisions are needed beyond those currently provided by the variable housing allowance (VHA). In short, policy makers might reasonably question whether a simpler, more direct method of managing military compensation might not be superior to today's complex structure of pay and allowances with its growing patchwork of ad hoc changes. Indeed, three other English-speaking countries with volunteer forces (Australia, Canada, and the United Kingdom) have dramatically streamlined their compensation systems within the past two decades.[3]

Accordingly, the 7th QRMC has conducted a broad review of the existing military compensation structure with particular emphasis on the function, rather than the level, of each element alone and as part of a system. This chapter presents our evaluation of the adequacy of the compensation structure. As background, we begin with the evolution of the current compensation system and then present a brief description of that system. Next, we detail the many factors influencing the military compensation structure, follow that with a critique of today's system, then develop three case studies to illustrate consequences and implications associated with modifying the current pay and allowances system. Finally, the chapter concludes with the 7th QRMC's recommendations for immediate and long-term structural improvements.

PURPOSE OF THE COMPENSATION SYSTEM

The purpose of the military compensation system, like any compensation system, is to attract, retain, and motivate people. Moreover, the system should be affordable, which suggests that it meaningfully differentiate among its beneficiaries. There are some other implications of these objectives. First, the system must match individual opportunities over time based on talent and transferability of skills. Second, the amount and timing of lifetime earnings will be influenced by the experience levels (career content) desired in the force. Third, the system must offer premiums based on specific terms and conditions of service. Finally, the system must support the missions of the seven uniformed services.

EVOLUTION OF THE CURRENT SYSTEM

Historically, the United States has maintained a large military only in time of war or when the threat of war looms large. Interwar periods have been marked by small standing armies made up predominantly of young, single males. The compensation system has reflected that situation. Through most of the nineteenth century, officers received *pay proper*, or *base pay*, plus an allowance for quarters based on grade and *rations* (in money), again based on grade.[4] Enlisted members, who were expected to live in the barracks and to eat in the dining halls, received only base pay. This situation continued until World War I with one major exception: between 1871 and 1922, officers were paid on a salary basis. Though prices fluctuated throughout this period, pay rates were updated only occasionally when their inadequacy became obvious. Matters began to change with the massive mobilization—and significant inflation—of the First World War.

That mobilization called up 2.9 million men, and for the first time since the Civil War there were significant numbers of members with dependents, particularly in the officer corps.[5] Consequently, a commutation pay was authorized on a temporary basis in 1918 to insure support for families of married officers.[6] In 1915, the first statutory provision for an enlisted quarters allowance was passed, covering the top three grades.

Although the demobilization following the war resulted in a return to the traditionally small standing military, compensation provisions instituted during the hostilities lingered on, and in fact took on new life as inflation during and after World War I substantially eroded the value of military pay. The pay table then in force for officers had been established in 1908; by the early 1920s, increased costs of living had cut its value in half. The enlisted force did not fare quite so badly, with small pay increases sporadically granted to the higher grades and a 100-percent increase legislated for privates in 1917.

The solution implemented by Congress through the Pay Readjustment Act of 1922 included variable allowances for officers, with rates depending both on rank and family status, to cover increases in living costs. Congress chose to leave *base pay* virtually unchanged from the levels of 1908, but added money differentially to the subsistence allowance to provide greater income for married members. The discussion accompanying adoption of these measures made it clear that one of the principal reasons for the dependency differential

was to avoid an *unjustifiable burden on the Public Treasury*. Interestingly, that discussion also included examples of how firms in the private sector provided compensation, particularly in kind, that effectively favored married men. Housing allowances for officers continued to be determined based on tables listing the number of rooms authorized for officers by grade. Finally, the 1922 Act introduced explicit consideration of the cost of living in setting allowance rates.[7]

Mobilization for World War II led to the next set of significant changes in military compensation. As was the case for the First World War, the standing military before mobilization consisted mostly of bachelors who were provided quarters and food. The extensive draft, however, again brought many men with families into the services. The Servicemen's Dependents Allowance Act of 1942, a temporary measure to deal with family financial burdens created by mobilization and conscription, established allowances geared to the number of dependents and was paid directly to those dependents rather than to the individual member.

The onset of the cold war brought with it the first sizeable standing military in U.S. history. It also marked passage of the Career Compensation Act of 1949, which laid the foundation for the current compensation system. The 1949 Act approved administration policy of not recognizing dependents for pay purposes among junior enlisted grades. This reflected the circumstances of the time: a force that was conscription-based and largely located on post. For all entitled grades, the housing allowance was aimed at providing a cash component to income that matched housing expenditures by civilians of similar income levels.[8] Thus, it was an income and spending pattern-based allowance, referenced to civilian peers. It specified two rates, by grade, based on dependency; the dependency differential was based on civilian spending differences between married and unmarried people. The subsistence allowance was specified at a single rate for all officers, and three separate rates for enlisted members based on availability of messing. Aside from the officer-enlisted difference, rank was removed as a criterion for different subsistence allowances.

With the coming of the Korean conflict, the Dependents Assistance Act of 1950 established enlisted housing allowances based on the number of dependents primarily to provide financial assistance to junior enlisted members. This Act did not fully expire until 1973.

Since 1951, except during buildups to larger levels during the Korean and Vietnam conflicts, active duty military personnel strength has ranged from 2.0 to 2.8 million members. These forces far exceeded any previous peacetime levels. Between 1950 and 1972, the military was largely conscript-driven; compensation policies continued to reflect that fact. When the draft ended in 1973, the force was 2.3 million members strong. It was young (58 percent were under age 25), with about 60 percent of new accessions having high school diplomas.

During the past 19 years, there have been significant changes. The force has become older, better educated, and more diverse. Now, military strength is being reduced to levels not seen since the late 1940s. By the end of 1991, active duty military strength was at 2.0 million with further reductions planned to meet a goal of 1.6 million by 1995.[9] Only about 49 percent of members were under 25, and 98 percent of new accessions had high school diplomas. Over the past decade, the Armed Forces Qualification Test (AFQT) scores of new entrants have also improved dramatically.[10]

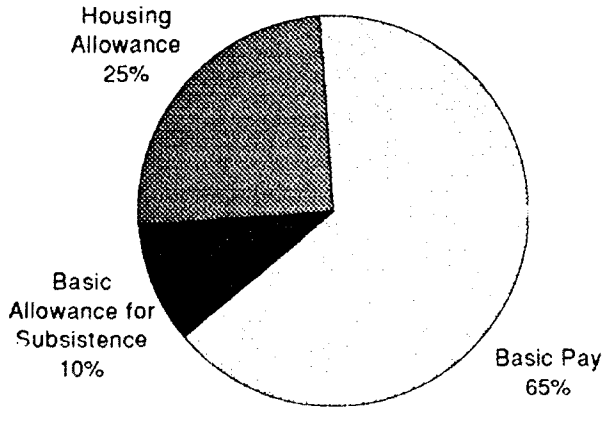
The high quality of the modern force is suggested by its increases in experience and education, and verified by its recent performance in the Persian Gulf. While recent world events—the fall of the Berlin Wall, the dissolution of the Warsaw Pact, and the collapse of the Soviet Union—offer the opportunity to reduce the defense burden, the manifest success of the high-quality force now assembled suggests its ultimate economy in terms of the total resources needed to meet national security objectives. Indeed, this point has been

made both by members of the Congress and Administration officials.[11] Current force goals, while including 25 percent fewer billets than in recent years, call for recruiting members with first-rate entering credentials and, by implication, attractive alternatives. To maintain experience levels corresponding to the force of the late 1980s, the continuation and reenlistment rates achieved during that decade must be sustained.

THE CURRENT COMPENSATION SYSTEM

The core of the military compensation system is regular military compensation (RMC). RMC is the compensation provided to each member, directly or indirectly, either in cash or in kind. It is composed of basic pay, the basic allowance for subsistence (BAS), the basic allowance for quarters (BAQ), the variable housing allowance (VHA), the overseas housing allowance (OHA), and the Federal tax advantage that accrues because these allowances are nontaxable. Basic pay, on average, is almost two-thirds of the total; the housing allowances[12] are about 25 percent of RMC; and BAS is about 10 percent of RMC (Figure 2-1). All members receive basic pay. They are either provided food and housing in kind, or paid BAS and the housing allowances. For purposes of estimating RMC, in-kind elements are usually attributed a cash value equal to the alternative allowance.

AVERAGE REGULAR MILITARY COMPENSATION (RMC) Figure 2-1



Note: Tax advantage included in allowances

Basic Pay

The largest share of RMC, and the cornerstone of cash compensation, is basic pay. Basic pay is predicated on rank and tenure of service, and is published each year in a table detailing the pay for each of 26 grades and 14 longevity points. Pay steps for longevity are separately structured for each grade and are based on time in service (TIS), the elapsed time since entering service. Typically, basic pay is the only cash income for junior enlisted members who receive quarters and subsistence in kind.

Basic pay for active duty personnel is the basis for computing Reserve component drill pay. It is also the basis for establishing the initial levels of retired pay for all components. Finally, the levels of basic pay are linked to other elements of the compensation system, e.g., the terms on which separating or retiring members redeem unused annual leave. Because of the linkage between retired and basic pay, a promotion effectively increases pay for a career member over his entire lifetime, which thus amplifies the effect of rank on compensation.

Housing

About 76 percent of single members and about 35 percent of members with dependents live in government-furnished quarters; all other members receive housing allowances.[13] In most cases, the housing allowances are paid in two elements:[14] the basic allowance for quarters (BAQ) and in the United States a regionally variable component, the variable housing allowance (VHA). BAQ varies based on grade and on whether or not the recipient has dependents; therefore it is said to be *needs-based*. It was originally intended to pay housing costs for members not afforded government quarters;[15] it now covers approximately 60 percent of

member expenditures on housing, on average. It is typically adjusted annually at the rate specified for the annual pay raise regardless of the trend in housing prices.

VHA was instituted in 1980 as a supplement to BAQ. It varies based on grade, on whether or not the member has dependents, and on the relationship between local and national housing costs. Legislation subsequently revising the VHA program envisioned that, on average, members would cover 15 percent of their off-base housing costs from income other than the housing allowance.[16]

VHA rates are based on a survey of member housing expenditures.[17] Note that, within the United States, VHA is the only element of cash compensation that varies regionally in recognition of geographical differences in living costs (prices) or wages.[18] A member receiving VHA who does not spend it all on housing must forfeit half of the amount not spent; this is referred to as the *50-percent offset.*

Subsistence

The basic allowance for subsistence (BAS) is paid monthly in cash to all officers and to most members of the career enlisted force. The 1991 rates were $129 for officers and $184.50 for the majority of enlisted members.[19] In law, the justification for BAS differs between officers and enlisted members. All officers receive BAS and are charged for meals provided. In contrast, enlisted members are entitled to food in kind or to the subsistence allowance in lieu of food.[20] In fact, 65 percent of enlisted members receive BAS.[21] Like BAQ, BAS typically increases annually by the amount of the pay raise.

Special and Incentive Pays

There are 55 separately authorized special and incentive (S&I) pays, generally offered as incentives to undertake or continue service in a particular specialty or type of duty assignment. These pays vary from token payments (e.g., $110 per month for hazardous duty) to substantial bonuses (e.g., $36,000 per year for physicians). On average, these highly leveraged pays, going to 43 percent of the force, comprise about 5 percent of current cash compensation outlays.

The terms and rates payable under the S&I program are, in most cases, fixed in law, and the funds for each are appropriated as a separate line item in the budget.[22] The notable and important exceptions to this are the enlistment and reenlistment bonuses. These programs provide flexibility to change rates administratively, based on accession and retention requirements and trends, within program limits.[23]

Other Allowances

In addition to BAS, BAQ, and VHA, there are 31 other allowances.[24] Most of these are reimbursements similar to civilian expense accounts or allowances, such as moving expenses, and are tax-exempt.[25]

Benefits

The retirement program heads the lists of uniformed services benefits. Members are eligible to retire after 20 years of service and, except for flag officers and exceptional cases, must retire on or before 30 years of service. The program is noncontributory.

There are currently three sets of retirement provisions in effect, based on when an individual entered the service. Members entering the service prior to September 8, 1980 are eligible to retire after 20 years of service at 50 percent of their final basic pay, increasing to a maximum of 75 percent of basic pay with 30 years of service. After retirement, the stipend is adjusted annually to offset inflation, based on the Consumer Price Index (CPI).

Members who entered between September 8, 1980 and July 31, 1986 are eligible to retire after 20 years of service, but the amount of their initial retired pay will be equal to 50 percent of the aver-

OTHER BENEFITS AVAILABLE TO MILITARY MEMBERS Table 2-1

Child Care and Services	Unemployment Compensation
Regular Leave	Survivors' Benefits
Holidays	Family Support Centers
Sick and Maternity Leave	Commissary and Exchange Services
Education (GI Bill)	Morale, Welfare, and Recreation Activities
Disability Retirement	Home Loan Insurance
Legal Services	Group Life Insurance (SGLI)
Uniform Issues	Social Security Contribution

age of their three highest years of basic pay. This change reduces the deferred value of basic pay increases experienced very close to the retirement date.

For members entering after July 31, 1986, the computation base was maintained at the average of the three highest years of basic pay. However, the multiplier for 20 years of service was reduced to 40 percent, with an increase of 3.5 percent per year up to a maximum of 75 percent at 30 years of service. Inflation offset will be capped at one percent below the CPI. This will erode the purchasing power of retirement until the member reaches age 62, when a one-time restoration of the value of the pension occurs.[26] This retirement plan is commonly referred to as REDUX. Because data on member responses are not yet available, the retention and performance incentive effects of the retirement reduction are not fully understood. The need for further study in this area is discussed in Chapter 8.

Surveys suggest that medical care is the benefit members value most after the retirement program. Members are afforded full medical treatment. Typically, but not necessarily, medical services are provided in kind. Dependents of active duty members are treated in military facilities on a space-available basis, or otherwise are covered by the Civilian Health and Medical Program of the Uniformed Services (CHAMPUS). The CHAMPUS program is, essentially, medical insurance that normally involves copayment and deductible payment. Total annual CHAMPUS cost to any active duty family is limited to $1,000.

In principle, retirees and their dependents are also entitled to space-available treatment in medical facilities. In practice, their priority is below dependents of active duty members, and actual availability of the service becomes problematic. Retirees and their dependents are covered by CHAMPUS, but with greater exposure to copayment, through age 65. After 65, coverage passes from CHAMPUS to the Social Security medical program. The value of the medical benefit to the member varies with age and family status. On average, comparable family insurance coverage costs around $3,600 annually. The medical benefit is discussed in more detail in the 7th QRMC Staff Analyses, MTS 1—*Compensation Structure.*

There are several other benefits of lesser or occasional value, depending on usage, available to military members. Table 2-1 is a listing of the most commonly cited elements.

FACTORS INFLUENCING THE COMPENSATION SYSTEM

The purpose of the military compensation system is to attract, retain, and motivate people. There are several factors influencing the compensation system that must be understood. First are the underlying principles that provide general direction for policy development. Second are the institutional factors that make military service unique. Third are

organizational considerations; fourth, the factors that serve to differentiate pay among members. This section provides details in each of these areas as they affect the military's compensation system.

Principles

Design and evaluation of a compensation system requires a foundation of grounding principles that establish the conceptual framework within which specific compensation structures, and ultimately rates, are developed. First, the nature of public service demands such a framework—witness the legislation establishing the quadrennial review process. Second, such a framework is essential for guiding compensation policy in any large organization, where, for example, considerations of internal equity take on special importance. Finally, service in both peace and war requires a complex and durable set of interlocking loyalties. It is crucially important that the compensation system support, and not undermine, that fabric.

Appendix A describes 7th QRMC principles of military compensation. These principles, which address concepts such as wartime requirements, equity, efficiency, flexibility, motivation, and stability, set boundaries on compensation system development. That is, they offer a rationale for rejection, or a touchstone for identifying proposals likely to fail when applied to the uniformed services. They are general in nature and are not intended to delineate specifics of the compensation system.

Institutional Factors

Military service is characterized by positive and negative aspects that set it apart from many civilian jobs. Most analysts have stressed those factors that are negative, assuming a premium in military pay is needed to induce talented members of a pluralistic society, with attractive job alternatives, to enter into a service career. These negative features include acceptance of military discipline, forfeiture of some personal rights, frequent moves, long and irregular working hours, field and sea duty, potential for remote assignment involving family separation, and exposure to combat.[27]

There are also positive aspects of service, which the 3rd QRMC classified into three groups: those that are part of the job (e.g., on-duty educational benefits), those that are compensatory or money saving (e.g., leave), and others, (e.g., space-available air travel). A complete discussion is in volume V of the 3rd QRMC report.

The compensation system must also recognize and support unique military institutions and requirements. These include practices that support operational requirements, such as billeting part of the force in quarters close to duty sections for immediate mission response and maintaining messing facilities to support both routine and contingent operations. Additionally, the health care benefit is an outgrowth of the requirement for medical support of combat operations.

Other practices support the unique needs of military personnel. For example, the uniformed services bring in hundreds of thousands of young men and women, mostly between the ages of 17 and 19, every year. For the most part, they are away from home alone for the first time in their lives; they have little life experience and are separated from their traditional sources of support and advice. It would be unrealistic to expect them to go through a few weeks or months of initial training and then fend for themselves when posted away from home, particularly overseas. Rather, it is service practice to quarter these young people on post, to make nutritious food available to them in the dining halls, and to devote a fair amount of noncommissioned officer and officer time to overseeing their welfare. These practices are reasonable, proper, and practical, and the compensation system must be consonant with them.

Organizational Factors

The sheer size of an organization has implications for all aspects of its operation. Large organizations tend toward centralized decision

making, at least on matters of policy.[28] In part, centralized compensation policy making is the functional outcome of the need for internal equity: a large organization's members must believe that people who make the same or a comparable contribution to the company are treated alike. Thus, large organizations tend to establish grading systems that group jobs of similar skill, knowledge, and responsibility and stratify them to produce a compensation common denominator. Execution is, of course, another matter. For centrally set policy to be executed at lower levels, it has to be made up of a set of simple, understandable rules.

A public activity's compensation system is open to public scrutiny, comment, and criticism. It must define pay in terms of readily recognized employee characteristics, established with the approval of the fiscal authorities. Part and parcel of these requirements is that the system operate within the Federal budgeting process and that it conform to nontrivial administrative requirements for fiscal control.

The military is a large public sector organization. Compensation decisions are made centrally, ultimately by Congress, as part of the budgetary process. The pay system unambiguously specifies the individual incomes of millions of members while effectively and efficiently differentiating among them. Although policy and administrative rules are set centrally, execution is decentralized. Moreover, operating requirements often lead to in-kind compensation provisions. A *building blocks* approach, which a pay and allowances system offers, allows centralized policy making and decentralized execution.

Many systems can meet the criteria suggested by the above considerations, as is clearly shown by the diversity of military and civil service compensation arrangements in countries such as Australia, Canada, and the United Kingdom. However, in general, a building blocks approach is useful because it allows an individual element to be established separately and centrally, while permitting unified, decentralized execution. By subjecting different elements to varying degrees of specific control, it can even provide for flexibility in the execution process. For example, the basic pay table, while perhaps very complicated in its design, is nevertheless simple in terms of execution because two easily determined facts establish an individual's entitlement: rank and time in service. Additionally, different combinations of pay and allowances allow for substantial variation among members, so motivational needs, for example, can be met fairly.[29]

COMPENSATION DIFFERENTIALS

Like any compensation program, the military pay and allowances system differentiates among its beneficiaries—some people are paid more than others—to meet the organization's personnel goals economically. However, differences in pay that are perceived as capricious or unfair are likely to be at best wasteful and at worst divisive or contrary to organizational objectives. Given this caveat, what are the objectives of the compensation differentials and what are the appropriate determinants of these differentials?

Objectives of Differentials

Five military personnel objectives stand out as warranting compensation support:

- Attraction of recruits of appropriate quality
- Retention of talented members
- Motivation of superior performance
- Incentives for special skills or talents
- Reimbursement for expenses occasioned by military assignment.

Each objective is discussed in turn as a preface to developing determinants for pay differentials.

Recruiting. Like large private firms, the military offers a premium to attract high-quality applicants. However, as is also the case for large private

firms, the military is somewhat uncertain about the individual qualities of each applicant—some applicants will do well while others with the same credentials will not. Economy therefore suggests offering entry pay that is modest, rising to attractive rates after an initial probationary period, while weeding out unsatisfactory performers and individuals prone to leave.[30]

Retention. Members who perform well generally have attractive civilian opportunities. As is the case for recruiting, attractive compensation is an essential ingredient of quality retention. Thoughtful individuals are more likely to be motivated by expectations of future income than past earnings. Taken with concerns for affordability, this also implies a fairly steep pay gradient, with low entry pay during the initial sorting process followed by higher subsequent pay rates, as is the case in civilian organizations desiring relatively high retention rates.[31] This also implies timing compensation increases to influence continuation decisions. Finally, to reinforce quality goals, raises should be linked positively to measures of military performance.

Motivation. Total organizational performance is clearly strongest when members make an effort to do their best. Generally, compensation contingent on performance encourages effort. One mechanism suggested to motivate performance is to reward performers with a desirable advancement. Within a range, this structure tends to motivate the performance of many while rewarding top achievers.[32]

Incentives for Special Skills. To compete economically in the market, differentials can be offered selectively to retain individuals with transferable skills, to encourage acceptance of certain duties, or to hold particularly talented or experienced individuals in essential military positions. These incentives normally relate to productivity.

Productivity is an expression of contribution to the goals of the organization, while opportunity cost generally is a monetary expression of the alternatives open to an individual. The two are normally, but not always, closely related in a market economy. Members with transferable skills—skills that would enable them to easily find attractive civilian employment—have high opportunity costs, measured by the pay they could earn in counterpart jobs. The services, like any employer, must acknowledge these opportunity costs by paying a premium to retain members with generally marketable skills.

In a competitive market, opportunity costs also measure productivity as a monetary expression of the output that a worker with specified skills could be expected to produce. However, this relationship breaks down for military skills that have no civilian analog. From a long-term perspective, pay should continue to reflect both productivity and opportunity costs. To attract and retain a talented individual in uniquely military career fields, career earnings must be attractive compared to that individual's civilian alternatives, taking into account post-military pay (including retired pay), unemployment, and any other factors germane to choosing among the alternatives. The implication is that pay for military skills must match the alternatives open to young people with the desired credentials.

Expense Reimbursements. There are substantial and apparently growing price differences across the locations where military members are stationed in the United States, particularly for housing. These price differences effectively impose differential expenses on members. A pay structure established to be attractive, motivating, and economical on average may be undermined by geographic variations in prices. The effects on the compensation system of local variations in prices should be minimized to prevent undermining the overall system.[33]

The government may choose to provide part of military compensation in kind, either to meet operational requirements or for administrative convenience. An example is the traditional practice of feeding enlisted members in government messes. When in-kind compensation is the norm, it is administratively convenient to pay a cash allowance to those who are the exception. It is reasonable to expect there would be no effective income dif-

ference imposed by the fact that a member receives the compensation in cash or in kind. Otherwise, the distinction between the allowance and in-kind compensation leads to spurious and possibly improper incentive effects. At first approximation, this implies that the amount of the allowance should, therefore, correspond to the price of the item.

Unfortunately, it is difficult to equate a cash allowance with in-kind compensation. Cash, because it allows for discretionary spending, generally provides greater value to the member, at a given cost to the government. Hence, except when the recipient of an allowance would buy exactly the same items as are provided in kind, a differential is introduced, typically favoring the recipient of the cash allowance. A general conclusion is that unless the item is provided in kind in the preponderance of cases, there are advantages to eliminating the allowance by moving it into basic pay, for example. This is particularly true when all members in a given status receive an allowance at the same rate.

Determinants of Pay Differentials

After considering the personnel objectives and theoretical issues briefly touched on above; and looking at the compensation systems of foreign militaries, large private sector firms, and U.S. public sector organizations, the 7th QRMC found three primary determinants of military compensation differentiation: status, skill, and locality. (A fourth, dependency, is embedded in the current system and will be discussed in the critique of the compensation system.)

Status. Rank and longevity convey a great deal of information about performance and productivity. Rank is the best single available vehicle for stimulating military performance through compensation. Longevity captures experience and the gains in productivity that accompany it.

The military personnel and manpower systems reinforce rank as a compensation determinant in two major ways. First, the personnel system manages the promotion process to make it an excellent measure of past productivity and predictor of future performance. The promotion process very concisely captures previous performance, experience, professional development and a projection of the future needs of the service. Continued success indicates development as a manager with broadening responsibility or technical expertise. Because compensation is contingent on promotion, it motivates performance of everyone competing for advancement, whether ultimately selected or not. The manpower requirements process also supports rank as a pay determinant by reviewing each position in the military to determine the qualifications needed. The level of responsibility and breadth and depth of technical knowledge required lead to a grade being assigned for each position. Individuals are then assigned to positions calling for their rank. Thus, while rank resides in the individual, the manpower and personnel systems function together to match qualifications and jobs.

Taken together, rank and longevity provide important vehicles for economically recruiting and retaining a quality force. Because promotion in the junior grades is fairly predictable, pay based on status can be established that is attractive over the first term to new entrants, yet economizes by paying trainees modestly until they have demonstrated their ability and willingness to complete their contract. It also allows compensation to be focused on known career decision points, offering the most affordable incentives for continuation.

Skill (or specialty). A system of exceptional pays based on specialty or duty status is an obvious way to motivate and retain people with specific skills or experience, or to motivate individuals to accept onerous duty assignments. While ultimately the test for setting specialty-based pays is whether or not the services are retaining individuals in the right numbers and quality, the real question is how to identify those cases. At first glance, it seems that this sort of pay would most apply to those military members whose skills are in substantial demand in the civilian labor markets. Indeed, this is a primary use of such differentials.

However, incentives also can be beneficial for skills where experience is particularly valuable to the military even though the skills are not directly transferable to the private sector. Indeed, differential compensation may be most warranted when the skills are *not* directly transferable, precisely because the services ask talented individuals to foreclose their options for a civilian career. Finally, in some instances, the high costs of total training suggest offering incentives for high continuation rates because retention is a cost-effective alternative to replacement.

Locality. Significant cost-of-living variations among assignment locations can undermine the effectiveness of an otherwise well-designed compensation structure. On the surface this may appear to be a straightforward cost-of-living issue; however, it is a bit more complicated. Members are apt to compare their earnings against those of their local civilian peers, which suggests local wages are the proximate comparator. Certain areas are also more attractive than others, and many people would take a cut in real income to live there. For example, Minot AFB, North Dakota, has the lowest cost of living identified by the 7th QRMC of any major CONUS installation, while Travis AFB, California (just outside San Francisco), has a cost of living substantially above the norm. Yet the Air Force has trouble filling billets at Minot and turns down volunteers for Travis. What then is the proper guide to setting geographic variations in military pay: local wages or local costs of living?

The arguments for local wages are that they are the immediate referents to civilian peers and that they incorporate not only local labor productivity but also locale attractiveness because wages tend to be bid down in places where people would like to live. However, unlike most civilians, military members generally do not enter into a contract that specifies the duty station, and the referent is the national market as a whole; assignment attractiveness is in large part a matter of luck. Moreover, the relationship between local wages and local amenities breaks down under fairly common circumstances (e.g., when local amenities enhance productivity and therefore encourage industry to locate there). In short, the 7th QRMC finds that local cost of living is a proper dimension of compensation differentiation, and one of growing concern and importance.

SYSTEM CRITIQUE

Thus far, this chapter has presented the evolution of the military compensation system, reviewed the current system, and discussed the various factors influencing its structure. Using that information as a foundation, it is important to address two major criticisms of the current system. Critics generally contend that the system is excessively complex, causing its value to be generally misunderstood and underestimated.[34] Second, they accuse it of being inefficient in two respects: (1) a single pay system is used to attract many different specialties or *occupations*; and (2) the allowance system differentiates pay on the basis of dependency. In fact, the architects of the current pay and allowances system considered it a temporary expedient:

> In the future, when the Military Establishment becomes stabilized . . . it is to be hoped that compensation for the Uniformed Forces will consist of a single payment without distinction between compensation for responsibility and work performed and reimbursement for subsistence and quarters. Basic compensation will then be on the same footing as compensation in private industry and in civil government.[35]

Complexity

The complexity of the system is attributed to two sources: the operation of the tax advantage and the proliferation of pays and allowances.[36]

Tax Advantage. Most allowances are tax-free. Critics argue that eliminating the income tax advantage for food and housing allowances would have three advantages. First, it would more clearly show decision makers the actual cost of military

personnel.[37] Second, the total pay members receive would be clearer to them than it is now. Because the value of the tax advantage depends on an individual's circumstances (i.e., family size, outside or spouse income, and tax deductions), many believe it unrealistic to expect military personnel to make or understand reasonable comparisons with civilian pay under the current system.[38] Third, it would eliminate an inequity in the current system that (dollar for dollar) favors those in higher tax brackets.[39] Those favoring monetizing the tax advantage argue that it would not increase the cost of military manpower, but merely account for it properly.[40]

While there are some benefits to eliminating the tax advantage, there are also some drawbacks. First, increased liability to state income taxes would affect members differently, based on state of residence. The effect would fall heavily on the most junior people since a larger portion of their income is in the allowances. Second, increased liability to Social Security taxes would affect members differently, based on grade. Officers in grade O-6 and above would be affected very little due to their income levels. Middle grade personnel would arguably give up current for future cash (increased Social Security payments). In contrast, the most junior members—about half of the force—would simply experience a loss because the quarterly earnings credited to their Social Security accounts would, in all likelihood, be replaced later, when their incomes are higher. Finally, while the ultimate fiscal impact is not clear, in the near term this would, in effect, transfer funds from Treasury general revenues into the Social Security Trust Fund. Deliberate policy thought should be given to this outcome.[41]

Proliferation of Elements. There are two points to be made regarding the proliferation of compensation elements and the complicated nature of their workings. First, one should recall the nature of the system and the purpose for compensation differentials. Different people are paid different amounts in order to attract and retain the force as a whole efficiently. Second, compensation rates for the uniformed services are set formally, in rules that are applied to all members and published in advance. The military compensation system allows open scrutiny of the provisions for differentiating among millions of people doing thousands of things, worldwide. All things considered, the number of distinctive pay differentials may not be excessive. Given the number of people, their diverse locations, and different jobs, one would expect a fairly elaborate mechanism for setting individual earnings. Certainly that is true for other military systems.[42]

Efficiency

Two areas of inefficiency have been cited: failure to distinguish among occupations and paying a premium to members with dependents.

Occupation. By paying everyone from a common table, critics argue that the services are forced to overpay many members to attract those few with skills that are readily marketable outside the military or with duties that are particularly onerous.[43] Put simply, the gist of this criticism is that basic pay set at levels sufficiently high to retain members with skills in demand in the private sector (e.g., jet engine mechanics or computer specialists) overpays members without such attractive civilian prospects. Critics have suggested two ways to improve the efficiency of compensation in this regard. First, establish separate pay tables by specialty or occupation.[44] Second, separate rank from pay grade. This scheme, for example, could have a member holding the rank of corporal in pay grade E-6 in one specialty and E-3 in another.[45] The basic issue seems to be how to offer members serving in some specialties additional pay to attract or hold them, without overpaying everyone else.

The existence of a significant number of special and incentive pays suggests that DoD and Congress agree in principle with the notion of specialty-based pay. The real question seems to be one of execution: how to identify the level of pay needed to induce general military service and then the proper differentials to attract and retain those in selected specialty areas. The 7th QRMC agrees that

there is a clear requirement for pay differentiation based on specialty or duty conditions. The current S&I system is the preferred vehicle for setting such differentials, especially in the framework of the current DoD budget process. The system of S&I pays can be more responsive to changing circumstances than separate tables, especially when a specified pool of money is appropriated within a rate structure that allows the services to adjust individual bonuses quickly. However, there are improvements that can be made to the current system.[46] Generally, the basis for these pays is to man the force economically, keeping in mind specific requirements for skills, talents, experience pools, and outside alternatives.[47]

Dependency. On the surface, the compensation differential based on having dependents is confined to the housing allowance rate and to other relatively minor elements (e.g., family separation allowances). However, the matter is deeper, involving policy choices between providing allowances or in-kind support and the amount and quality of in-kind provisions.[48] Other observers have argued that this practice increases costs and undermines mission effectiveness.[49] Several interrelated issues are involved.

In terms of cost, critics allege that the military will tend to attract and retain members who have or are inclined to have more dependents, both because pay is greater for members who have dependents and because the cost of supporting dependents while in the military is lower. The budgetary implications are substantial: dependent medical care, PCS moves, DoD schools overseas, separation allowances, family support prog ams, etc., are costly programs.[50] Moreover, it is conceivable that because of pay discrimination based on dependency, the wage bill is greater than necessary for a force of equivalent quality.[51] Finally, it is argued that in combat skills and for deployments young, single members will be more responsive.[52]

The role of dependency is entwined with the provision of in-kind support. Some of that support is a concomitant of military operations (e.g., maintaining portions of the force close to their duty stations), and some of it is a component of reasonable personnel support.[53] However, that support does not necessarily imply unique compensation arrangements.[54]

The question of dependency also involves the function of the major allowances. The subsistence allowance has lost its relationship to real food costs, is administratively cumbersome, and, as recently evidenced, has become a source of irritation during mobilization. Additionally, problems relating to the housing allowance generate the most member complaints and press coverage. Therefore, the questions become whether family status is a desirable basis for military compensation and, in particular, are there productivity or retention factors that justify, in principle, the existing dependency differential?

The 7th QRMC reviewed the literature dealing with the relationship between productivity and dependency both in the private sector and in military service. The findings from the private sector were that, on a widespread basis, married civilian males have higher incomes than their unmarried peers. The difference builds gradually upon marriage, and decays when a marriage ends. Moreover, fragmentary evidence suggests that the marriage differential is related to productivity. In contrast, married females on average earn less than their single peers.[55]

The survey of military performance showed mixed results. Generally, married members tend to be promoted slightly faster and have significantly higher retention rates. However, the evidence is less clear for combat arms. Retention and performance statistics in Army infantry service and some measures of effectiveness in sea duty favor bachelors. In sum, married males tend to perform somewhat better, but with notable exceptions by career field.[56]

The overall conclusion is that documentable performance ar 1 productivity differences do not warrant an income differential based on depend-

ency. Rather, such differences are better dealt with through promotion and skill differentials. Considerations in eliminating dependency as a pay determinant are identified in the case studies below, and are further discussed in greater detail in Appendix C to the 7th QRMC Staff Analyses, MTS 1—*Compensation Structure.*

STRUCTURAL REVIEW CASE STUDIES

Because there are virtually unlimited possibilities for alternative compensation designs, the 7th QRMC limited its evaluation to three case studies to identify potential consequences and implications of simplifying the pay and allowances structure. The first case improves the pricing and management of allowances in the existing system; the second goes further, eliminating BAS; and the third eliminates both BAS and BAQ. In each case, the principal design criterion was to maintain recent continuation rates, as estimated in an econometrically-based inventory projection model, and thereby implicitly preserve member satisfaction.[57] Among those solutions that preserve recent force structures, the 7th QRMC chose that which was least expensive to the government. A secondary design objective was to minimize disruptions to the current system.

In constructing and evaluating alternative compensation structures, three aspects of the current system and existing laws emerged as limitations on structural change: the linkages among military compensation elements, the tax status of the existing allowances, and the cost-benefit tradeoffs between active duty current income and retired pay that arise as a consequence of the linkages. A summary discussion of these factors is presented first, as a prelude to the case studies that follow.

Design Considerations

To maintain service continuation rates at or above recent levels, reductions or increases in allowances would have to be matched with a corresponding increase or reduction in basic pay. However, retired pay for all members is defined in terms of basic pay, as are several other pays and allowances, most notably Reserve component drill pay. The consequence is that there are large side effects that entail windfall gains or losses to members and corresponding losses and gains to the Treasury. These linkages in their current form pose formidable barriers to any significant structural changes. The QRMC developed alternatives to deal with the linkage to retirement as mechanisms to facilitate an evaluation of changes affecting BAS and BAQ. While these dispositions are perhaps suggestive, they were developed as analytic devices and are not intended to be conclusive.

The tax-exempt status of the allowances likewise poses a barrier to change. Three factors are involved: Federal income tax, state and local income taxes, and Social Security taxes. The Federal income tax can be monetized effectively; i.e., an amount can be added to members' pay that will, on average, maintain their after-tax incomes and be cost neutral to the Treasury. However, state taxes affect members nonuniformly based on state of residency (rates range from 0 to 15 percent). Even if an effective formula were developed to monetize these tax increases, it is not clear that the implied transfer from Federal to state treasuries, on a hit or miss basis, would be good policy. The Social Security tax poses yet an additional problem, because generally an increase in taxable income raises both employee and employer taxes.[58]

Finally, differing views of the future limit the options for rebalancing compensation. Generally, individuals placing a current value on future income—in this case retired pay—subjectively weight it less than the DoD Actuary, who estimates the current cost to the government. Consequently, analyses of alternative compensation structures yielding current personnel continuation rates tend toward variants with increased current pay and reduced retirement income.

Case Study Results

Improved Allowances. First, the 7th QRMC considered improvements to the existing allowances, revised essentially by pricing the housing

allowance and BAS equal to housing and food costs, respectively. While transition to a price-based housing allowance could be cost neutral, the change to BAS cannot be accomplished without associated costs. Currently, BAS for enlisted members is higher than food costs while BAS for officers is lower than food costs. To bring both rates in line with USDA cost figures and to minimize impact on members and the government, a possible solution is to transfer money from BAS to basic pay for enlisted members, thereby lowering their BAS, and to transfer money from basic pay to BAS for officers, raising their BAS. However, as noted earlier in this chapter, any change to basic pay affects retired pay. Therefore, a naive change in this case costs over $300 million annually, principally due to windfall gains to junior members living in the barracks and to senior NCOs, whose lifetime retirement earnings would increase. Since most very junior members are subsisted in kind, this implies gains in income. Likewise, increasing basic pay increases the retired pay going to senior NCOs. On the other side of the ledger, because BAS for officers is less than food costs, maintaining current cash income by increasing BAS and reducing basic pay implies a loss of retirement income. By eliminating most windfall gains, and balancing gains and losses between active duty and retired pay, current continuation rates can be achieved at a cost of $70 million annually.

This approach would eliminate many of the undesirable income effects of the current BAS, ameliorate most of the allowances problems associated with deployment, reduce the effect of dependency, and simplify administration.[59] This proved to be the most feasible option for near-term implementation. A more detailed discussion of this case study can be found in Chapter 4.

Eliminate BAS. Naive elimination of BAS simply by monetizing the tax advantage and combining it with basic pay costs about $3 billion annually, even when members now subsisting in the mess are required to purchase meal cards. The principal expenses are increased retired pay (a windfall on the order of $100 per month for retirees at the 20-year point), windfall gains to bachelors in the dorms (as above, due to current mispricing of the allowance), and Social Security tax increases for members whose incomes are below the taxable ceiling.

The BAS can be eliminated and current continuation rates maintained, however, at a cost of about $200 million annually, entirely in employer's Social Security tax. This solution is based on modifying the retirement rules to specify 45 percent (vice the current 50 percent) of (increased) basic pay at 20 years, to preserve the current relationship between active duty and retired pay for enlisted members.[60] Officers would trade some retirement income for an offsetting addition to active duty pay; increased current cash turns out to be less costly than the status quo. Finally, windfall gains for first-term members would be eliminated, on average.

Although there are employer Social Security costs, this solution is attractive and warrants further study. In addition to potential fiscal advantage from the Treasury perspective, it eliminates a degenerating allowance and reduces the influence of dependency on compensation. However, several factors detract from its attractiveness as an immediate policy objective. First, there would be retirement income reductions for officers now on active duty. Second, the policy implications, and in particular the incentive effects, of reducing officer retired pay in favor of current cash must be addressed. Third, solutions to remaining problems of member Social Security and state income taxes must be found. Finally, there are uncertainties in the retirement cost accounting process that must be resolved (regardless of other changes). In summary, eliminating BAS is attractive as a pay simplification although there are barriers to its immediate pursuit. Further evaluation is clearly warranted.

Eliminate BAS and BAQ. Eliminating both BAS and BAQ by combining them and their monetized tax advantage into basic pay would essentially eliminate dependency from the compensation

system altogether and greatly simplify the current compensation system. There are really two dependency considerations: first, member responses and government costs associated with alternative compensation structures, and second, the effects of these changes on the total number of military dependents supported by the DoD.

The case was constructed with three separate scenarios, designed generally to conform to current operating procedures. Therefore, junior members were assumed to buy meal cards and to live in government quarters. However, rents would be charged, on average at current BAQ plus VHA for family housing, but at *dorm fee* rates for the barracks. Dorm fees would be less than the proposed combined housing allowance. Furthermore, the resultant changes to basic pay are so great that some alternative arrangement must be specified to preserve the existing benefits and government cost of retirement. For purposes of analysis, the 7th QRMC therefore stipulated a stand-alone retired pay table, at current levels and annual rates of increase.

The three specific scenarios are: all members paid at with-dependents rates, all paid at the without-dependents rates, and all paid initially at the without rates, but with rates rising steadily to the with-dependents rates between the third and eighth years of service. The results show that eliminating BAQ across the board tends to be costly (on the order of $3 billion annually at the with-dependents rates) due mostly to additional payments to members in the barracks. Moreover, moves that unambiguously increase career content—including retention of bachelors—tend to increase the number of dependents. This is because a bachelor retained in the fourth year is more likely to marry than an unmarried recruit, simply as a function of age and income. Finally, if reducing dependency were a policy objective, starting all members at the without-dependents rate and later making the transition to the with-dependents rate is the most attractive of the scenarios for further development in terms of the impact on experience levels. This has the effect of reducing continuation of members with dependents and encouraging retention of members without dependents.

Each of these cases was developed to determine possible consequences and implications of simplifying the pay and allowances system. The results highlight the difficulties associated with possible change while identifying areas for future study. The first case study is covered in Chapters 4 and 7; detailed discussions of the second and third case studies are in Appendix C to the 7th QRMC Staff Analyses, MTS 1—*Compensation Structure*, while areas for future study are explained in Chapter 8 of this report.

FINDINGS AND RECOMMENDATIONS

Our most significant finding is that the current compensation system is adequate to support the force structure of the twenty-first century; however, it can be improved. It is a structure that works, that has stood the test of time, and that will continue, with careful modifications, to attract and retain the needed number and quality of military personnel. Modifications necessary to improve individual elements of the compensation system, touched on above, are discussed in Chapters 3 through 5.

The current pay and allowances structure works because it provides individual building blocks that can be arranged flexibly, within a framework of centralized policy making and fiscal control. These blocks allow compensation to be related to productivity and to be structured as effective incentives for recruiting, retention, and motivation.

Compensation differentials among members are the key to an effective, affordable system. There are properly three major military pay determinants:

- Status (rank and longevity). Status incorporates a great deal of information about performance in the past and potential for the future. Both for officers and for NCOs, maturation as a military leader or as a managing technician is required for advance-

ment. Status is appropriately the predominant pay determinant.

- Skill (or specialty). Pays based on military specialties (the special and incentive pays, including bonuses) provide economical means to meet outside competition for high-value skills, hold valuable experience, reduce training costs, and encourage particularly talented members to pursue demanding career fields.

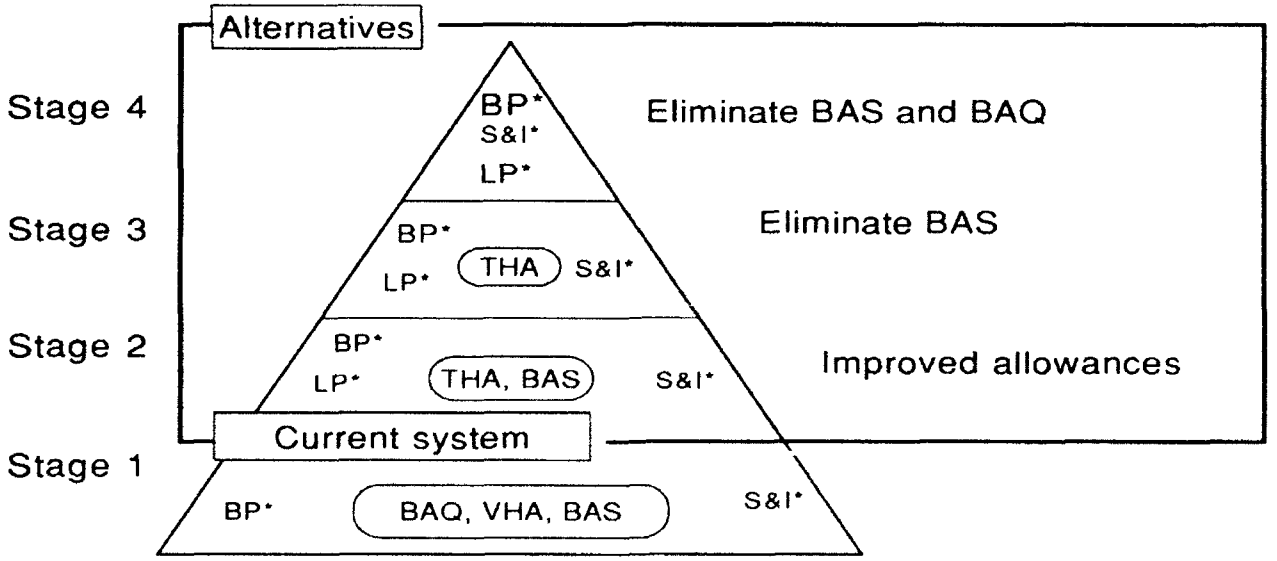
- Locality (cost of living). Locality-based allowances cope with geographic variations in the cost of living. A compensation system, no matter how well designed for one location, can be undermined by variations in the prices of housing and other elements of household expenditure.

The QRMC envisions a simplified system in which each of three elements plays a unique role. Basic pay would cover status; special and incentive pays would cover skill or specialty; and by adjusting for differences in cost of living, locality pay would prevent regional price variations from undermining the system. The locality-based allowance could vary according to dependency status. However, in the interests of efficiency, careful consideration should be given to eliminating dependency pays.

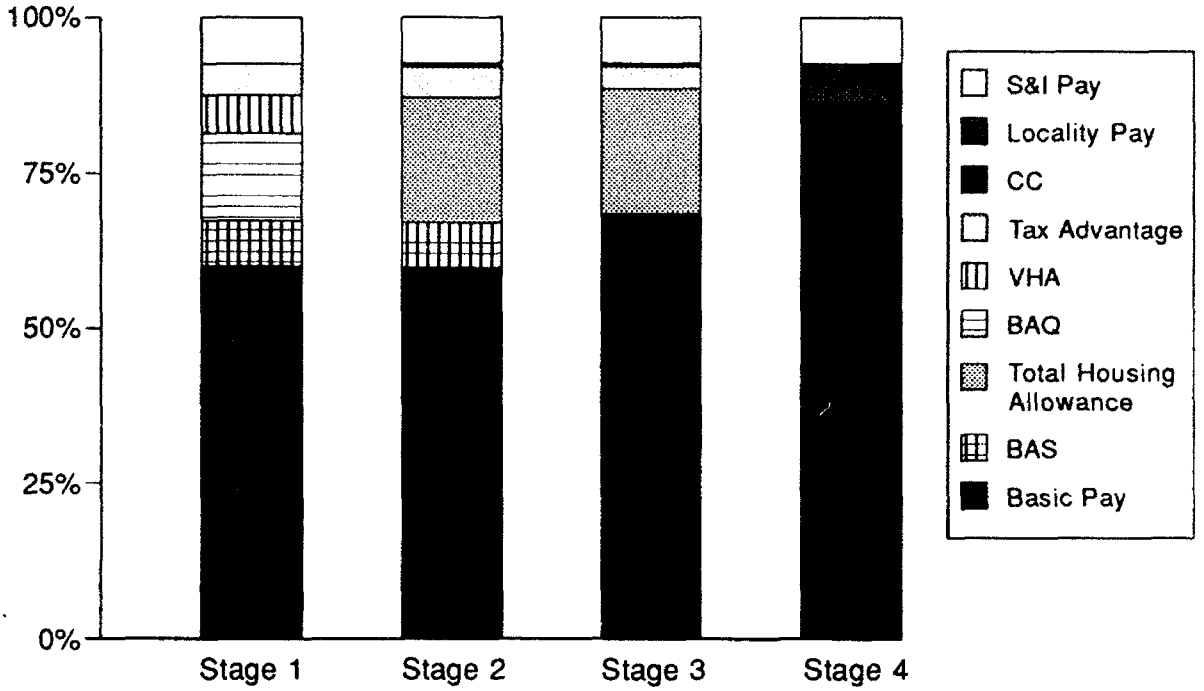
Figure 2-2 depicts a series of careful and deliberate evolutionary changes that peak at the QRMC vision of a simplified system. The base, Stage 1, is the system we have today. Stage 2 is the result of incorporating the recommendations for immediate change as summarized in chapter one.

The final two stages result from eliminating the two major allowances, BAS and BAQ. Allowances generally serve two purposes: to reimburse members for out-of-pocket expenses usually provided in kind, and to offset the effects of variations in prices. When all members, regardless of status, receive the same allowance, its utility becomes questionable. This is arguably the case with BAS,

SIMPLIFICATION PYRAMID FOR THE MILITARY COMPENSATION SYSTEM Figure 2-2



SIMPLIFICATION OF THE PAY AND ALLOWANCES SYSTEM Figure 2-3



eliminated in Stage 3. Similarly, while the housing allowance performs to some extent the important function of offsetting variations in prices due to locality, the largest portion is provided in common to all members of the same status. Therefore, future consideration should be given to moving the common portion of the housing allowance into basic pay and the portion due to locality variations into locality pay (Stage 4).

Figure 2-3 displays the same four-stage progression of pay elements, with the imputed tax advantage, for the average service member.

The underlying utility of the current system combined with the difficulties in making the transition to attractive alternatives suggest that there is no urgent need for major change. Major hurdles must be overcome to effect these future changes. Included among these are policy issues regarding the balance between current and deferred income, pay element linkages, tax implications, and associated transition costs. Nonetheless, careful and deliberate pursuit of a simplified system is warranted.

The 7th QRMC recommends the following:

- ***A near-term policy of continuing the present system of pay and allowances. However, realistic pricing of existing subsistence and housing allowances and an internal restructuring of basic pay are needed to fulfill the objectives of the system.***

- ***Deliberate pursuit of a simpler, more functional pay and allowance system that will better support the future force. Consideration should be given to eliminating compensation linkages that currently thwart structural change.***

NOTES

1. *Report on the National Defense Authorization Act for Fiscal Year 1991*, H.R. Conf. Rep. No. 923, 101st Cong., 2d Sess. § 1116, 159 (1990).

2. Congressional concern regarding the allowances is reflected not only in the provisions of the 1991 DoD Authorization Act dealing with BAS but also in language concerning the capacity of the housing allowance to provide an adequate standard of housing; see *Report on the National Defense Appropriations Act for Fiscal Year 1990*, S. Rep. No. 132, 101st Cong., 1st Sess. 11 (1989).

3. See the 7th QRMC Staff Analyses, GSP A—*Foreign Military Compensation Systems Review.*

4. Typically, an officer received a multiple of the *standard ration*, varying from 2 rations for the lowest grades to 15 for general officers; the Commander of the Armies drew 40 rations as an emolument.

5. The draft for World War I exempted married men, although not all took the exemption.

6. Act of April 16, 1918, 40 Stat. 530 (quarters or commutation thereof for commissioned officers).

7. Military Pay Readjustment Act of 1922, §6, 42 Stat. 625, 628.

8. The allowance was predicated on corresponding civilian spending, at the 75th percentile. U.S. Department of Defense, Advisory Commission on Service Pay (The Hook Commission), *Career Compensation for the Uniformed Forces: A Report and Recommendation for the Secretary of Defense* (Washington, December 1948), 12.

9. National Defense Authorization Act for Fiscal Year 1991, § 401, 104 Stat. 1485, 1543 (1990).

10. Descriptive statistics from the Defense Manpower Data Center for 1990 and prior years, and the Office of the Assistant Secretary of Defense (Force Management and Personnel), Officer and Enlisted Personnel Management Directorate for 1991.

11. See Les Aspin, Chairman, House Armed Services Committee, speech to the Atlantic Council, "National Security in the 1990s: Defining a New Basis for U.S. Military Forces," January 1992; and LTG Donald W. Jones, Deputy Assistant Secretary of Defense for Military Manpower and Personnel Policy, testimony delivered before the U.S. Senate, May 14, 1991. General Jones emphasized the important link between force readiness and experience.

12. The total housing allowance consists of a basic allowance for quarters (BAQ) and a regionally based variable housing allowance (VHA) in the continental United States, or BAQ plus an overseas housing allowance (OHA) otherwise. The 7th QRMC Staff Analyses, MTS 3—*Allowances*, addresses allowance rates in much greater detail.

13. Rates for the housing allowances (BAQ and VHA) depend on whether or not a member has dependents but not on how many: the married member with no children receives the allowances at the same rates as the member with a large family. Dependents include spouses and children up to the age of 21. They may also include stepchildren, disabled parents, and minor siblings if the service member supports them.

14. Some military members (about 9 percent of the force) assigned to low-cost areas receive only BAQ.

15. The BAQ rates were originally established based on income levels and the 75th percentile of national housing spending patterns. See the Hook Commission Report, page 12, and the Committee Report for the Career Compensation Act of 1949.

16. This proportionality was established at the time BAQ was set to cover 65 percent of the average national median housing costs, with the member to absorb approximately 15 percent based on the 1985 DoD Authorization Act. A combination of caps on VHA funding and of other circumstances have resulted in member absorption of 22 percent of housing costs.

17. Detailed descriptions of the survey process and the rate-setting method currently used are given in the 7th QRMC Staff Analyses, MTS 3—*Allowances.*

18. The Per Diem, Travel, and Transportation Committee in the Office of the Assistant Secretary of Defense (Force Management and Personnel) (OASD(FM&P)) establishes and updates VHA rates. There is also an overseas cost-of-living allowance that addresses international cost variations, including foreign currency requirements and rate fluctuations.

19. There are actually six rates for enlisted members. Three of these rates are for those in the grades of E-1 with less than four months of service (most of whom are in initial training and therefore receive rations in kind). For most members authorized to *mess separately* (meaning a dining hall is available where they could purchase prepared food, but often there are schedule conflicts or other impediments to using it), the rate is $184.50 monthly. Rates are higher when a mess is not available ($208.20) or under *emergency* conditions ($276). Ninety-three percent of enlisted members receiving BAS do so at the $184.50 rate.

20. The BAS is authorized in 37 U.S.C. § 402.

21. Based on information furnished by the services and on 1991 data from the DMDC.

22. Reprogramming of funds, within limits, is authorized.

23. The S&I program is discussed at length in the 7th QRMC Staff Analyses, MTS 4—*Special and Incentive Pays.*

24. A summary of the allowances is found in the 7th QRMC Staff Analyses, MTS 3—*Allowances.*

25. Some confusion about complexity seems to arise from commingling compensation and reimbursements for exceptional expenses under the same nomenclature. Classification of allowances as compensation or as reimbursement has long been a cloudy issue; for example,

Jones v. U.S., 60 Ct. Cl 552 (1925) describes military allowances as being "in the nature of compensation and sometimes in the nature of reimbursement.

26. See U.S. Department of Defense, *FY 1991 DoD Statistical Report on the Military Retirement System*, RCS No. DD-FM&P(Q) 1375 (Washington, 1992) for a detailed discussion of retirement provisions.

27. See, e.g., Martin Binkin and Irene Kyriakopoulos, *Paying the Modern Military* (Washington: Brookings Institution, 1980) 20-22; *Report of the Third Quadrennial Review of Military Compensation*, vol. III, Tab H, 21, and vol. V, 16-17; and General Accounting Office, *Military Compensation: Key Concepts and Issues*, GAO/NSLAD-86-11 (Washington, Jan. 10, 1986), 7.

28. What is meant by centralized decision making is the general tendency for large organizations to set pay scales and compensation policies (including benefits programs) by boards of directors or other senior managers, based on recommendations of personnel and compensation specialists. These decisions are typically removed from direct contact with affected employees and often based on aggregated information. Execution may be decentralized, based on these rules. In contrast, in small organizations, both policy and individual decisions are, by the nature of things, more apt to be made by managers or owners with direct knowledge of the affected individuals and their specific value to the organization and personal alternative opportunities. When very specific outcomes are devised (as is the case for military compensation), centralized decision making is normally undertaken. For a succinct account from the theory relating to management within a private firm, see Vijay Gurboxim and Seungjin Whong, "The Impact of Information Systems on Organizations and Markets," *Communications of the ACM* 34 (Jan. 1991): 59-73, 60.

29. See discussion in 7th QRMC Staff Analyses, MTS 1—*Compensation Structure*, Appendix C.

30. Beth J. Asch and James R. Hosek, *Designing Military Pay: Contributions and Implications from the Economics Literature* (RAND (WD-5734-FMP), 1991), 15-20; and Andrew Weiss, "Job Queues and Layoffs in Labor Markets with Flexible Wages," *Journal of Political Economy* 88 (June 1980): 526-538.

31. Ibid.

32. See Asch and Hosek, 38-53, and Edward P. Lazear and Sherwin Rosen, "Rank-Order Tournaments as Optimum Labor Contracts," *Journal of Political Economy* 89: 841-864.

33. This point is discussed at some length in the 7th QRMC Staff Analyses, MTS 3—*Allowances*.

34. The General Accounting Office (GAO) found in one study that RMC was underestimated significantly by 40 percent of enlisted personnel and 20 percent of officers. See General Accounting Office Report, *Military Compensation Should Be Changed to Salary System*, FPCD 77-20, (Washington, August 1, 1977). Other researchers have questioned the materiality of this finding. See Winston K. Chow and J. Michael Polich, *Models of the First-Term Reenlistment Decision*, R-2469-MRA&L (Santa Monica, CA: The RAND Corporation, September 1980), 36.

35. U.S. Department of Defense, Advisory Commission on Service Pay (the Hook Commission), *Career Compensation for the Armed Forces: A Report and Recommendation for the Secretary of Defense* (Washington, December 1948), 10.

36. See the discussion in the 7th QRMC Staff Analyses, MTS 3—*Allowances* and MTS 4—*Special and Incentive Pays*.

37. Richard Cooper, *The All-Volunteer Force: Five Years Later*, RAND Paper P-6051 (Santa Monica, CA: The RAND Corporation, December 1977), 41-53.

38. General Accounting Office, *Military and Federal Civilian Disposable Income Comparisons and Extra Pays Received by Military Personnel*, GAO/NSIAD-84-41 (Washington, May 9, 1984), 6. It has also been argued that some in-kind provisions, such as the medical benefit, are undervalued by beneficiaries. See the 7th QRMC Staff Analyses, GSP D—*Tax Issues*.

39. Congressional Budget Office, *The Costs of Defense Manpower: Issues for 1977* (Washington, January 1977), 92; and Department of the Treasury, *Tax Reform for Fairness*, (Washington, 1986), 47.

40. See, for example, General Accounting Office, *Military Compensation Should Be Changed to Salary System*, FPCD-77-20, (Washington, August 1, 1977), 31-34.

41. Ibid.

42. See the 7th QRMC Staff Analyses, GSP A—*Foreign Military Compensation Systems Review*.

43. General Accounting Office: *Military Compensation: Key Concepts and Issues*, 15-16. Numerous authors and reports are cited.

44. President's Commission on Military Compensation, (Zwick Commission), *Report of the President's Commission on Military Compensation* (Washington, 1978), 125-129. Something like this is done for enlisted tables in Australia, Canada, and the United Kingdom (all smaller services).

45. Binkin and Kyriakopoulos, *Paying the Modern Military*, 56-61.

46. These are discussed at greater length in Chapter 5 and in the 7th QRMC Staff Analysis, MTS 4—*Special and Incentive Pays*.

47. On the subject of divisive pay, from two different perspectives, see Charles C. Moskos, Jr., "Compensation and the Military Institution," *Air Force Magazine* (April 1978), 31:35, and Beth Asch and James Hosek, "Designing Military Pay: Contributions and Implications from the Economic Literature," unpublished manuscript (Santa Monica, CA: The RAND Corporation, 1991), 43-44. See also Moskos, "From Institution to Occupation: Trends in Military Organization," *Armed Forces and Society*, vol. 4 (1977).

48. Most notably, family housing is generally preferable to dormitory space, the medical benefit is of substantially greater value to members with dependents, and a variety of family support programs benefit them. It has also been argued that the commissary benefit is of greater value for married members. See, e.g., Cooper and Company, *The Attractiveness of Air Force Non-Monetary Benefits* (Brooks Air Force Base, TX: Air Force Systems Command, Air Force Human Research Laboratory, July 1974); and Research for Management and Hay Associates, *Field Test of the Perceived Value of Military Benefits, Final Report* (Philadelphia, PA: Hay Group, March 1980).

49. See Patrick C. Mackin and Jeffrey A. Peck, "Economic Impact of Differential Pays by Dependency Status," SAG Issue Paper (Washington, DC, SAG, 1991); and Paul F. Hogan, "Should Military Pay Vary by Dependency Status? Some Issues," unpublished manuscript (Washington: Decision Science Corporation, 1991).

50. This is an issue much discussed. See, for a general summary, General Accounting Office (GAO), *Military Compensation: Key Concepts and Issues*, GAO/NSIAD-86-11 (Washington, January 10, 1986), 45-49. See also Defense Manpower Commission (DMC), *Defense Manpower: The Keystone of National Security*, Report to the President and the Congress (Washington, April 1976), 330-331; Congressional Budget Office, *The Costs of Defense Manpower: Issues for 1977* (Washington, January 1977).

51. For DoD to be a cost minimizer, and accept higher unit costs for members with dependents, those members would have to be (generally speaking) more productive. Note that one must be very careful with costs here; they include full life-cycle costs (training, pay and allowances, support costs, etc.).

52. See Hogan, note 49.

53. For example, the services recruit large numbers of 17- to 19-year-old members every year. It is reasonable to expect that they will continued to be housed on post until they gain some experience in coping for themselves.

54. Three other volunteer militaries—those of Australia, Canada, and the United Kingdom—continue traditional personnel support with fewer compensation differentials. See 7th QRMC Staff Analyses GSP A—*Foreign Military Compensation Systems Review.*

55. QRMC charts from Current Population Survey data are in the 7th QRMC Staff Analyses, MTS 1—*Compensation Structure.* A more general discussion is in Sanders Korenman and David Neumark, "Does Marriage Really Make Men More Productive?," *Journal of Human Resources* 26 (1991): 282-307.

56. D. Alton Smith, Stephen D. Sylwester, and Christine M. Villa, "Army Reenlistment Models," in Curtis L. Gilroy, David K. Horne and D. Alton Smith, eds. *Military Compensation and Personnel Retention: Models and Evidence* (Alexandria, VA: U.S. Army Research Institute for the Behavioral and Social Sciences, 1991).

57. ACOL models generate continuation rates based on historic responses and projections of future policy variables (e.g., pay) and economic variables. These continuation rates imply future force structure tendencies.

58. See 7th QRMC Staff Analyses, GSP D—*Tax Issues*, for further discussion.

59. See the 7th QRMC Staff Analyses, MTS 1—*Compensation Structure*, and MTS 3—*Allowances*, for details.

60. See the 7th QRMC Staff Analyses, MTS 1—*Compensation Structure*, for more details of the assumptions for this and the other simulations.

Chapter 3
Restructuring Basic Pay

RESTRUCTURING BASIC PAY

INTRODUCTION

Basic pay—the largest, most visible pay element—is the foundation of military compensation. Its purpose, together with the other elements of military compensation, is to attract and retain the right numbers of high-quality people with the right skills to support national defense objectives. It helps to do so by providing the member a stable and predictable basis for his or her career decisions. As the only pay element that every uniformed service member receives, it also fulfills the special role of reflecting a service member's military status and responsibility.

The current basic pay table,[1] established in 1949 based on recommendations of the Hook Commission, differentiates pay levels among service members on the basis of rank, or pay grade, and time in service. Although the table's fundamental structure has not changed since then, a number of ad hoc changes have skewed its elements. These changes resulted from legislation directing various pay adjustments, targeted pay raises, pay caps, and the creation of new pay grades. They have given rise to the following problems in today's pay table:

- Compression—the distinction between pays of different grades at similar years of service is too small to provide a clear reward or incentive for promotion.
- Inconsistent relationships between pay differentials, with no apparent reasons for the differences—for example, promotion-triggered pay raises range from 2.8 to 38.2 percent; longevity raises, from 1.3 to 21.8 percent.
- Promotion and longevity imbalance—years of service weigh more heavily than promotion for the due-course member, weakening monetary incentives for performance.

We targeted our review of basic pay on the fundamental question:

> *Is individual performance adequately motivated and rewarded by the structure of the current basic pay table?*

In the process of addressing this question, we needed to answer two others. Should the various services continue to use the same basic pay table—or develop service-specific tables? Should the services continue to use time in service to gauge the value of experience for setting basic pay—or switch to a system of rewarding time in grade?

This chapter begins with a discussion of the basic pay table format. We explain our basic assumption that a single set of tables is appropriate for all the services, and our conclusion that the time-in-service (TIS) format is preferable to the time-in-grade (TIG) format for the basic pay table. Then, we examine the potential for shifting the relative weight of rewards toward promotion for both enlisted members and officers. Finally, we propose specific changes to improve the structure of the pay tables, and show that the changes positively influence compensation and retention.

EVALUATION OF THE BASIC PAY TABLE FORMAT

The format of the basic pay table should reflect the fundamental objectives of a compensation system—to attract and retain—which support military organizational requirements in the context of a volunteer force. Effective variations in basic pay must be competitive and efficient. As we learned from our early experience with the All-Volunteer Force, significant perceived deviations from these compensation goals may undermine morale and personnel readiness. From the perspective of DoD and the taxpayer, the basic pay table should sup-

port a force of appropriate quality and size. Efficient differentials in basic pay will make the best use of scarce dollars allocated for personnel.

The primary military organizational requirement that should be reflected in the format of the basic pay table is the need to establish appropriate pay differentials for military status. Beyond this, the format of the basic pay table should be consistent with other aspects and policies of the personnel system that are fundamental to the military. Perhaps most relevant is the military's *closed* personnel system, wherein most hiring happens only at the lowest level of the hierarchy. The format should therefore recognize that key career retention decisions are affected by pay expectations. Military enlistment contracts typically include an active duty service obligation of two to six years' duration with the largest group of contracts ending at four years of service. The basic pay table format should align raises with key service-length characteristics of enlistment and reenlistment contracts.

The timing of promotions is another personnel policy affecting the format of the basic pay table. The Defense Officer Personnel Management Act (DOPMA) dictates that officers who are not promoted after two opportunities must be separated, and recommends that opportunities for promotion occur within specified tenure windows for each rank. The Reserve Officer Personnel Act (ROPA) includes similar provisions for Reserve officers. Both laws aim to enhance the overall quality of the officer corps. With similar intent, the services also have implemented high year of tenure policies for the enlisted force. These rules specify the maximum permissible tenure, or total length of service, for individuals in each grade. Closely linked to high year of tenure policy is the normal promotion timing for each service, which varies significantly among services. Thus, total years of service and job performance together govern the timing of promotions. In addition, many other personnel policies are linked to the timing of promotion, including duty assignments and training. The format of the basic pay table must recognize the range of personnel policies within and among the services.

A Single Set of Pay Tables for All Services

The 7th QRMC advocates a single basic pay table for the seven uniformed services. Within the military compensation system, this commonality helps to develop a sense of shared purpose and to bring the different services together into a single, effective force; special and incentive (S&I) pays account for the unique needs of each service.

Proposals have surfaced from time to time, beginning with the Cordiner Commission in 1957, to shift from a single basic pay table to separate basic pay tables for each service.[2] The argument for doing so is based on the principle of efficiency, given differences in personnel requirements among the services. Differences in demand and supply for skills and experience *could* be reflected in different basic pay tables, with the table for each service incorporating career pay profiles that achieve desired recruiting and retention results.

Today, such differences are efficiently handled via S&I pays. These pays already provide more flexibility than separate tables for each service could provide. This is because S&I pays can target not just individual services, but *any* sub-population within a service. A system of separate basic pay tables sufficiently disaggregated to add to that flexibility would imply staggering administrative and oversight costs: it would be inefficient.

The argument for separate tables gives little weight to either the current defense strategy of *jointness* or the reasons behind it. The 1986 Goldwater-Nichols Defense Reorganization Act directs the kind of close cooperation among the services that was vividly witnessed in Operations Desert Shield and Desert Storm. A common compensation system strengthens the cohesiveness of our joint forces.

Furthermore, basic pay is the one element of compensation all members receive. Because it is based on rank, which is consistent across services, basic pay ought to be equally consistent across services. Service members have made a common com-

mitment to serve their country, and accepted the unique demands of military service, including the ultimate risk of war. Significant differences in basic pay among the services would undermine the sense of fairness associated with the current single table.

Time-in-Grade Versus Time-in-Service Basic Pay Table Format

A major purpose of basic pay is to provide recognition and reward for military status, indicated by rank. Because rank represents both a measure of past performance and the current level of responsibility within the organization, it should be the largest source of variation in basic pay.

Choosing secondary dimensions of the basic pay tables is more complicated. Relevant work experience is commonly used in private and public compensation as the second major determinant of pay. Should relevant work experience be defined as the entire military career (time in service) or as the time spent in a particular pay grade? Several past reviews of military compensation have recommended that the current TIS tables be converted to the TIG format, so we reevaluated the issue with the goal of enhancing the performance incentives in the current pay tables.

Given that better performance is reflected in faster promotion, and that performance rewards should be increased, the TIG format offers an advantage over the TIS one. Figure 3-1 illustrates the progress of two hypothetical members through both TIS and TIG basic pay tables. In this stylized example, basic pay rises with grade (G1, G2, G3) and with experience (the number in each cell). One individual follows the fast track of early promotions; the other, an average course. The lower panel shows that the faster member maintains a long-term compensation edge by having more time in grade, even after the average member is promoted to the same rank. As shown in the top panel, with a TIS table, the faster member's pay advantage is eliminated as soon as the average member is promoted. That is why the TIG format is often recommended as a better way of recognizing promotion.

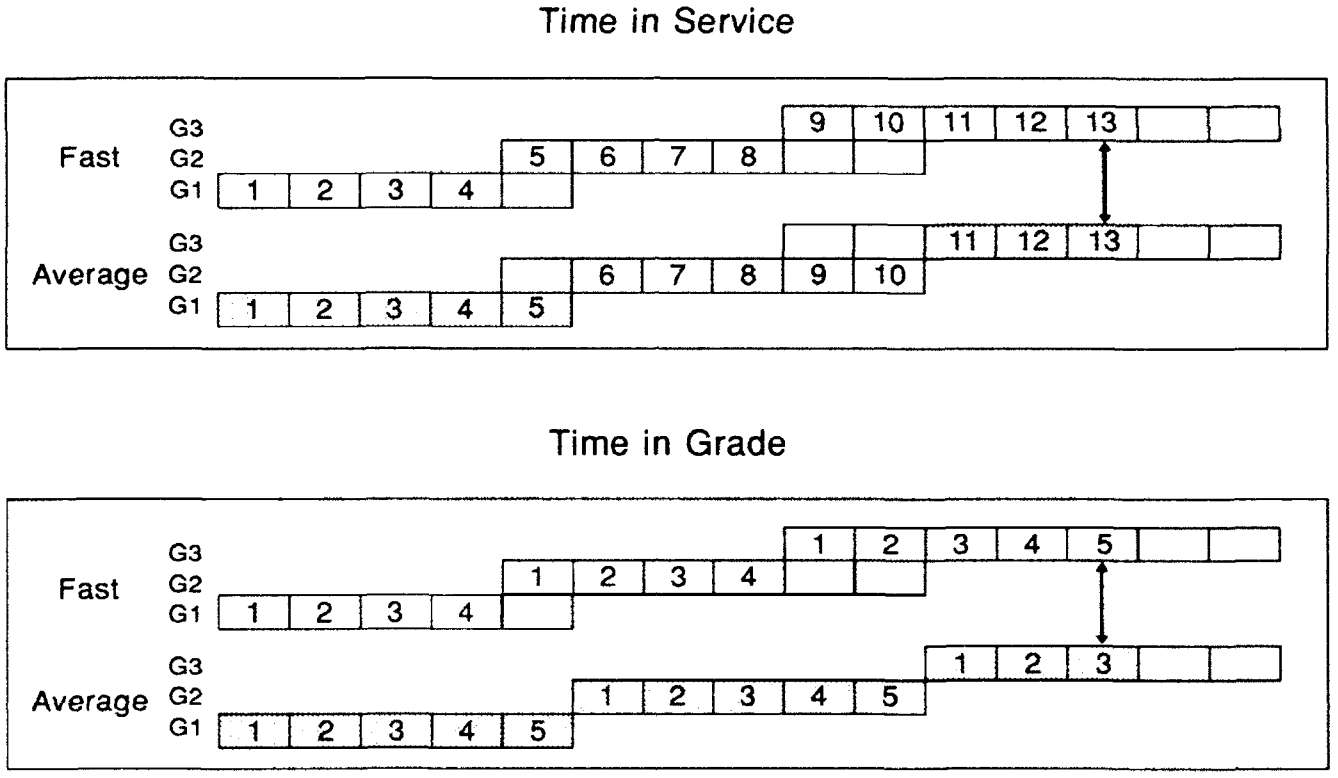
However, a TIG format is so sensitive to promotion timing differences that a number of unintended and inequitable consequences would accompany its implementation. These consequences result from the fact that the TIG format overlooks the *reasons* why some individuals may be promoted faster than others. Within individual services and narrowly defined skill groups, faster promotion generally does recognize superior performance. However, there are two important variations in promotion timing that have nothing to do with individual merit.

First, there are significant differences within and among the services in the amount of time it takes to reach a given grade. For example, it now takes about three years longer, on average, to reach the grade of E-5 in the Air Force than it does in the Navy. Any pay table that emphasizes promotion raises will thus increase the pay of Navy enlisted members relative to Air Force enlisted members. The TIG format would magnify this interservice pay differential by conferring a permanent pay advantage to the faster promotee, even when the timing is not a result of individual merit.

Second, there are significant differences in promotion timing among different skills in the same service. For example, it takes about two and one-half years longer to reach the grade of E-5 in the Navy's Master-at-Arms skill than it does as an Intelligence Specialist. Such circumstances arise in the Navy, at least in part, because promotions are based on vacancies by career field. If retention is high in a skill category, for whatever reason, the relative average speed of promotions tends to be slower in that skill, along with career compensation.

To the extent faster promotion results from supply differences, the resulting pay differentials may be desirable. This self-adjusting retention mechanism operates under either a TIS or TIG system. The boost a TIG system would provide to this mechanism is outweighed, in our view, by the need for consistent recognition of rank across the services.

PERMANENT TIME-IN-GRADE PAY ADVANTAGE Figure 3-1



In the military's closed personnel system, almost all individuals start at the bottom of the rank or status ladder and ascend one step at a time. In practice, there are many different ladders, and the speed with which individuals ascend is partially determined by policies, laws, and existing force distributions that are beyond their control. Thus, although it can be argued that a TIG system would be more efficient because of its inherent edge in motivating performance, it may be perceived as inequitable within the military. Such perceived inequities would likely undermine the positive motivational effects of emphasizing pay based on promotion.

Fortunately, it is possible to adjust the TIS format to offer greater rewards for performance and, in so doing, to balance such changes with these institutional considerations. In the current table, there are a number of places where pay raises can be shifted to accentuate increases in rank relative to time in service. Compared to TIG tables, revised TIS tables would likely trigger less extreme pay differentials upon promotion, as Figure 3-1 showed. However, given the variability of promotion timing described above, this is an *advantage* of the TIS format—it tends to protect the taxpayer during times of faster promotions, and protect the service member during times of slower promotions, as is occurring now.

To summarize, the 7th QRMC finds that the time-in-service format of the basic pay table is superior to the time-in-grade format. A TIS table can be designed to place greater emphasis on promotion relative to longevity, yet still mitigate the effects of nonmerit-related differences in promotion timing on pay. In contrast, a TIG table would

spuriously decrease or increase pay of groups whose overall promotion timing slows or quickens. Staying with TIS tables entails none of the inequities of changing the table format; it tends to reduce member uncertainty during a period of major force structure shifts; and it maintains consistency with the TIS parameters of many personnel policies, including terms of reenlistment, high year of tenure, promotion, and retirement eligibility.

RESTRUCTURING THE ENLISTED BASIC PAY TABLE

We estimate that about half of the increases in basic pay received by the services' enlisted members over their careers are due to promotion. While both promotion and experience are reasonable indicators of productivity, promotion explicitly recognizes better performance relative to one's peers. On the other hand, the value of additional experience varies more widely and is bound to be smaller on average because it includes individuals whose performance is just adequate for their current levels of responsibility. We believe that a greater portion of basic pay raises should be triggered by promotion, and that the current pay table should be revised to place greater emphasis on pay for performance.

In this section, we evaluate the pattern and relative sizes of the promotion and longevity raises in the current basic pay table. Following the evaluation, we describe our design criteria, recommended revisions to the enlisted table, and their estimated income and retention effects.

Evaluation Criteria

To evaluate the current structure of promotion and longevity raises, we posited two criteria derived from the concept of paying for recognition of military status and, implicitly, performance:

- Promotion differentials should increase with rank (in absolute terms), to provide career performance incentives and appropriately recognize military status.
- Longevity differentials for members promoted on time should be relatively uniform and substantially smaller than promotion differentials.

These pay relationships have been recommended by military pay study groups since the Hook Commission. Moreover, these relationships are the norm in compensation systems of large, hierarchical organizations in general. This is because pay differentials that meet these criteria motivate individuals to develop better skills and to strive to achieve higher grades rather than be content to continue in the same grade. They also tend to motivate better worker-job matches, retention, and performance.[3]

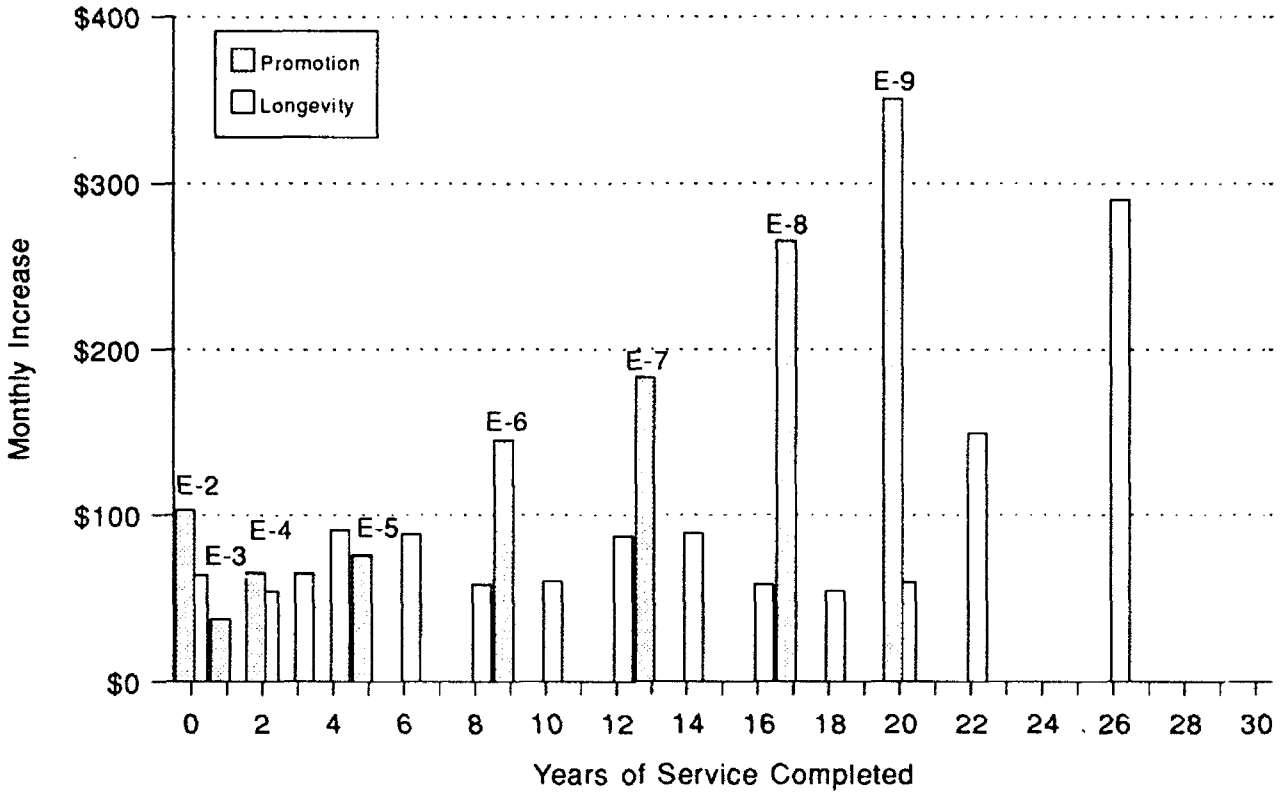
Promotion and Longevity Relationships

Figure 3-2 portrays the dollar increases associated with both promotions and longevity steps that a hypothetical member would receive over a full career. The shaded bars show the monthly basic pay raises associated with promotion at DoD-average timing. Similarly, the unshaded bars show the TIS, or longevity, increases this member would receive over a career. The member promoted at other than average timing would see a different pattern of promotion and longevity raises.

Figure 3-2 shows that promotion differentials in the current table do not always increase with grade. While the graduation in promotion raises from E-6 to E-9 reflects a member's increasing status, the E-2 raise is greater than each of the raises to E-3, E-4, and E-5. In fact, promotion raises in these three grades are on average smaller than longevity raises in the same period.

Longevity raises in the enlisted table vary considerably and show some anachronisms. The over-four month raise was originally introduced in 1949 to reward completion of initial training. Yet, today many members are promoted to E-2 before completing four months of service; furthermore, the initial training periods of all the services are more than four months. Also irrelevant is the over-26 year raise for active duty E-7s (similar to the

CURRENT ENLISTED PROMOTION AND LONGEVITY RAISES Figure 3-2



over-26 year raise for E-9s, shown in Figure 3-2) occurring after members have reached service high year of tenure limits and must separate.

Longevity raises at completion of both 22 and 26 years of service are disproportionately large. The over-26 year raise was legislated in 1963 to entice members to a *full career*; however, this now works counter to efforts to reduce the size of the force. Because the level of retired pay is directly linked to basic pay, the raise exerts a strong influence on members' retirement decisions, tending to pull them to 26 years of service for the raise's lifetime impact on retired pay.

Findings

In some instances, today's pay table fails to recognize appropriately the increased responsibility reflected in selection for promotion. Longevity differentials equivalent to or larger than promotion differentials potentially undermine members' incentive to perform at their peak. Moreover, the variation in longevity differentials suggests areas where budgeted dollars could be shifted to both maintain consistent influence as policies change and reorient the pay table to emphasize promotion.

The longevity raises in the enlisted basic pay table are, to a significant degree, the cumulative result of past manipulation to solve temporary manning problems. For example, on at least two different occasions during the draft era (1958 and 1963), and again in 1971 in preparation for the all-volunteer force, longevity raises were legislated to improve first-term retention. As a result, the current enlisted pay table contains relatively large longevity raises after two, three, and four years of

service. Likewise, the current large increase at over-26 years of service was implemented at a time when increased experience in the force was needed. Before S&I pays were well developed, it made sense to adjust basic pay table to solve transitory problems. However, such incentive pays are well established for the foreseeable future. Forty years of ad hoc changes to the basic pay table have created many opportunities to restructure the promotion and longevity raises to better support the force of the future.

Pay Table Design Guidelines

We developed pay table design guidelines from our evaluation of the findings and recommendations of previous studies; the economic literature on compensation; and other public sector, private sector, and foreign military service pay practices.[4] In our judgment, the following design criteria, which incorporate the evaluation criteria discussed previously, are consistent with both the market and institutional demands on military compensation. The basic pay table should:

- Provide stable and predictable career compensation offering an attractive alternative to civilian opportunities, considering current and deferred compensation.

- Encourage performance by rewarding promotion. Between-grade differentials should be larger than within-grade differentials, and longevity increases should be relatively uniform, ceasing after an appropriate amount of time.

To insure that pay differentials in a revised pay table will work to improve its effectiveness for a given budget, we revised the table to meet the following goals: First, pay table costs for the expected fiscal year 1994 force structure should be roughly the same under the proposed table as under the current table, accounting for expected annual adjustments.[5] Second, cumulative career earnings and retention of individuals promoted at average or faster-than-average intervals should increase. Third, overall retention should not fall as a result of the revisions. Earnings and retention results should hold for each service's promotion timing. Finally, the revisions were aimed at establishing relationships that would be valid for the long term, rather than focusing on current force management concerns such as the drawdown.

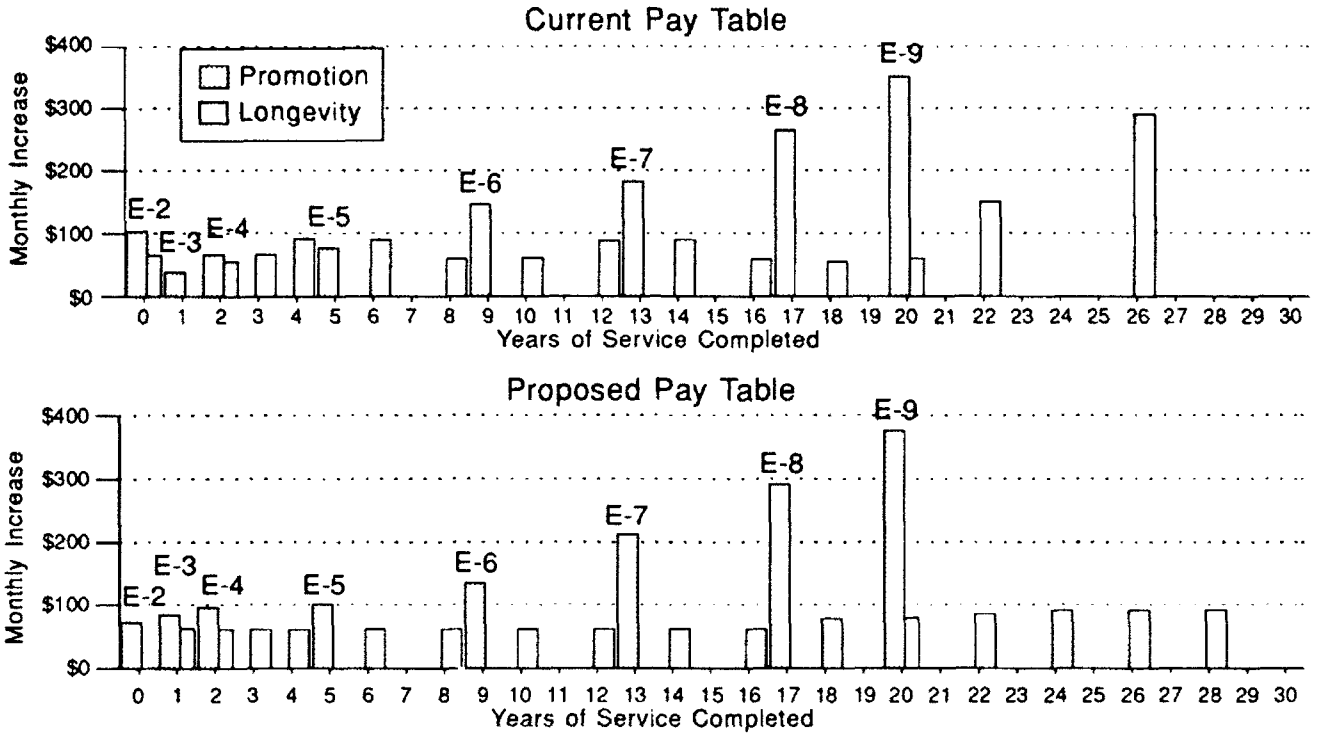
Proposed Revisions

The proposed revisions satisfy our guidelines and criteria. They furnish appropriate differentials for military status, shift the balance of pay increases toward promotion to enhance performance incentives, and make longevity differentials consistent throughout the table. Figure 3-3 compares the proposed promotion and longevity differentials to those found in the current enlisted basic pay table.

Revised Promotion Differentials. The major changes to the promotion differentials involve grades E-2 through E-4. These promotions do not discriminate as strongly on relative performance as later promotions, and generally are scheduled by each of the services as a matter of policy. Because timing of promotion to these grades differs significantly among services, a heavy emphasis on promotion differentials for these grades would introduce considerable disparity in first-term earnings across services. We recommend promotion increases graduated by grade throughout the pay table. However, the early promotion differentials are small, by design, to reflect the relatively small distinctions in performance and potential, yet still larger than longevity raises to instill early in the career an appreciation of the value of promotion. The relatively large pay raises at the highest pay grades are intended and expected to increase performance incentives as far down the promotion chain as E-5 and below, as members plan their careers.

Revised Longevity Differentials. The basic assumption underlying longevity increases is that increased proficiency derives from additional experience in a relatively smooth fashion. The longevity raise for E-1s at four months of service is deleted in the proposed table because the com-

PROPOSED ENLISTED PROMOTION AND LONGEVITY RAISE COMPARISON Figure 3-3



Note: Both current and proposed tables are projected to 1994 using programmed pay raises

pletion of initial training that it once recognized now occurs, on average, after promotion to E-2, somewhat later than the four-months mark. A new raise is added at the one-year mark to supply annual longevity increases during the first four years of service. Unlike promotion raises, whose timing may vary, these longevity raises during the first term consistently support first-term retention because enlistment contracts are for a specified number of years, typically four. After four years, longevity raises become biannual through 28 years of service.

Adding a raise at over-24 years and reducing the raise at over-26 years effectively adds an over-28 year raise. The anticipated result will not be increased retention beyond 26 years. Rather, the intent is to establish a pay table structure appropriate for retention in the long term. Instead of one large raise, three smaller, more uniform longevity raises will tend to neutralize the impacts of longevity raises on the retirement decision during either force expansions or contractions, regardless of the retirement system in force. The smoothing of the longevity increase at over-26 years of service introduces the same consistency and uniformity of longevity raises in this part of the table as proposed at other experience levels.

Estimated Effects

The test of the efficacy of the proposed revisions to the enlisted basic pay table is whether they support the key objectives of the military personnel system to attract, retain, and motivate a highly qualified force. As expected, shifting emphasis from longevity to promotion within the pay table tends to increase career earnings of members promoted at

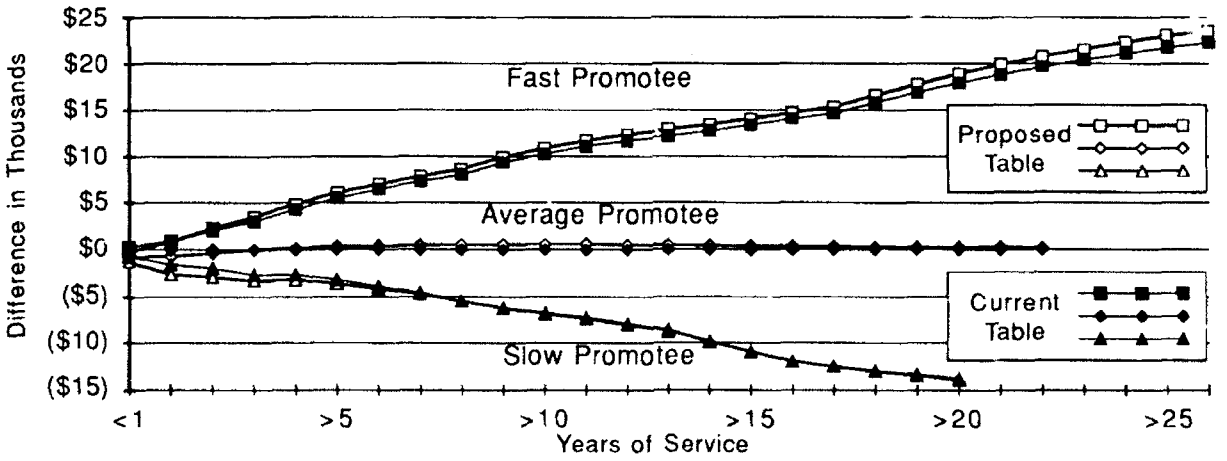
average or faster timing, which tends in turn to increase retention of these higher-quality members.

Financial Effects on Members. To calculate the financial effects of the proposed changes on members, we estimated cumulative career earnings. Because the revised table was designed to keep the levels of basic pay similar to those in the present table throughout a member's career, but to shift the weight of the differentials toward promotion, the overall financial effects are not large. The differences in the present value of cumulative career earnings are calculated for three alternative careers corresponding to fast, average, and slow promotion. A fast career path is defined as reaching the grade of E-9 at the average promotion point after being promoted early to E-6 and E-7. The present value of the cumulative career earnings for this category is evaluated through 26 years of service. The average career path represents reaching E-7 on time, and is calculated through 22 years of service. The slow career path is defined as reaching E-6 at slower-than-normal timing, calculated through the 20th year. We used a 10-percent discount rate to compute the present value of future earnings from the member's point of view.

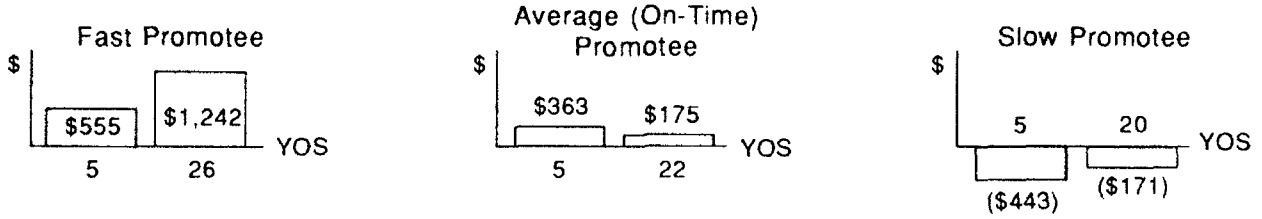
Figure 3-4 shows that average and faster promotees fare better under the proposed pay table than under the current table. The upper chart graphs differences in the present value of cumulative career earnings, at entry. Consider first the average promotee. The line representing pay for the average promotee under the fiscal year 1991

CUMULATIVE CAREER BASIC PAY DIFFERENCES, CURRENT VERSUS PROPOSED PAY TABLE

Figure 3-4



Note: All differences are relative to cumulative pay for the average promotee under the current table (zero axis).



Note: The vertical bars show the net change to the present value of cumulative career basic pay through the years of service indicated, under the proposed pay table.

pay table (black diamonds) is set to zero for reference. The adjacent line (open diamonds) represents the difference in cumulative earnings under the proposed table for the average promotee. Similarly, the top two lines represent the differences for the faster promotee, again in comparison to the average promotee on the fiscal year 1991 table. The lower curves represent differences for slower promotees. The bar charts below the line graph show that faster and average promotees see net increases in expected cumulative earnings, compared with expected earnings under the current table; slower promotees see a slight decrease.

Retention Effects. We estimated the changes in retention for members on the three career paths, based on these estimates of effects on career earnings and applying the Annualized Cost of Leaving (ACOL) methodology. The proposed table was developed as a cost-neutral alternative, so it is not surprising that the overall inventory impacts are modest. What is significant is that retention of the *right* people—average and faster promotees—tends to increase at the expense of slower promotees' retention. Because the proposed changes in basic pay increase the earnings of members who are promoted at average timing or faster, their retention is estimated to increase by about 500 per year. This increase would be offset partially by additional losses of slower-promoted members of less than 100 per year. In the long-run, other things being equal, the proposed changes in basic pay would slightly increase the number of career members relative to first-term members. For example, the ACOL projection shows that, for all of DoD, there would be about 250 additional members in each year of service from 10 through 19, and fewer additional members with under 10 years of service.

RESTRUCTURING THE OFFICER BASIC PAY TABLE: O-1 THROUGH O-6

Our analysis of the internal structure of the basic pay table for officers (O-1 to O-6) uses the same evaluation and design criteria as for the enlisted force. The restructuring process is also similar—we identify inconsistencies in the current table, propose a revised structure that supports our design criteria, and show financial and retention effects.

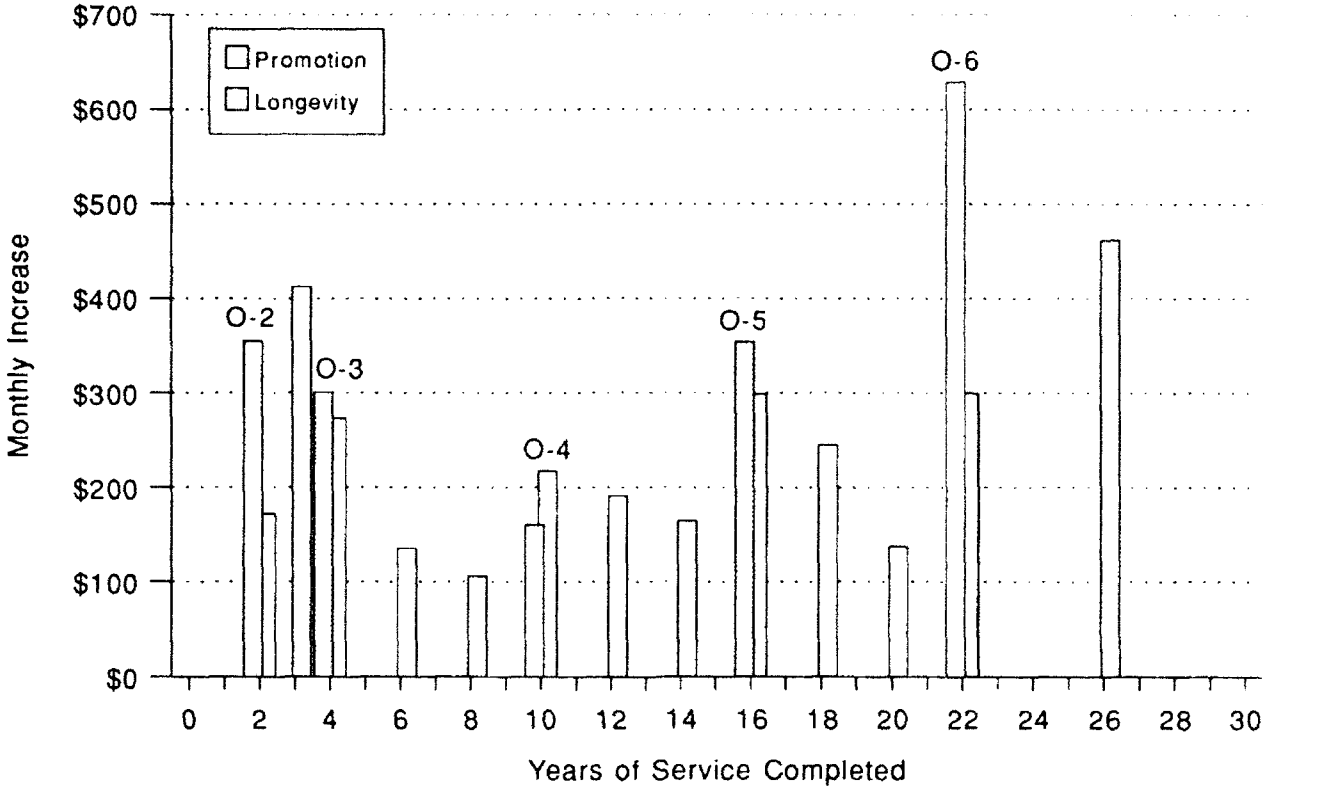
The immediate practical problem with the officer pay table is that it produces a period of rapid pay growth during the first four years of a career that is followed by about eight years of slow pay increases. The rapid early pay growth occurs when officers are still serving their initial active duty service commitments and are ineligible to separate. The attendant pay compression over nearly half a 20-year career detracts from the ability of the pay system to retain and motivate mid-career officers, and inadequately recognizes military status—particularly in the promotion to O-4.

Promotion and Longevity Raises in the Current Table

Figure 3-5 illustrates the pattern of promotion and longevity raises experienced by a hypothetical member promoted to each grade within DOPMA timing. As before, the shaded bars represent promotion differentials and the unshaded bars longevity differentials. The O-2 raise is larger than all the other pay raises through O-5, and the O-3 raise is nearly as large. Most striking is the relative insignificance of the promotion raise to the grade of O-4. Yet, the promotion to O-4 is one of the most important: it is the first carrying any significant possibility of failure and subsequent automatic separation from the service under DOPMA; it comes after the member has completed half of a 20-year career; and it is recognized as a significant achievement, as DOPMA automatically confers the status of a regular commission upon officers accepting promotion to that grade.

The longevity differentials in the current officer basic pay table vary by a factor of about nine from smallest to largest. The longevity raises at over-three and over-26 years of service exceed all other raises in the table except the O-6 promotion raise. The over-three year longevity raise is large even though no significant career event occurs in the third year of service. It was implemented in 1955 to encourage junior officers to continue in service

COMPARISON OF CURRENT OFFICER PROMOTION AND LONGEVITY RAISES Figure 3-5



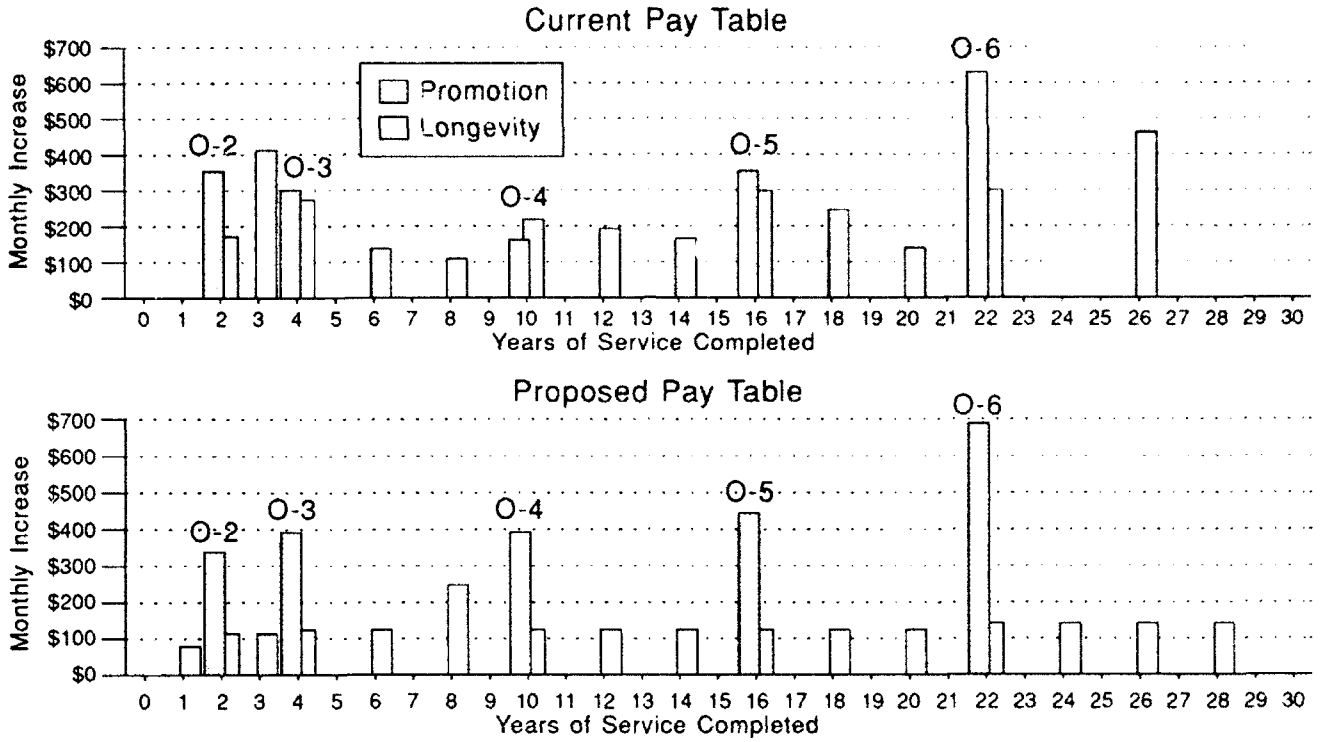
at a key decision point, during an era when typical initial active duty service commitments were two and three years. Today these initial commitments typically are four or more years. The biennial longevity raises between 10 and 22 years of service are all at least as great as the O-4 promotion raise. The combination of the large longevity raise at over-three years of service, and the two large promotion raises in the second and fourth years of service, produces the pattern of very rapid pay growth during the initial service obligation. By contrast, both longevity and promotion pay raises are small between the fifth and fifteenth years of service.

Proposed Revisions of the Officer Basic Pay Table

As with the enlisted table, the proposed revisions in promotion and longevity differentials satisfy our guidelines and criteria. They specify appropriate differentials for military status, shift the balance of pay increases toward promotion to enhance performance incentives, and provide consistent longevity differentials throughout the officer basic pay table. Figure 3-6 compares the proposed promotion and longevity differentials to those found in the current officer basic pay table.

Revised Promotion Differentials. The first two promotions for officers, to O-2 and O-3, have very low failure rates, and do not significantly distinguish between individuals on the basis of performance. The promotions to O-4 through O-6 are strongly influenced by an individual's potential to handle greater responsibility and span of control. To meet our design criteria, we therefore propose to establish generally increasing promotion differentials for the grades O-2 through O-6. The overall

PROPOSED OFFICER PROMOTION AND LONGEVITY RAISE COMPARISON Figure 3-6



Note: Both current and proposed tables are projected to 1994 using programmed pay raises

graduated promotion raise structure provides a powerful performance incentive, not just for O-5s, but for many individuals at lower ranks who are looking forward to the opportunity to make O-6.

Revised Longevity Differentials. Except for the proposed O-4 increase, the most significant proposed changes are to the longevity differentials. The resulting pattern of longevity raises is uniform, with one significant exception at eight years of service. The TIS pay table format supports just this kind of justifiable departure from the uniform pattern of longevity raises implemented in the rest of the pay table. The QRMC proposes a larger longevity increase at the eight-year point to counter possible negative retention impacts if promotion timing to O-4 is uncertain. There are several arguments to support such a deviation, noting first that this longevity raise is still smaller than any promotion raise, and that the raise makes sense from a long-term perspective.

If the O-4 promotion raise becomes significant relative to surrounding longevity raises and consistent with other promotion raises, then the *timing* of that promotion becomes extremely significant, pay-wise. Not only do several services currently promote two years beyond the middle of the DOPMA window, but the DOPMA window itself spans two years (form 9 to 11 years of service). This can create considerable pay uncertainty on the part of O-3s looking ahead to possible promotion to O-4. At about the same time, these members are making their initial retention decisions—in years 6, 7, and 8—following the end of their initial service commitments. Over the past ten years, the seventh and eighth years of

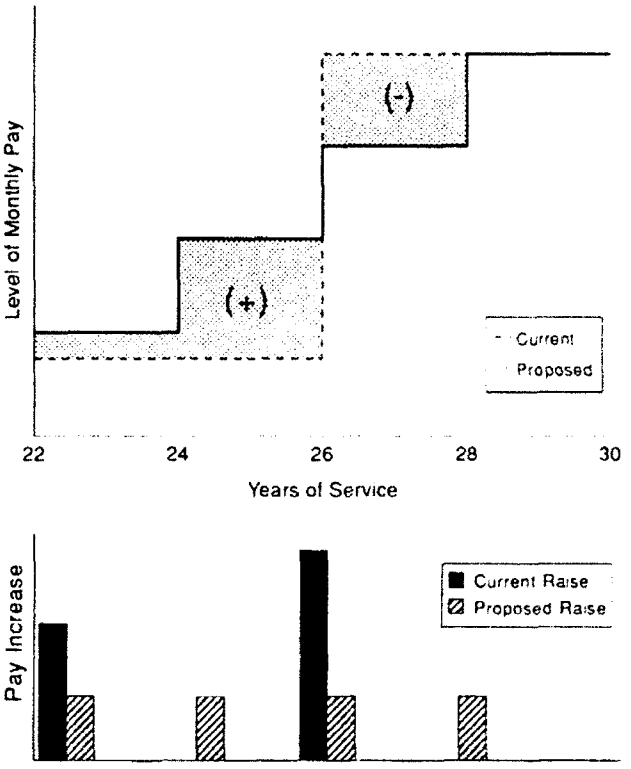
service have been relatively low points in officer continuation. The larger longevity raise at over-eight years will help ensure pay progression at a point in members' careers when it can have a positive impact on retention at a decision point that is likely to retain significance for the foreseeable future.

Independent confirmation for the idea of creating a distinct discontinuity in the pay line of O-3s is provided by the work of Hay Management Consultants.[6] These industry experts found that the job content span—a measure based on a job's requirement for generic personnel capabilities such as know-how, accountability, and problem solving—was significantly greater for O-3 than for other officer grades. This, in turn, suggests that the grade of O-3 actually encompasses more than one distinct job level, and could conceivably be split into at least two separate ranks. The large longevity raise at over-eight years of service gives a significant pay boost to senior O-3s, which is commensurate with their positions of increased responsibility. In sum, the QRMC believes it is important to place the proper relative weight on the promotion raise to O-4 and, having done that, to compensate via the longevity structure for potential vagaries in promotion timing, as a long-term stabilizing factor within the pay table.

The longevity raise at over-26 years of service is the largest in the current pay table. Like the large enlisted pay raise at over-26 years, it unduly influences the timing of retirement decisions because of the linkage between basic pay and retired pay. We propose to spread a portion of this raise over two additional pay raises, at completion of 24 and 28 years of service, following the same rationale as for the enlisted pay table.

Figure 3-7 focuses notionally on O-6 pay levels (above) and longevity raises (below) from over-22 to over-28 years of service. As the top graph shows, cumulative pay in these years is greater under the proposal than under today's structure, as the increased pay from years 22–25 more than offsets the reduction at 26–27 years.

NOTIONAL PAY LEVELS AND LONGEVITY RAISES: O-6, >22 TO >28 YEARS Figure 3-7



The proposed distribution of pay raises from 22 to 28 years of service will have several benefits. For the member, the proposal increases retirement options—he or she is no longer held hostage to the 26-years-of-service longevity raise. For the service, the proposed pattern will give a smoother distribution of exits, regardless of the retirement system in force. Finally, although budget impacts are difficult to estimate, increased exits at 24 and 25 years of service should tend to reduce retirement costs.

Estimated Effects

Our proposal would eliminate pay compression and graduate promotion raises from O-2 through O-6, so that pay raises for promotion to each grade are quite distinct. Under this proposal, basic

pay would be somewhat lower for junior O-3s, then higher from year 8 through the remainder of a career.

Financial Effects on Members. As with the enlisted table, we examined the financial effects on members by comparing the present value of cumulative career earnings under the current and proposed officer tables. But because of the way this proposal redistributes officer pay, we were particularly concerned with its potential impacts on existing members.

The proposal's effects differ depending on a member's current rank and experience. For an individual who begins service under the proposed table, and continues with on-time promotions through 20 years, the present value of the increase in cumulative career earnings is just over $1,000. However, because pay would be shifted from large longevity differentials during the first four years of service to larger promotion differentials during the mid-career years, some current members may suffer a small decrease in the present value of cumulative career earnings. But, even for the worst case, an O-2 who faces a smaller longevity raise after three years of service, the estimated reduction is only about $440 over a 20-year career, and actually turns into an *increase* if he or she were to stay until 25 years. For everyone else, career pay would unequivocally increase—O-3s between four and seven years of service gaining from about $2,000 to $6,600, with the increase coming primarily from larger field grade promotion raises. Under the proposed transition plan, described in Chapter 7, no member would see a reduction in current pay.

Retention Effects. Again, because the overall effects of the proposal on cumulative career earnings are not large, the estimated retention effects are relatively modest. However, the changes tend to motivate the *right* people to stay. DoD-wide, in the steady state we could expect to retain 150 to 250 more officers per year in each year between 9 and 19 years of service, all of whom are promoted at average timing or faster.

REVISING THE BASIC PAY TABLE FOR PRIOR-SERVICE, WARRANT, AND FLAG OFFICERS

We revised prior-service and warrant officer basic pay tables not only to adhere to our design criteria, but also to maintain appropriate relationships with the enlisted and officer basic pay tables. Our revision of the promotion and longevity differentials in these tables specifically accounts for these considerations, and maintains the relationships embedded in the current tables. We believe that the structure of flag officers' pay merits special attention because almost all of today's pay variations among flag officers are associated with grade.

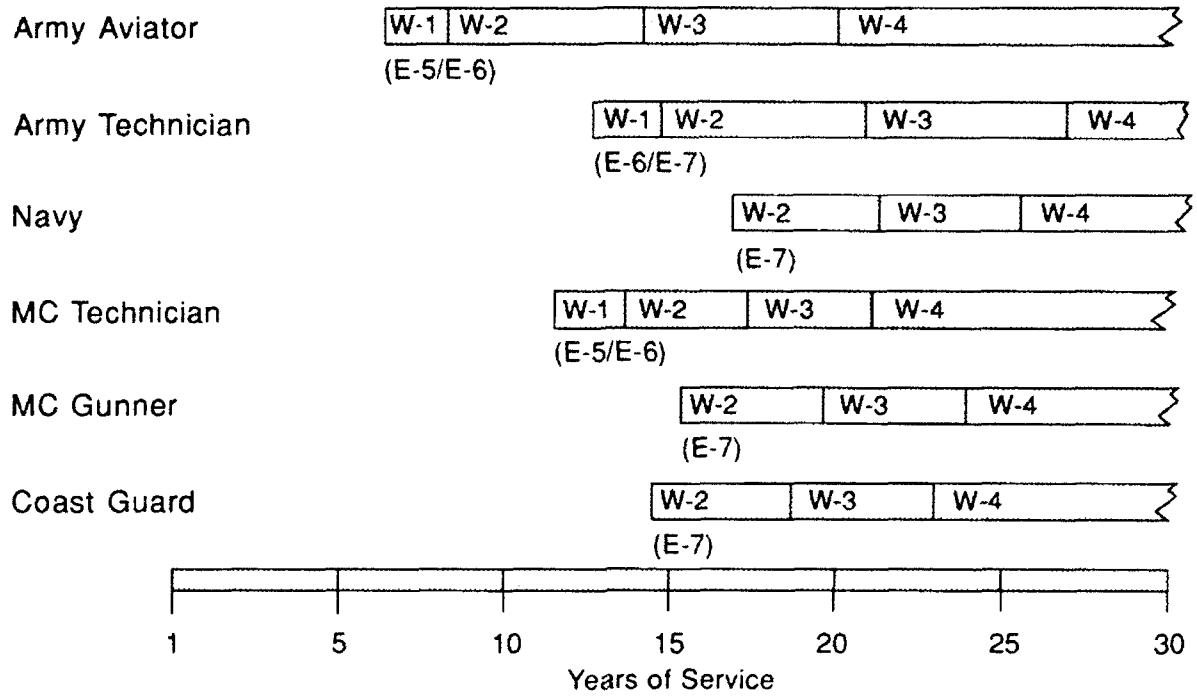
Prior-Service Officer Basic Pay Table

The prior-service pay table was created by the Military Pay Act of 1958 as a separate schedule for officers with more than four years of prior service as enlisted or warrant officers. That act aimed to reduce pay inversions between grades by discontinuing longevity increases to personnel who were not promoted after a reasonable time. But, without special consideration, an unintended effect of the law would have been to penalize officers with prior enlisted service who, although earning normal promotions, had passed the cutoff for longevity raises. The prior-service pay table was created to maintain the incentive for enlisted members to become officers by continuing longevity raises beyond the point at which they ceased in the officer table. Other than these additional longevity raises, there is no difference between the officer table and the prior-service officer table.

We propose revising the prior-service pay table to maintain its current relationship to the officer pay table. In addition we propose new longevity raises after 16 and 18 years of service, for two reasons. First, the current table does not fairly treat the value of additional experience of prior-service O-3s with 14 to 20 years of service, who are progressing normally. Second, the current

SERVICE WARRANT OFFICER PROGRAMS

Figure 3-8



Note: These timelines indicate the average entry point and promotion timing for each program. For example, on average an Army Technician will enter the WO program from the grade of E-6 or E-7 at 12.5 years of service.

structure of promotion and longevity raises provides an incentive for some members to postpone retirement primarily on the basis of a large potential increment in retirement income associated with possible promotion to O-4. With the additional longevity raises for O-3Es, individual incentives are more closely aligned with their value to the service.

Warrant Officer Basic Pay Table

Our review of the warrant officer pay table considered both the internal structure of the table, and its relationship to the other pay tables. The internal structure of the table was reviewed using our evaluation and design criteria. Relationships with the other tables were evaluated in light of the services' reported experiences in gaining and retaining warrant officers. Differences among the accession policies of the various services complicate the process of fitting a new table between the proposed enlisted and officer tables while ensuring that pay complements career opportunities. For example, the Army aviator warrant officer program is designed to attract warrants with little or no prior enlisted experience, while the Navy program requires at least 12 years of service for entry. Figure 3-8 demonstrates the variation in service warrant officer programs.

From the perspective of internal structure, we impose uniform longevity raises. The one exception is for the W-1 pay grade at six years of service. The sea services expressed concern that, without a relatively large increase at that point, they would not be able to attract high-quality E-7s to warrant officer careers because of compression of E-7 and W-1 pay. A second issue regarding the

relationship with the enlisted table is that, in the current table beyond 20 years of service, E-9 basic pay can exceed the pay of W-3s. Individuals who become warrant officers from E-7 could then be worse off financially—throughout retirement—than if they had gained two additional enlisted promotions. We shifted the W-3 pay line to ensure that it provided more equitable incentives for promotion given the relationships between the tables. Otherwise, our proposed pay table for warrant officers maintains current relationships with the other tables.

Flag Officer Basic Pay

The services reported no pay or retention problems affecting flag officer personnel. For consistency, we examined the flag officer panel of the pay table for potential areas of improvement based on our design criteria. Because the population is concentrated beyond over-26 years of service, most flag officers do not receive longevity raises. Taking the position that the structure of flag officer pay should conform to the same principles as the other pay tables, we propose some changes.

The proposal smooths flag officer pay lines, and adds a longevity raise at over-28 years of service. The proposed flag officer pay table maintains consistency with the overall pay table by implementing a similar promotion and longevity structure. Officers promoted earlier than average to O-7 will receive longevity raises similar to those earned in other grades for accumulated experience. These individuals will receive smaller current income that will be offset by greater future income. The pay differential between O-6 and O-7 is consistent, and compression between the grades of O-7 and O-8 is alleviated.

RETIREMENT AND RESERVE LINKAGES

It is difficult to change the basic pay table because of its linkages to other components of military compensation. Because retirement income is linked to basic pay, any changes in basic pay at or near the retirement point will be reflected in retirement income. This linkage acted as an additional constraint on changes we proposed in the basic pay table in two ways. First, the budget implications of relatively small basic pay changes may be large when the implied retirement accrual is considered. Second, the smoothing of the over-26 longevity raise could reduce the prospective retirement income of some individuals now retirement-eligible, requiring special consideration to hold the members harmless. In general, proposed changes to the basic pay table are expected to have an insignificant impact on the retirement income of service members.

There are also two key linkages involving the Reserves. One is that Reserve retirees draw retired pay based on the basic pay table in force when they reach age 60. The second is that drill pay, or pay for inactive duty training, is derived from the basic pay table: pay for one training period is one-thirtieth of monthly basic pay. These linkages constrain basic pay changes through their effects on personnel costs. Promotions under ROPA generally are slower than under DOPMA, and the Guard and Reserve components have more than five times as many members with over-26 years of service as do the active forces. The proposed table accommodates both active and Reserve components.

Our proposed changes in active duty promotion and longevity raises were developed with full recognition and accounting for the effects of these linkages.[7] For example, the proposed pay table maintains longevity raises for O-2s through four years of service, and for E-7s through 28 years of service, to support the Reserve components.

SUMMARY AND RECOMMENDATIONS

Basic pay is the foundation of military compensation. Our review of the basic pay table finds that the single-table, TIS format is appropriate to support, and improve, future force readiness. Nevertheless, we find that improvements in the internal structure of the pay table can better motivate members, modestly increase retention, and better support pay differentials based on military status. Our

proposed pay table relieves compression between grades by restoring significance to every promotion relative to longevity pay increases; eliminates inconsistencies; and shifts the balance in emphasis toward promotion, while retaining meaningful and consistent longevity raises. By lashing pay more tightly to promotion, the resulting pattern of pay raises rewards performance and motivates our higher-quality members to compete.

Specifically, in the proposed pay table:

- The member promoted at average or faster timing is better off than under the current table (net plus to cumulative career earnings).
- The member promoted at slower-than-average timing is less well off than under the current table (net minus to cumulative career earnings).
- Retention of average and faster promotees is improved, while overall retention is sustained.
- Longevity differentials for average promotees by service are uniform and smaller than promotion differentials.
- Promotion differentials for average promotees by service increase with rank and exceed longevity differentials.
- Instances and magnitude of pay inversions are reduced from current pay table.
- Changes to the current table ensure long-term viability of the military force.

The proposed pay table is found at Table 7-1.

The 7th QRMC recommends that its proposed TIS pay tables be implemented to achieve a consistent and appropriately weighted promotion and longevity structure across all grades, and that future changes adhere to the structure and principles underlying the proposed table.

NOTES

1. In fact, there are separate pay tables for officers, prior-service officers, warrant officers, and enlisted members. In this report, the term *basic pay table* is used generically to mean this *set* of basic pay tables.
2. For another argument for an occupationally based compensation system, see Martin Binkin and Irene Kyriakopoulos, *Paying the Modern Military* (Washington, DC: Brookings Institution, 1981).
3. Beth J. Asch and James R. Hosek, *Designing Military Pay: Contributions and Implications from the Economics Literature*, WD-5734-FMP (Santa Monica, CA: The RAND Corporation, 1991), v-viii.
4. The 7th QRMC Staff Analyses, MTS 2, *Basic Pay*, reviews public sector, private sector, and foreign military service pay practices.
5. See Chapter 7, Integration and Transition, for an accounting of the costs of these proposals and how the costs are affected by the choice of transition alternatives.
6. Hay Management Consultants, *Military Pay Comparability Report* (Alexandria, VA: 1992).

7. Chapter 8, Issues for Future Review, discusses the role of these linkages as barriers to restructuring military compensation.

Chapter 4
Allowances

ALLOWANCES

INTRODUCTION

A distinctive feature of our military compensation system is its provision for allowances. Historically, the government has found it necessary to house, feed, and provide services to its members to develop and maintain an effective military force. Today's pay policies continue to support this requirement, with an allowance structure that makes cash payments to members whenever in-kind services are not provided by the government. The purpose of this chapter is to summarize the 7th QRMC's analyses, findings, and recommendations regarding this integral, but complex, part of the military compensation system.

The long-held rationale for allowances was asserted in the 1978 report of the President's Commission on Military Compensation:

> The military relies to a much greater degree than most public- and private-sector institutions on allowances and in-kind compensation, which accounts for 30 percent of military pay. This reliance on allowances is justified on the grounds that it supports the military way-of-life. That is, to ensure readiness and to provide for needs in isolated areas, personnel must live at the site of, or in close proximity to, their duties. In addition, the pay and allowance form of compensation appears to reinforce the view that the services "take care of their own," and thus contributes directly to building effective fighting units.[1]

While one could argue that the requirement for allowances has not changed significantly from the 1970s, the demographics of the All-Volunteer Force, societal values, and economic conditions have challenged the ability of the allowance system to support today's personnel force structure in a credible and cost-effective manner.

Our review focused on the relationship between the current system of allowances and the costs faced by service members who are not provided in-kind support. First, we present our analysis of the basic allowance for subsistence (BAS), which provides for members' food costs. In the second section, we evaluate the two current housing allowances paid to members located in the United States: the basic allowance for quarters (BAQ) and the variable housing allowance (VHA). The third section of this chapter identifies a gap in the current allowance structure—the variation in nonhousing costs between duty areas—and proposes a new allowance, the continental United States cost-of-living allowance (CONUS COLA), to fill it. Finally, we describe our brief review of the 31 other allowances provided to eligible service members.

BASIC ALLOWANCE FOR SUBSISTENCE

Historically, the government has furnished subsistence to members of its armed forces. Today, military members continue to receive a basic allowance for subsistence to defray the cost of their food when they are not provided subsistence in kind. This allowance is payable to officers at all times on a monthly basis and to enlisted personnel on a daily basis when (a) rations in kind are not available, (b) permission to mess separately is granted, or (c) personnel are assigned to duty under emergency conditions.

The 7th QRMC finds that the current BAS system is unnecessarily complex, having multiple rates with no explicit link to food costs. We propose a single-rate system that is linked to a government food cost measure and administered across the services through standard procedures.

Problems with the Current BAS System

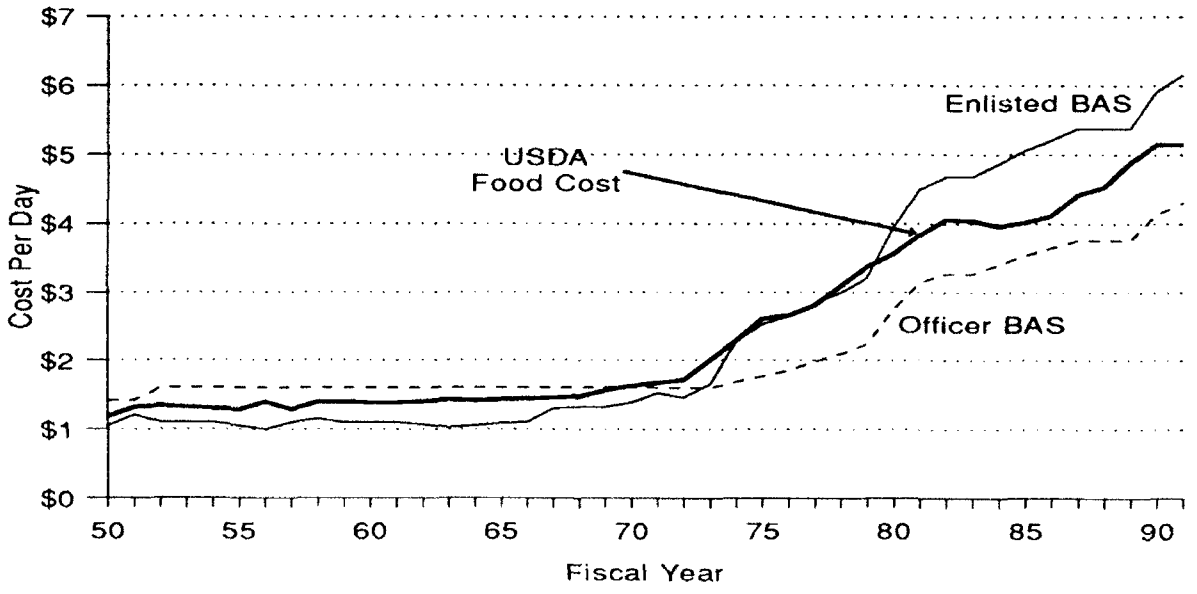
The 7th QRMC found several problems with the subsistence allowance as it is presently structured.

First, BAS is *not related to food costs.* Figure 4-1 displays daily BAS rates, for officers and for enlisted personnel who are authorized to mess separately, compared with a daily food cost measure for the period from 1950 through 1991. Through 1973, BAS rates approximated food costs, as intended in the Career Compensation Act of 1949, which established the current BAS system. Since then, BAS has generally been adjusted by the military pay raise percentage, not by the increase in food costs, resulting in a divergence between BAS rates and food costs.[2]

Second, the current BAS system is *viewed as inequitable* by military members. The typical enlisted BAS rate, $6.15 per day in FY 1991, was greater than the officer rate of $4.30 per day, although enlisted and officer personnel face the same food costs when shopping at the commissary or local supermarket. In addition, all enlisted BAS rates were greater than the daily sale of meal rate (DSMR) of $4.90 per day, which is the amount charged in military dining facilities. As a result, enlisted members receiving the cash allowance enjoy more options and, if they choose to eat in military dining facilities, have more net income than those receiving subsistence in kind. In contrast, officers who eat in military facilities lose income, especially when the surcharge of almost $10 per day, to which they are subject, is added to the DSMR.

Desert Shield and Desert Storm highlighted a problem with the loss of BAS during deployments. Many members and their families perceived the stopping of BAS payments during the deployment as a significant loss of family income, just when members were being placed at great risk. Junior enlisted members lost as much as 22 percent of their pay. Furthermore, the amount collected from enlisted members was greater than the cost of paying for the meals individually. Other countries,

DAILY BAS RATES VERSUS FOOD COSTS Figure 4-1



such as Canada, the United Kingdom, and Australia, provide meals to deployed military members without reducing their compensation relative to that received when not deployed.[3] These governments absorb the extra expense on the grounds that feeding service members in the field is a legitimate cost of doing business.

Finally, the current BAS system is *unnecessarily complex.* A total of seven different rates are applied to officers and enlisted personnel. Entitlement and collection procedures vary significantly within and across the services, making the system difficult to understand and administer, especially in joint operations. The percentage of the enlisted force receiving BAS varies from a low of 51 percent in the Marine Corps to a high of 86 percent in the Air Force. Collection procedures are inconsistent and may in fact obscure the essential nature of BAS as an allowance. For example, an officer's Leave and Earnings Statement (LES) always shows BAS as income, with the cost of meals provided by the government as a deduction. In contrast, BAS appears and disappears from the income component of an enlisted member's LES as his or her eligibility changes.

An Improved Allowance

The 7th QRMC proposal for improving the BAS system consists of the following five interrelated recommendations, and an implementation strategy that is described in the next section:

- *Establish one BAS rate for officers and enlisted personnel. Set the DSMR equal to the BAS rate.* Having one rate for both the allowance and the cost of meals in military dining facilities would simplify the current system, making it easier to understand and administer. A common rate would acknowledge that all members face similar food costs and reduce the inequity between BAS recipients and those provided meals by the government.

- *Set the BAS and DSMR rate equal to daily U.S. Department of Agriculture (USDA) food plan costs.* This procedure would reestablish and maintain a clear link between BAS and food costs, the central flaw in the current system. USDA food plan costs are a recognized standard developed from survey data on nationwide food consumption and expenditure levels. There are four USDA food plans, each supplying the same nutritional requirements, which vary in cost from Thrift to Liberal as the composition of the food items in the market basket changes. The costs for the food plans are based primarily on food cooked at home, but they also factor in some meals eaten away from home. The 7th QRMC believes that the Moderate meal plan for males, age 20 to 50, best reflects the overall military population in demographic and spending patterns and is, therefore, an appropriate basis for setting BAS rates. Costs for this plan are plotted in Figure 4-1. The daily food plan cost for FY 1991 was $5.55, in between the current BAS amounts for enlisted personnel and officers.[4]

- *Adopt for all members the current collection procedures used for officers.* All members would receive BAS, which would appear on the member's LES as income. Charges for eating in military dining facilities would then be recorded as a deduction. Services would continue, as a matter of policy, to define who would be required to use the dining facilities. These changes would increase the visibility of BAS and simplify the administrative transactions associated with field and sea duty.

- *Have the government fund meals during contingency operations.* In addition to being inconsistent with the intent of an allowance, paying BAS to deployed members who are receiving subsistence in kind is expensive. We estimate that funding all field and sea meals—that is, continuing BAS payments to deployed members—would increase the cost of BAS by $366 million, or over 10 percent of the current total. However, the 7th QRMC believes it is appropriate to furnish combat meals without eliminating a member's BAS.

This could be accomplished within the current law by drawing a distinction between routine field and sea duty, for which meal costs would be charged to the member, and contingency operations, for which members would not be charged. With this change, members and their families would not face a pay cut at the same time the member is placed in extraordinary danger.

- *Eliminate the surcharge on dining facility meals.* The surcharge was established to recover operating costs for meals provided in military dining facilities. However, because so many members are exempt from paying the surcharge, including almost all enlisted personnel, it recovers less than three percent of the $1.5 billion in operating expenses for dining facilities. Moreover, those who are subject to the surcharge, such as most officers, avoid eating in dining facilities because it more than triples the cost of these otherwise reasonably priced meals. Hence, key supervisors are discouraged from eating in the dining facility. Because the surcharge is ineffective and deters dining hall usage by supervisors, the 7th QRMC recommends that the Secretary of Defense eliminate the surcharge by exempting all members except those in a temporary duty status.[5]

Establishing a single BAS and DSMR rate, equal to the cost of the USDA Moderate food plan, would generate a number of benefits. The system would be less complex and more understandable. Members would know that their allowance is based on real food costs and that all of them are charged the same amount when meals are provided. A single BAS rate would eliminate most perceived inequities of the current system. Meals would cost the same for officers and enlisted personnel, whether eaten in a dining facility, in the field, or on the economy. In addition, adopting standard collection procedures, funding contingency meals, and eliminating the surcharge on dining facility meals would further improve and simplify the BAS system.

Solution Alternatives

Because of the current divergence between BAS rates and food costs, implementing a single-rate system would require a reduction in enlisted BAS and an increase in officer BAS. The 7th QRMC evaluated several alternatives for making these changes with the objective of controlling costs without disadvantaging members.

One approach—freezing enlisted BAS until the USDA food plan cost catches up, while increasing the officer BAS to current food costs—was rejected because enlisted members would lose pay. Another approach—shifting funds between BAS and BAQ—was also considered and rejected. Because all members do not receive both BAQ and BAS, moving money between the allowances, even while keeping the total funding for BAS and BAQ constant, would produce an unacceptable number of perceived winners and losers. The QRMC concluded that the best approach would be to move an appropriate amount of money to or from the members' basic pay.

Implementing the Recommendations

While shifting money between basic pay and BAS is relatively straightforward, coincident changes—tax consequences and retirement accrual being the most significant—must also be considered in making the adjustments. We examined the following adjustments to establish a single BAS rate:

- Reduce enlisted BAS rates to the USDA food cost while adding the reduction in the BAS rate, plus the value of the associated Federal tax advantage, to basic pay for all enlisted members.

- Increase the officer BAS rate to the USDA food cost while subtracting the increase in the BAS rate from the basic pay for all officers.

This approach would establish a single BAS rate without reducing the current, after-tax income of the average member. For example, enlisted mem-

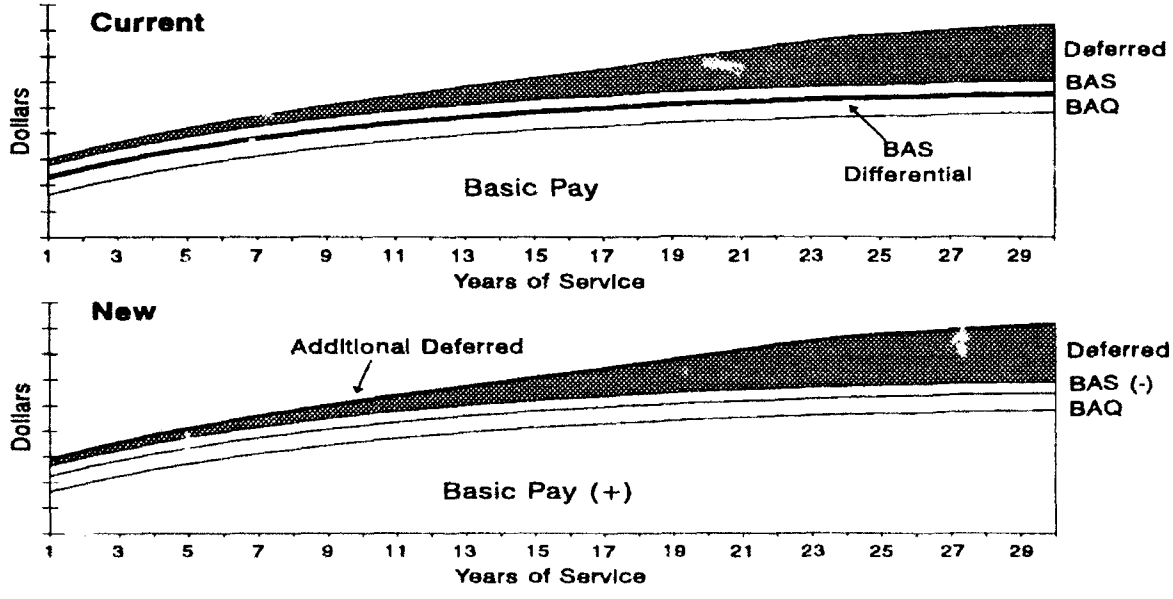
bers receiving BAS would see a reduction in their allowance balanced by an increase in basic pay, which, after taxes, would equal the reduction in BAS. The cost for this approach, however, would be significant—an estimated $316 million increase in military compensation for FY 1994.[6]

The principal source of increased costs is the basic pay increase for junior enlisted members who typically receive subsistence in kind. Because these individuals do not receive BAS, there is no offsetting reduction in allowance costs. To reduce the costs of moving to a single-rate system and minimize the windfall gains to junior enlisted personnel, the 7th QRMC recommends phasing in their increase in basic pay as follows: for members with less than two years of service, do not increase basic pay; for members with two years of service, include a third of the increase; for members with three years of service, include two-thirds of the increase; and for members with four or more years of service, provide the full increase.[7] Implementing this procedure would reduce the estimated cost for BAS reform from $316 million in FY 1994 to $123 million.

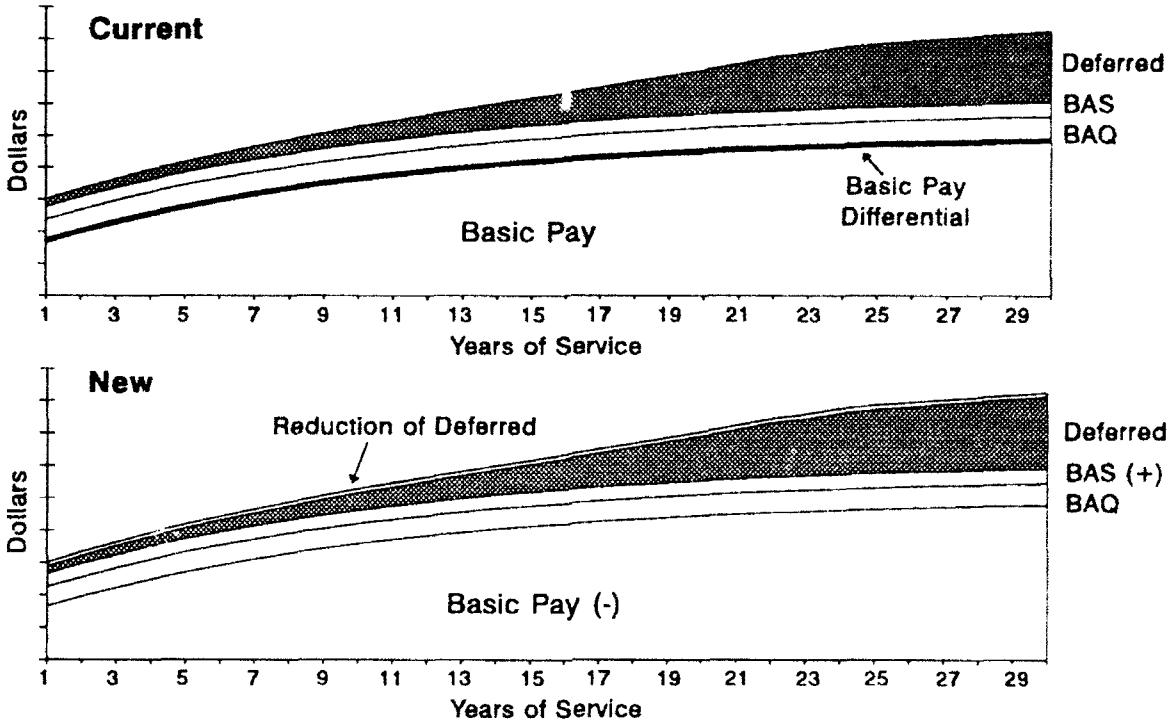
Shifting funds between BAS and basic pay also has the significant effect of producing potential windfall gains or losses in future retirement earnings. Retirement eligible enlisted members would receive more retired pay due to the increase in their basic pay, while officers would receive relatively less. The 7th QRMC recommends adjusting the changes in basic pay for members nearing retirement eligibility so that the total value of their current plus deferred compensation is unaffected.

Figures 4-2 and 4-3 demonstrate the notional adjustment process. Enlisted personnel nearing retirement eligibility would receive a smaller increase in basic pay that is balanced by an increase in retired pay. Conversely, the reduction in basic pay for officers nearing retirement eligibility would be less but balanced by a slight reduction in retired

BALANCING CURRENT AND DEFERRED INCOME: ENLISTED PERSONNEL Figure 4-2



BALANCING CURRENT AND DEFERRED INCOME: OFFICERS Figure 4-3



pay. The 7th QRMC estimates that with these adjustments, including the phase-in for junior enlisted personnel, the implementation costs would be $72 million for FY 1994.[8]

Thus, for about a two-percent increase in cost over the current BAS system, the single-rate system proposed by the 7th QRMC could be implemented without disadvantaging current members. We believe the benefits that would accrue from this improved BAS system are worth the modest increase in costs.

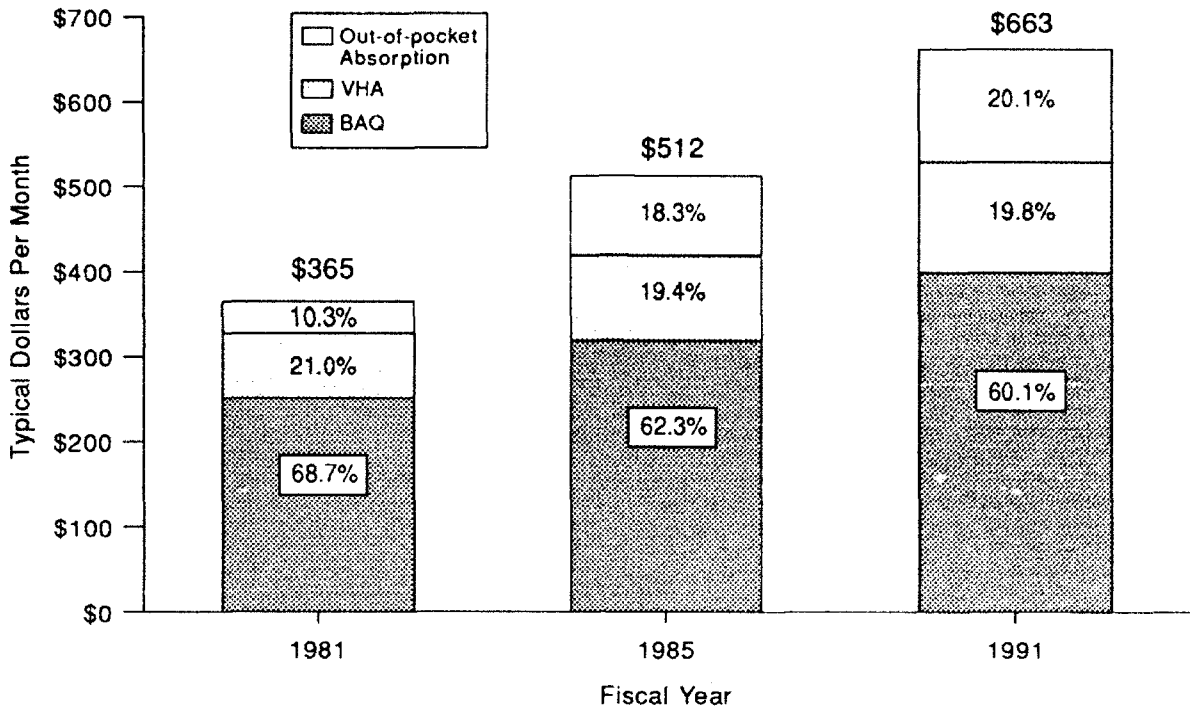
HOUSING ALLOWANCES

As with subsistence, the military services have historically been committed to housing their members. When government-owned housing is not available, service members stationed in the United States are eligible to receive two nontaxable housing allowances. The basic allowance for quarters, which was created by the Career Compensation Act of 1949, is paid according to a schedule that varies by the grade of the service member and whether or not the member has dependents. Recognizing the substantial variation in housing costs across duty areas, the Military Personnel and Compensation Amendment of 1980 established the variable housing allowance, which is paid to service members in high-cost areas at rates that vary by grade, dependency status, and location. In the United States, approximately 68 percent of all members receive BAQ in lieu of in-kind housing; 67 percent also receive a VHA payment. Together, these housing allowances are the largest component of the allowance package, costing the government almost $6 billion per year.[9]

Given the overall purpose of allowances in a compensation package, the 7th QRMC believes that

HOUSING COSTS AND ALLOWANCES, 1981-90

Figure 4-4



an effective housing allowance program should meet two specific objectives:

- The housing allowance should be sufficient to procure adequate housing commensurate with that occupied by civilians at similar income levels.[10]

- A service member should be unaffected by the housing price variations between locations.

The *Joint Services Housing Allowance Study (JSHAS)*, which was published by DoD in November 1991, found that the current housing allowance system does not fulfill these objectives because allowances do not accurately mirror housing costs. The report points to two specific problems. First, the average allowance has not kept pace with average housing costs; as a result, the fraction of housing costs that members have to pay out of their other compensation—called the *absorption rate*—has doubled from 10 percent to 20 percent over the last decade. Figure 4-4 compares median housing costs, represented by the height of each bar, with the housing allowances for selected years during this period. Although the 1985 DoD Authorization Act effectively established a 15-percent absorption rate goal for the combination of BAQ and VHA, funding limitations have left the allowances short of this objective.

Second, the *JSHAS* found that the combined housing allowance is frequently not sufficient to acquire adequate housing for junior enlisted personnel assigned to high-cost areas. A comparison by duty area of E-4 housing expenditures with Department of Housing and Urban Development (HUD) cost data for adequate housing shows that costs exceed median expenditures by $125 per month or more in a significant number of

locations. Because the current methodology for setting VHA rates does not incorporate a physical standard for adequate housing, there is no guarantee that junior enlisted are able to rent adequate dwellings.

The 7th QRMC supports the three principal proposals made in the *JSHAS* to remedy these housing allowance problems:

- Reestablish the intended relationship between housing allowances and housing costs by creating a single variable Housing Allowance (HA) for duty locations in the United States. The HA for each location should equal local median housing costs minus an absorption amount equal to 15 percent of national median housing costs.
- Maintain the linkage between allowance and cost by adjusting the HA budget annually in accordance with the rental component of the Consumer Price Index (CPI).
- Assure adequate housing for junior enlisted personnel by using an external survey of housing costs to establish a floor for the HA.

Our analysis of the current housing allowance system, which is presented in this section, builds on the *JSHAS*. First, we review the current methodology used to set housing allowances by geographical area. We find that the dependence of that methodology on a survey of service member housing expenditures is the source of several problems, including the adequacy issue for junior enlisted personnel. Next, we evaluate two external sources of data on housing costs, looking specifically at the advantages and disadvantages of each, to establish a floor for the housing allowance. In this subsection, we also estimate the cost of the floor proposal. A significant portion of these costs can be offset and housing allowance equity improved if, in areas with very low housing costs, the current requirement to pay BAQ were eliminated.

Looking to the future, the 7th QRMC proposes a new rate-setting methodology that would, by improving the linkage between housing allowances and housing costs by area, assure that service members are neither disadvantaged by reassignment to high-cost locations nor overcompensated for assignments in areas with low housing costs. Preliminary analysis suggests that our Price-based Housing Allowance (PHA) would cost about the same as the current system but would be simpler to implement and justify. However, more study is required before the PHA could be instituted.

Finally, we also reviewed the VHA offset provision, which reduces a member's VHA by 50 percent of the amount not spent on housing, and the treatment of Reserve members under the housing allowance system.

Setting Housing Allowances by Duty Area

Consider the conceptual problem of designing a payment sufficient to maintain an individual's purchasing power when he or she moves from a low- to high-cost area. One definition of *constant purchasing power* is that the individual can buy the same market basket of goods and services in both locations.[11] To construct a payment based on this definition, we need to be able to measure how the *prices* of goods and services in the market basket differ by location. The change in prices multiplied by the quantities of each good consumed in the baseline market basket equals the payment required to maintain purchasing power.

This conceptual framework can be applied to the procedure for setting housing allowances. First, one establishes the bundle of housing characteristics, such as size, quality, and location, that is typically sought by members at each grade. Then, one determines the price of this standard bundle across duty areas. An allowance based on these prices would allow members to purchase standard housing services wherever they are assigned.[12]

The current methodology for determining VHA rates does not follow this approach. It starts with an annual census of service members receiving housing allowances to collect information on actual

housing expenditures and on the characteristics of their dwellings. Note that expenditures are not the same as the prices identified in our conceptual approach—expenditures are the product of the price of housing services and the quantities actually purchased by members.[13] Recognizing this difference, the current methodology adjusts the expenditure data for differences in the size (specifically, the number of bedrooms) and in the type (single family, townhouse, apartment, mobile home) of dwelling occupied by duty area.[14]

A key question for our review of the rate-setting methodology was whether the adjusted expenditure data provided by the member survey accurately tracks the variation in local prices of housing services. If the adjusted expenditure data represent expenditures more than prices, allowances will not be correctly set by area. Consider what happens to a member who moves from a low- to high-cost area. Responding to the higher housing prices, he or she will choose a smaller quantity of housing, so that expenditures will not increase as much as the price difference in percentage terms. Therefore, an allowance based on expenditures would undercompensate members in high-cost areas relative to the goal established in the conceptual model. Conversely, allowances would be set too high in areas with low housing costs.

To validate the adjusted expenditure data, we looked for an external source of housing cost data and found two candidates—the Department of Housing and Urban Development, which computes Fair Market Rents (FMRs), and Runzheimer International, a private sector company specializing in the collection and application of cost-of-living data. Because Runzheimer's data collection approach is closest to our conceptual model and for technical reasons described in the next section, we chose their data for our analysis. Starting with a survey of the civilian population in 160 U.S. cities, Runzheimer determines standard renter and homeowner profiles for a variety of income levels and family sizes. These profiles describe housing choices in terms of the total number of rooms, the number of bedrooms and bathrooms, and total square footage. The attributes associated with the particular location of a dwelling are accounted for by choosing residential communities that support given income levels and housing profiles. Runzheimer then obtains rental costs from local real estate agencies and property management firms.[15]

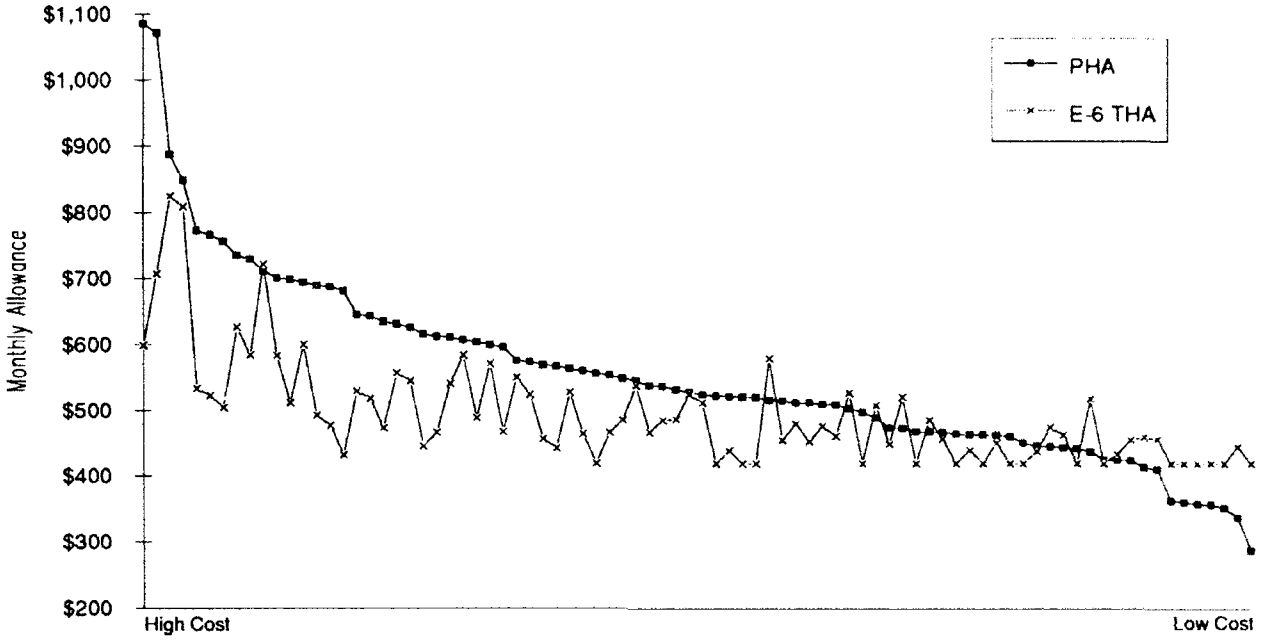
Currently, VHA rates are set for 332 Military Housing Areas (MHAs), in which 98 percent of all military members residing off-base live, and a number of County Cost Groups, which combine counties outside MHAs into like-cost groups based on FMR data. For our analysis, we obtained Runzheimer rental cost data (including rent, utilities, and rental insurance) for a random sample of 84 MHAs. These costs are for the standard bundle of housing services purchased by a family of four with a $30,000 annual income, a profile that fairly represents the RMC and family size of the typical E-6. Using these data, we calculated a *price-based* allowance for the 84 areas, assuming an absorption rate similar to that experienced by E-6s under the current allowance system in FY 1991.[16]

Figure 4-5 plots our price-based housing allowance by MHA against the total housing allowance (THA)—the sum of BAQ plus VHA—for the grade E-6. The price-based allowance, which applies our conceptual model of how an allowance should be determined, is generally higher than the THA in high-cost areas (the MHAs to the left in the figure) and lower in some low-cost areas. A reasonable conclusion is that the modest adjustments in the current methodology are not sufficient to convert expenditure data into prices. The result is that the current approach systematically undercompensates service members in areas with high housing costs, while paying too much relative to actual costs in others.

Reliance of the VHA rate methodology on the member survey leads to three additional problems. First, basing allowances on member expenditures, which are in turn affected by the level of allowances, causes undesirable feedback effects. Allowances that, for some reason, are set too low or too high tend to stay that way because members either

E-6 PHA VERSUS PRICE-BASED ALLOWANCE

Figure 4-5



cannot afford to procure housing significantly more costly than their allowance or, because of the VHA offset provisions, members don't want to spend less than the THA.

Second, the circular nature of the current rate-setting methodology hampers its credibility. The system creates the false perception that service members can obtain whatever housing allowance they want by simply filling out a VHA survey form. This increases the difficulty of justifying the housing allowance budget.

Third, due to the distribution of members living off-base, the housing survey does not provide enough information to set allowances for all grades in all duty locations. For example, less than 2 percent of the VHA population establishes the 4,186 different rates required for 91 MHAs. To fill in the resulting gaps, member responses are pooled across areas with disparate housing costs, which decreases the accuracy of measurements for individual locations.[17] The effects of pooling data are most severe for isolated resort areas, which are typically surrounded by rural districts with considerably less expensive housing. Because allowances seriously understate the cost of housing in resort areas, the Coast Guard, whose mission requires that its members reside close to their duty station, has had to increase its provision of in-kind housing through a leasing program.

In summary, the 7th QRMC believes there are significant problems with the methodology currently used to set VHA rates by duty location, all related to its use of a member survey of housing expenditures to determine the price of housing services. As a result, our proposed rate-setting methodology uses an external source for housing price data. However, we do not recommend elimination of the member

survey, but a change in its role and scope. The principal advantage of the survey is that it measures the housing choices of service members, which, because of the vicissitudes of their military service, may vary from the civilian population. A less ambitious survey, collected at periodic intervals from a sample rather than a census of members, could be profitably used to validate the housing choices obtained from an external source.

A Housing Allowance Floor

As noted before, an additional problem with basing housing allowances on a member survey is that, with no information on the physical quality of the housing occupied by members, we cannot be sure that the allowances provide for an adequate level of housing services. In this section, we evaluate two sources of external housing cost data that could be used to establish an allowance sufficient to acquire adequate housing for junior enlisted members, or a housing allowance floor: HUD's Fair Market Rents (FMRs) and Runzheimer housing cost data.[18] Both sources collect data only on units meeting a physical adequacy standard: FMRs incorporate HUD's quality standard; Runzheimer's data collection can be tailored to meet any standard specified by a client.

Our analysis uses the following three measurement criteria to evaluate the FMRs and Runzheimer data:

- The data must measure the cost of adequate housing at income levels that are relevant for junior enlisted personnel.
- It must be possible to target the data collection to the specific areas where service members are stationed.
- The data must be timely enough to track changes in housing prices.

In addition to these criteria, we examine the program costs of establishing an allowance floor using both data sources.

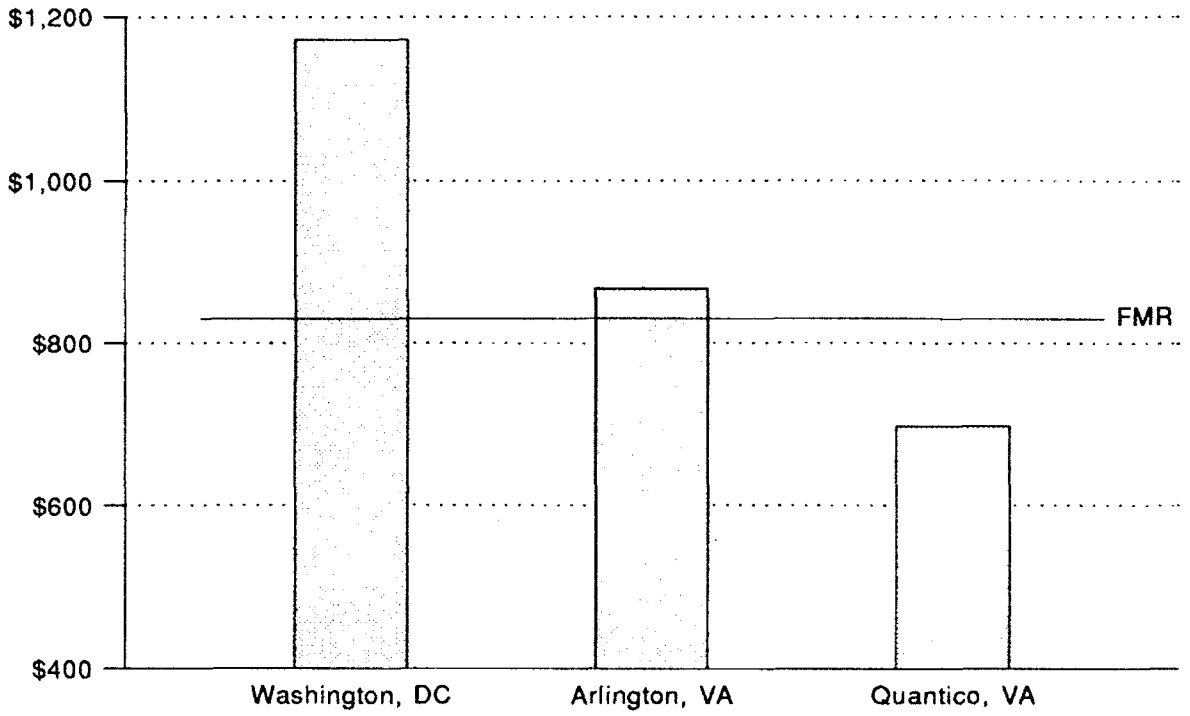
Housing Costs for Relevant Income Levels. Because enlistees are typically required to live in government-provided housing during training, most of the junior enlisted who receive housing allowances are E-4s, who have an RMC of approximately $20,000. As described above, Runzheimer housing cost data are collected for specific profiles, defined in part by income levels. Thus, Runzheimer can provide housing costs specifically for the types of dwellings occupied by individuals or families with $20,000 incomes. In contrast, FMR calculations do not directly control for the income levels of the renters. The FMR for an area is equal to the 45th percentile of rents observed for a particular size of apartment, where size is measured by the number of bedrooms. As would be expected, special calculations conducted by HUD showed that FMRs calculated using only those renters with incomes near $20,000 are lower than the published FMRs. We conclude that the Runzheimer data are more representative of the income levels of the junior enlisted than FMRs.

Costs Targeted to Military Duty Areas. FMRs are defined for relatively large geographical areas, such as Metropolitan Statistical Areas in urban locations and groups of counties in rural areas. This means that FMRs may not accurately capture the housing costs in local housing markets adjacent to military installations.[19] On the other hand, the Runzheimer methodology allows data collection from specific communities.

Figure 4-6 shows how this difference can potentially affect an allowance floor. The horizontal line shows the FY 1991 FMR for two-bedroom apartments in the Washington, DC, area, which extends up to 40 miles from the city. This single FMR value understates the cost of similar apartments in the District of Columbia, as measured by Runzheimer data, while overstating costs in peripheral locations, such as Quantico, VA.

There is a similar problem with FMR data in resort locations that are adjacent to rural areas. Figure 4-7 shows that rental expenses in Hatteras, NC, as measured by Runzheimer, are 60 percent

WASHINGTON, DC, FMR AND LOCAL RENTAL COSTS Figure 4-6



higher than the FMR for the collection of resort and rural counties that includes Hatteras. We conclude that Runzheimer housing cost data can be more closely targeted to the specific areas in which military members are likely to reside.

Timely Housing Cost Data. The Runzheimer housing cost data also perform better on this criterion. Because the infrastructure for capturing housing costs is permanently in place, new cost data can be provided with a lag of only two to four weeks. In contrast, FMRs start with decennial Census data, which are adjusted for metropolitan areas every four years using the results from the American Housing Survey (AHS). In between the quadrennial AHS and in rural areas, the shelter and utilities component of the CPI for each region is used to adjust the FMR values. These adjustment procedures can cause the FMR to lag behind changes in housing costs in particular local markets. In Washington, DC, for example, the two-bedroom FMR for FY 1992 is 13 percent higher than in FY 1991. However, data from both Runzheimer and a local government housing agency show a much softer market, with an average price increase of only 3 to 5 percent.

Cost Estimates for an Allowance Floor. We estimated the increase in housing allowance costs that would have occurred if floors based on FMR and Runzheimer data had been in place. For all 332 MHAs, we determined where the floor would increase the housing allowance and calculated, by grade, the difference between the floor and the THA. With both the FMR and Runzheimer data, we assumed a two-bedroom apartment for personnel with dependents. For those without dependents, we estimated the costs of a floor assuming an efficiency apartment for E-1 through E-4 and a one-bedroom apartment for E-5 and above.

HATTERAS, NC, FMR AND LOCAL RENTAL COSTS

Figure 4-7

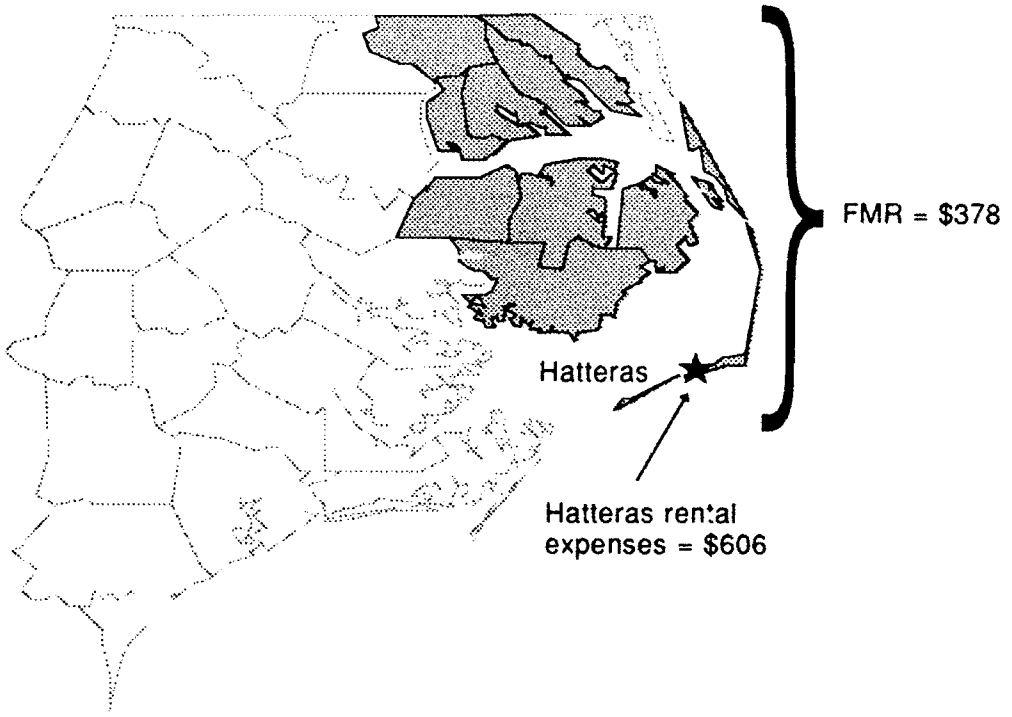


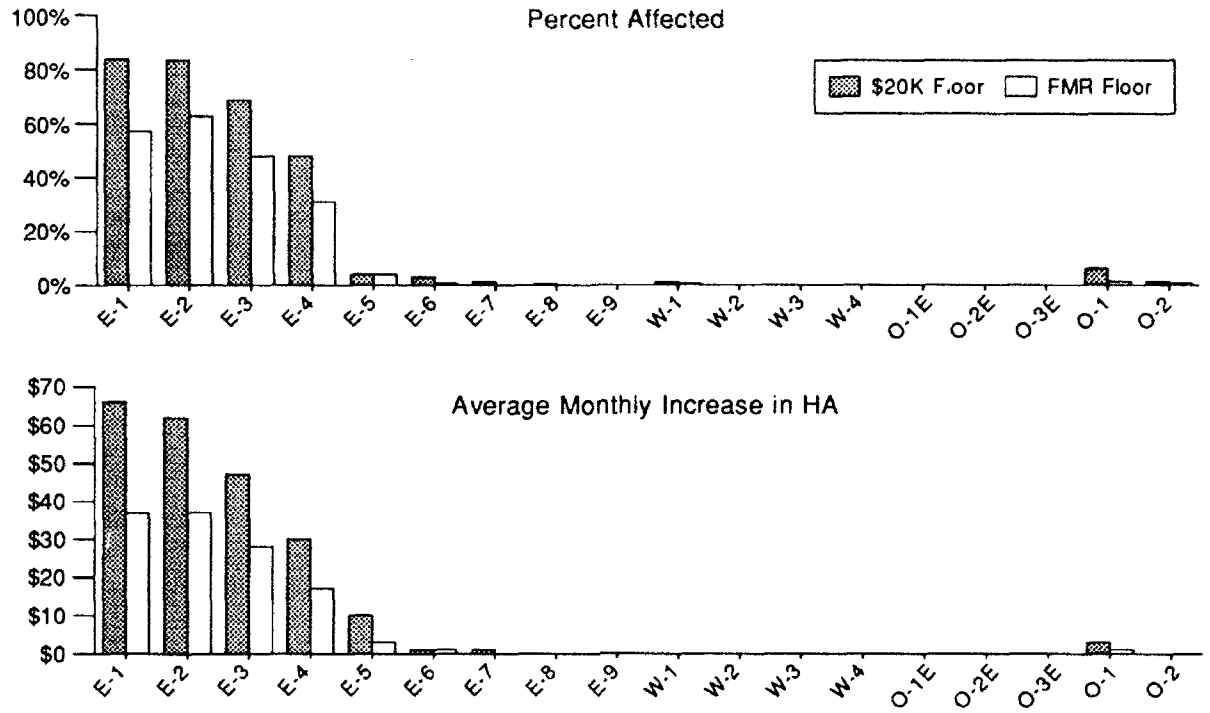
Figure 4-8 displays, by grade, the number of members with dependents affected by the Runzheimer (labeled $20K) and FMR floors and the average increase in the monthly HA. Figure 4-9 shows the same information for those members without dependents. As expected, it is mostly junior enlisted personnel who would be affected by the institution of an allowance floor, although some single enlisted personnel in grades above E-4 and a few O-1s in high-cost areas would also see a higher housing allowance. The average monthly allowance for those affected by the floor would increase by $10 to $60 for members with dependents and by $20 to $100 for those without dependents. Across all grades and dependency statuses, the $20K floor would affect more service members and provide a greater increase in the housing allowance than would a floor based on FMRs. After a detailed review by MHA, we concluded that the differences in the floors can be attributed largely to differences in the specific communities represented by the Runzheimer and HUD data.

Figure 4-10 displays the estimated FY 1992 costs for the $20K and FMR floors. Using either data source, the majority of the total costs would go to increasing the allowance for members with dependents.

Summary. Runzheimer's housing cost data for the $20K income level are a better basis for calculating an allowance floor than HUD's Fair Market Rents because they more accurately reflect, in terms of income, communities, and time, the costs of housing faced by service members. The 7th QRMC recommends that the $20K two-bedroom rental expense data be used to establish a floor for members with dependents. For those without dependents, we recommend basing the

FLOOR IMPACT: MEMBERS WITH DEPENDENTS

Figure 4-8



floor for E-1s to E-4s on rental expenses for efficiencies; and for E-5 and above, on one-bedroom apartment costs. Implementing these recommendations would increase housing allowance costs by $138 million, or about 2 percent.

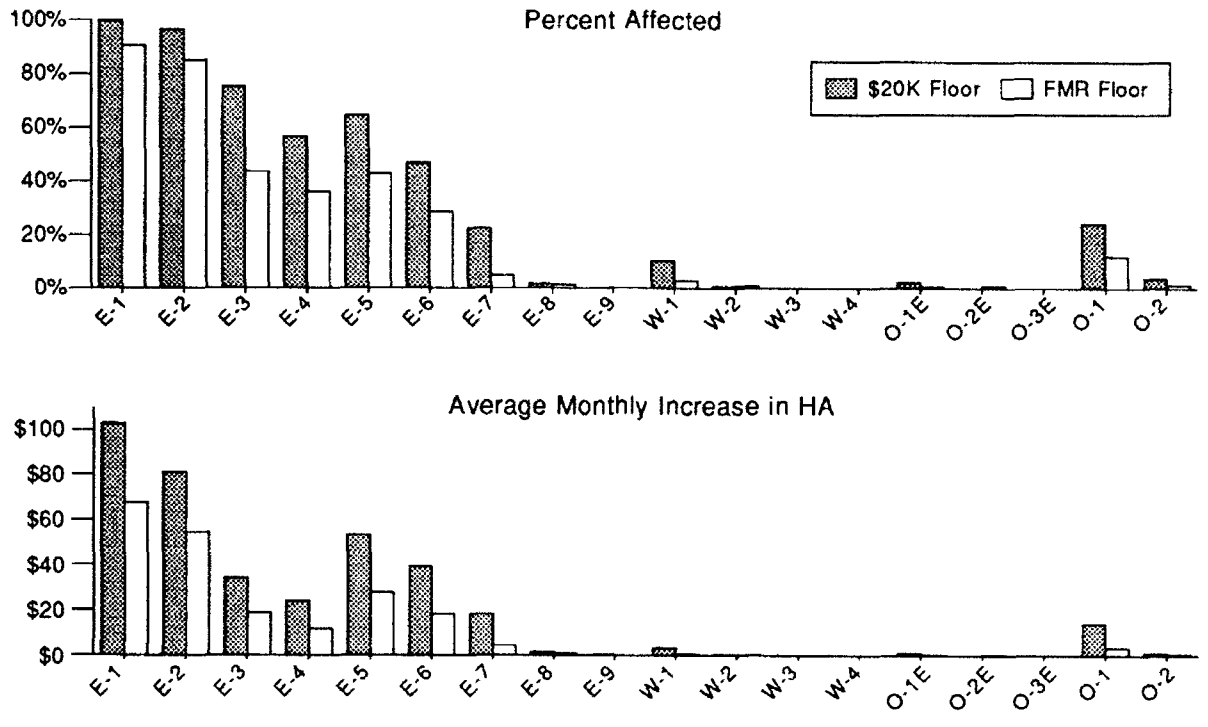
BAQ as a Minimum Housing Allowance

The concept of a housing allowance floor is not new to the military's housing allowance program. Currently, a service member receives at least the BAQ amount, which is equal to 60 percent of the national median housing cost, regardless of the price of housing services in his or her local area. External housing price data suggest that, in some low-cost areas, the typical rental expenses, less the standard amount for absorption, exceed the BAQ. This means that members in these areas are paying less out of pocket for housing than the DoD average.

In contrast to a floor based on local housing costs and incorporating a common amount for absorption, the requirement to pay at least the BAQ sets an inappropriate floor on the housing allowance. It is inequitable because service members in low-cost areas are treated more favorably than members assigned to more expensive locations. It is also an inefficient use of housing allowance dollars. The 7th QRMC estimates that DoD would have saved approximately $33 million in FY 1992 if allowances were based on local housing costs minus absorption in all areas, not just those where this amount is equal to or greater than BAQ. A single housing allowance, based solely on housing costs, would remove the inequity created by this "BAQ minimum."[20] Elimination of the BAQ minimum for all pay grades could be used to offset about one-quarter of the cost to implement an appropriate housing allowance floor.

FLOOR IMPACT: MEMBERS WITHOUT DEPENDENTS

Figure 4-9



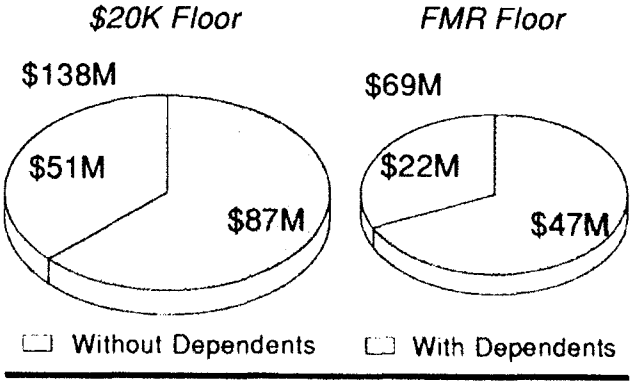
Toward a Price-Based Housing Allowance

Building on our investigation of the problems with the current methodology for setting VHA rates, the 7th QRMC examined the consequences of implementing a price-based housing allowance for all grades. A preliminary evaluation suggests that a PHA could fulfill each of the objectives for an effective housing allowance, as described in the beginning of this section, without necessarily increasing the costs of the housing allowance program. In this section, we describe the PHA allowance and report on the results from the initial evaluation.

For all the reasons previously outlined, the PHA would be based on housing cost data collected from an external source instead of the member survey. The basic procedure for computing allowances would resemble that currently used. Inparticular, the allowance for a given MHA, grade, and dependency status would start with the observed price for the average bundle of

COST OF ALTERNATIVE FLOOR PROPOSALS

Figure 4-10



housing services defined for that MHA, grade, and dependency status combination. From that price, we would subtract a national-average absorption amount, defined as the product of national average housing costs for each grade and dependency status and the absorption rate, to arrive at the allowance amount. To provide a basis for comparison in the analysis below, we assume the same absorption rate as that experienced by members in FY 1992.

We also considered a slight variation of this formula that modifies the housing price data before using them to establish allowance amounts. The modification results from a revised definition of the *purchasing power* we are trying to maintain as members are reassigned to new locations. Instead of being able to buy identical housing services in all locations, we believe it is also appropriate to design an allowance system that permits members to buy the quantity of housing services that yields the *same satisfaction or utility* across duty areas. While also protecting members from variation in housing costs, defining the objective this way is less costly because we utilize the service member's ability to choose different market baskets that yield the same satisfaction. In particular, a smaller increase in income is required to maintain a member's utility as he moves from a low- to high-cost area than is needed to buy the same quantity of housing because the member, in response to higher housing costs, will normally shift his consumption from housing to other less costly goods and services.[21]

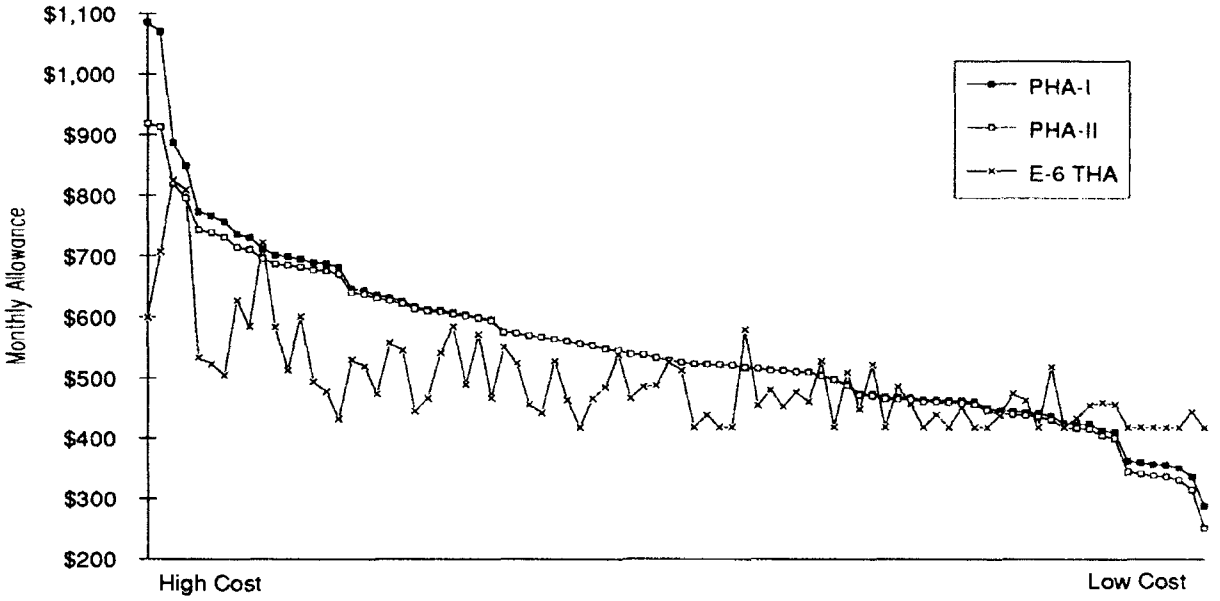
For E-1s through E-4s, we calculated both versions of the PHA for all military housing areas using the Runzheimer housing cost data collected for the analysis of the allowance floor. We did the same computations for E-6s with dependents using $30K income level data from the random sample of 84 MHAs. Figure 4-11 adds the modified PHA (labeled PHA-II) to the graph of the price-based (PHA-I) and current allowances shown earlier in Figure 4-5. Note that the PHA-II is less than the PHA-I in both high- and low-cost areas, although the differences are not great. One can also see the effect of the BAQ minimum, which sets a floor on the THA in low-cost areas.

For comparative purposes, we also estimated the costs of the PHAs for these enlisted personnel, assuming current absorption rates. It appears from the graph of the allowances by MHA that the PHAs, which pay more in high-cost areas, must also be more expensive. In fact, most of these high-cost areas have relatively few personnel assigned to them so that the increase in housing allowance costs for these areas is paid for by the small reductions applied to the many more service members assigned to low-cost areas. Figure 4-12 shows the approximate distribution of E-6s overlaid on the trend line differences between the PHA-I and the current housing allowance.[22]

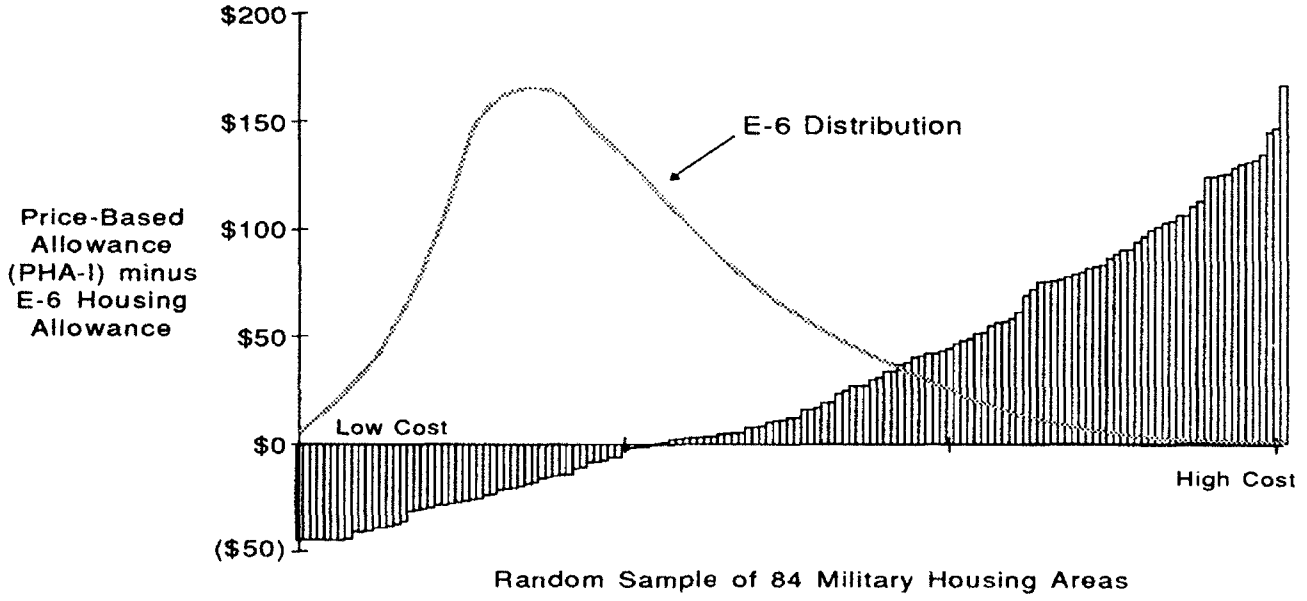
Table 4-1 summarizes the information used in the calculations and compares the resulting estimates with the costs of the current housing allowances.[23] Combining all the personnel considered in the analysis, the PHA-I would cost approximately $37 million more than the current BAQ plus VHA. The modified version of the price-based allowance is essentially cost neutral. In application, the price-based allowance could be constrained to be *exactly* cost neutral. It also appears that the costs of administering the PHAs, including the expense of obtaining external cost data, would be similar to the administrative costs of the current system.[24]

While yielding promising results, our preliminary analysis of the PHA has left some issues unresolved. First, with the available data we could only construct allowances for 60 percent of the population currently receiving a housing allowance. Housing cost data for a sample of MHAs should be collected at higher income levels to complete the evaluation. In addition, alternative methods for blending home ownership and rental expenses, an important issue at higher incomes, must be evaluated. Second, the specific communities used in assessing housing costs within each MHA should be reviewed. Choice of survey communities can have a large effect on the allowance amounts and, therefore, the cost of the program. A periodic member survey would provide guidance in selecting appropriate communities for each MHA.

PRICE-BASED HOUSING ALLOWANCES (PHAs) BY MILITARY HOUSING AREA Figure 4-11



E-6 DISTRIBUTION VERSUS HOUSING ALLOWANCE DIFFERENCES Figure 4-12



HOUSING ALLOWANCE COST ESTIMATES

Table 4-1

External Survey Specification				Pay Grades Represented		Annual HA Program Cost ($M)		
Annual Income	Family Size	Rental Profile	MHAs Surveyed	Pay Grade(s) & Dependency	Percent of Pay Grade Represented	PHA-I	PHA-II	Current THA
$30,000	4	1,300 sq ft apartment, 5 rooms, 3-BR, 2 baths	93	E-6 with dependents	55%	$456.8	$447.4	$455.2
$20,000	3	900 sq ft apartment, 4 rooms, 2-BR, 1 bath	332	E-1 to E-4 with dependents	100%	$858.5	$833.0	$834.5
$20,000	1	600 sq ft efficiency apt, 1 room, 1 bath	332	E-1 to E-4 without dependents	100%	$245.0	$236.5	$233.5
					Total Costs	$1,560.3	$1,516.9	$1,523.2

We believe that, by improving the linkage between allowance amounts and housing costs, a price-based allowance derived from an external survey has the potential to improve the equity and cost-effectiveness of the housing allowance program. Additionally, a full price-based allowance would eliminate the need for a separate housing allowance floor. The 7th QRMC, therefore, recommends that the PHA be studied further, with a goal of future implementation.

VHA Offset

Congress established the VHA offset in 1986 to recover what were perceived as windfall gains by members whose housing allowance exceeded their housing expenditures. The offset collects 50 percent of the difference between allowance and spending, up to a maximum equal to the member's VHA. The 7th QRMC evaluated the impact of the offset provision on member housing expenditures and found unintended consequences that conflict with the original objectives of the policy.

Conceptually, service members pay an offset when the housing allowance is set too high relative to local housing costs or when their desired housing expenditures are less than the allowance. In the first situation, the offset, combined with the use of a member expenditure survey to set allowances, acts to maintain the level of allowances in areas where housing costs are falling. Members are penalized for spending less than the allowance offered, and this level of spending is duly recorded by the member survey and used to set subsequent allowance rates. Anchorage, AK, which has experienced falling housing prices in recent years, provides a dramatic example of this problem. Currently, the total housing allowance for an E-4 in Anchorage is $749 per month, while the local two-bedroom FMR is only $469 and the Runzheimer $20K rental expense is $535. Perpetuating artificially high allowances increases the cost of the housing allowance program, negating the intended savings from the offset policy.

Some members pay the offset because they want to consume less than the average amount of housing services for their grade and dependents category. Those who live with other members (called sharers) are a good example. Faced with losing a portion of their allowance to the offset, the number of sharers has declined by 20 percent since the policy was introduced. The reduction in the number of sharers is an example of how members' behavior in selecting housing has reduced the effectiveness of the offset as a money saver. Another group with below-average housing demand includes members with large families, low military incomes, or both, who economize on housing to provide their families with the other necessities of life. Figure 4-13 shows the distribution of offset collections by grade. It is ironic that a policy designed to prevent windfall gains collects over 50 percent of its recovered funds from junior enlisted personnel, who can least afford the loss.

The offset policy is an example of misguided public finance. Nominally, it recovers less than 1 percent of the total cost of the housing allowance program, but this does not take into account the significant hidden costs of the policy. Allowances are slow to adjust in areas where housing costs are falling, a potentially expensive problem given the state of many housing markets in the early 1990s. Moreover, the offset is costly to administer because members must annually certify their housing expenses, which are, in turn, documented by clerks in units and in installation personnel and finance centers. Finally, the offset forces many members to make suboptimal housing decisions, reducing the benefits they receive from this element of military compensation. The 7th QRMC, therefore, recommends that the VHA offset provision be eliminated.

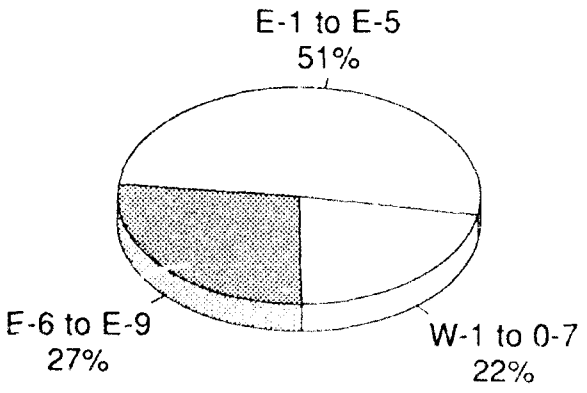
Allowance Provisions for Reserves

Currently, members of the Reserves must be on active duty for 20 or more consecutive weeks to receive both BAQ and VHA. Most duty periods, however, are less than 20 weeks, during which the reservist with dependents receives only BAQ. The erosion of BAQ relative to housing costs—from 85 percent in FY 1972 to 60 percent in FY 1991—means that Reserve members are, therefore, absorbing an increasing fraction of their housing costs. If, however, Reserve members received the full allowance amount (roughly equivalent to BAQ plus VHA under the current system), regardless of the length of their active duty, the value of housing allowance established for Reserve members in 1971 would be restored.

Additionally, the 6th QRMC highlighted a disparity in the housing allowance which results in no BAQ entitlement for Reserve members without dependents who are on short periods of active duty. The 6th QRMC recommended that BAQ be paid to these members; however, that recommendation was not adopted.

The 7th QRMC recommends that these two reserve housing allowance issues be studied further to determine the full impact of the BAQ erosion and disparity between Reserve members with and without dependents.[25]

OFFSET COLLECTIONS BY GRADE Figure 4-13



CONUS COST-OF-LIVING ALLOWANCE

Members of the armed forces move about the country as a requirement of their service. Over a career, a member is likely to be assigned to a variety of low-, medium-, and high-cost areas. Currently, military compensation is adjusted only to reflect differences in local housing costs; there is no pay element to compensate members for variation in nonhousing costs which have increased in the last 10 years—a trend likely to continue.[26]

The 7th QRMC found that CONUS nonhousing costs vary from 5 percent below to 19 percent above the national average. It is possible for a member to move from an average-cost to a high-cost area and suffer a more severe loss in purchasing power than that resulting from a reduction in rank. Furthermore, our analysis shows that members assigned once to the highest-cost areas are unlikely to regain that lost purchasing power over an entire career. Not compensating members for these losses causes inequities in the effective

value of military compensation and adversely affects retention as reported to us by the services.[27]

Other employers with nationwide locations, such as the Federal government and major corporations, adjust their employees' compensation to reflect differences in the local cost of living. The 7th QRMC recommends establishing a CONUS COLA, which would partially defray the added nonhousing costs in high-cost areas. Combined with improvements to housing allowances, the CONUS COLA would make the military compensation package more sensitive to variations in the cost of living across duty areas.

This section is organized into three parts. First, we report on our analysis of nonhousing costs across assignment areas in the continental United States. Then, we examine the consequences currently suffered by not adequately compensating for cost-of-living differences and the response of other employers to the same issue. Finally, we describe the details of our CONUS COLA proposal, including representative payments and the cost of the proposal.

Analysis of Cost-of-Living Variations

As with housing, our objective is to measure what the military member must spend to buy the same market basket of goods and services across different areas. The analysis consists of the following four steps:

- Determine the best sources of data on cost-of-living variations between duty areas.
- Select the appropriate income level and family size for measuring the typical market basket purchased by military members and their families.
- Adjust the costs of items in the market basket to reflect the special circumstances of military members compared with their counterparts in the private sector, such as the provision of a housing allowance.
- Select a sample of CONUS duty areas in which to measure the costs of the market basket.

We describe each of these steps in turn.

Best Data Source. We examined both government and private sector cost-of-living data. The government measures, such as the CPI and the Consumer Expenditure Survey (CES), focus primarily on national trends in living costs. The samples from which these measures are constructed are not large enough to provide information for the many local areas where military personnel are assigned. Area wage surveys were also considered. Although correlated with cost-of-living differences, wages reflect many other factors, including amenities of an area, labor demand from local employers, and the proportion of unionized establishments.[28]

The 7th QRMC reviewed cost-of-living data from six private sources and concluded that the data collected by Runzheimer International were best. As with housing cost information, Runzheimer provides the geographical coverage required for the analysis, their data collection is based on a sound methodology, and they are the choice of many Federal agencies and large corporations who use local cost-of-living data for setting compensation.

Appropriate Income Level and Family Size. For the purposes of describing the variation in nonhousing costs across military duty areas, we selected a representative income level—$30,000, which is approximately the average RMC of the career force—and family size of four members. The market basket to be priced across duty areas was defined from survey data on civilian consumer expenditures and represents the average nationwide purchases for families with the chosen income and family size.

By making selected area-to-area comparisons between this and other income level and family size choices, we found that the percentage change in living costs across areas does not vary signifi-

cantly with the range of income levels and family sizes relevant to the military population. This means that data for our representative income and family size can be used to construct a cost-of-living index that is reasonably accurate for all members.

Special Military Circumstances. Our objective is to measure those costs faced by military members. Adjustments to the measured cost of living are therefore necessary to reflect military housing allowances, the basic allowance for subsistence, the ability to buy certain goods and services at reduced rates on military installations, and the special status of military members with regard to state and local taxes. We removed housing costs and an amount equal to BAS from cost-of-living data.

Costs for goods and services were adjusted by area to account for access to installation facilities—commissaries, exchanges, and medical treatment facilities—and the savings available by using them. For example, commissary data show that military members living near installations save an average of 16 percent on their purchases of food and household items. If a military duty area was within 40 miles of an installation, we reduced the measured costs for food and household items by this percentage. Otherwise, we included the full costs less BAS. Similar procedures were applied for savings from the use of exchanges and military medical facilities.

Finally, we specified a common amount for state and local taxes across all areas because military members pay taxes to their legal state of residence, no matter where they are currently located.

Sample of the CONUS Military Population. We used military housing areas to define duty locations and collected cost-of-living data for 84 randomly selected areas (the same sample used in the housing analysis). Data were also obtained from the highest- and lowest-cost areas to increase the precision of our estimates of the full cost-of-living range.

Results. Figure 4-14 displays the adjusted cost-of-living amounts for the sampled MHAs, ordered from the lowest- to highest-cost areas. The solid horizontal line shows the adjusted cost of living for Runzheimer's *Standard City, USA*, which is a national average of the civilian population representing 160 areas. After excluding housing costs, BAS, and savings from access to military installations, we estimate that a military family at the $30,000 income level would have other annual expenses of $18,475 in this average cost area. Compared to this benchmark, the cost of buying the same market basket is $900, or 5 percent, lower in the least expensive area, Minot, ND, and $3600, or 19 percent, higher in the most expensive area, Westchester, NY. Even with the exclusions, there is significant variation in the income required to maintain purchasing power across duty areas.

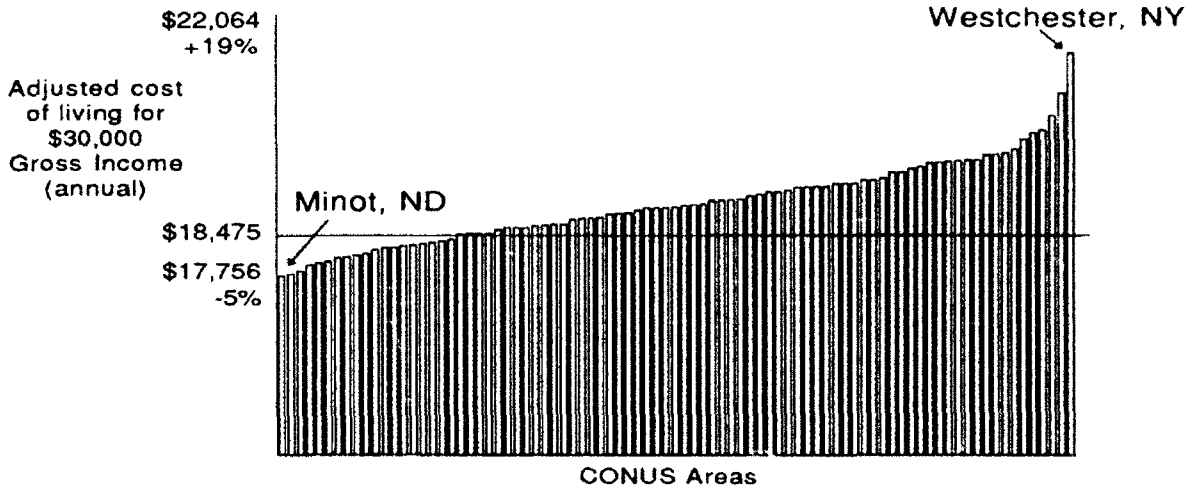
Moreover, the existing evidence shows that differences in the cost of living by area have been increasing, suggesting that this problem will not go away. Studies by the Bureau of Labor Statistics and Runzheimer International report a widening gap between high- and low-cost locations during the 1980s.[29]

Figure 4-15 displays the distribution of service members who are located in areas with cost-of-living estimates lower and higher than Standard City. Most members are assigned to areas with a cost of living within 5 percentage points of the national average. However, 16 percent live in areas, primarily coastal and urban locations, where the costs are more than 5 percent higher than average.

The implication of this asymmetrical distribution is that once a member is assigned to one of these very high-cost areas, he or she has little chance of offsetting the loss in buying power through subsequent moves to low-cost areas. Assuming random moves between duty areas, an individual assigned to a location with a cost of living 8 percent higher than the average has only a 4.1 percent chance of not being disadvantaged over a 20-year career. The situation is worse for Navy and Coast Guard personnel who spend a disproportionate time in high-cost

COST-OF-LIVING VARIATION BY CONUS AREAS

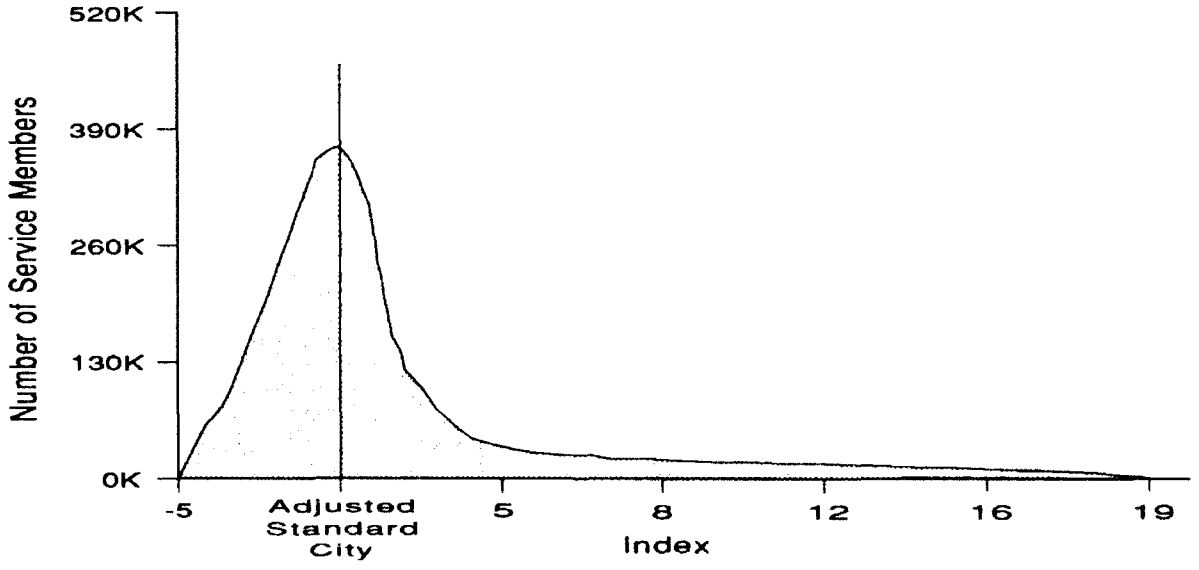
Figure 4-14



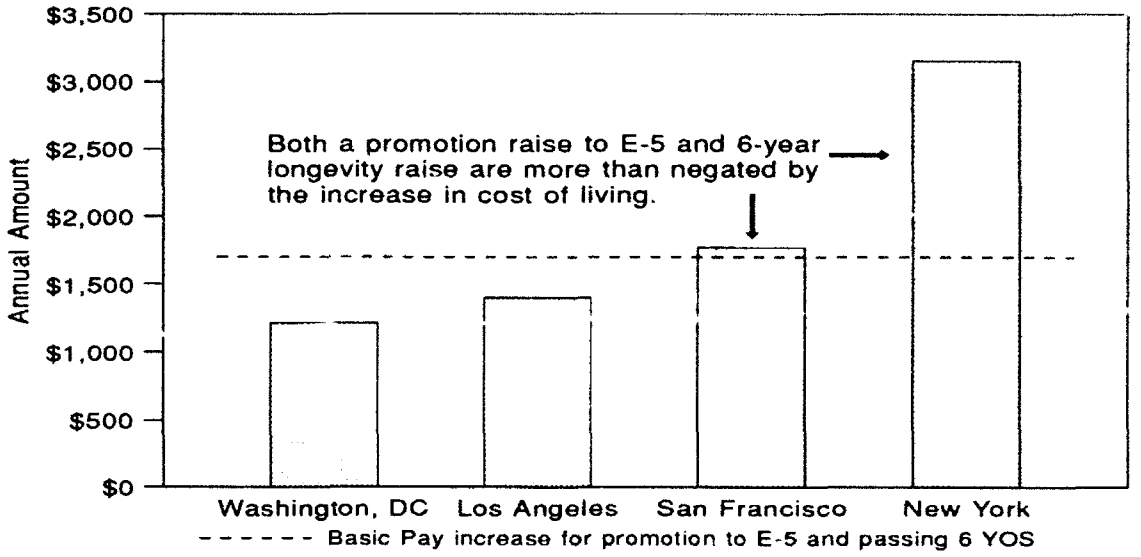
Note: Runzheimer cost-of-living data for July 1991; rank-ordered random sample of locations plus the lowest- and highest-cost areas; chart is not to scale.

DISTRIBUTION OF SERVICE MEMBERS BY DUTY AREA COST OF LIVING

Figure 4-15



COST-OF-LIVING INCREASE FOR AN E-5 TRANSFERRED FROM NORFOLK, VA . Figure 4-16



areas. Approximately two-thirds of the members in these services are located in areas with an adjusted cost of living higher than that of Standard City.

Consequences of Cost-of-Living Variation

Today a member assigned to a high-cost area may rightfully conclude that his or her compensation is unfair because the standard of living it supports is markedly inferior to that of another service member with identical status and responsibility assigned to a low-cost location. For example, Figure 4-16 shows the adjusted cost-of-living differences for an E-5 transferred from Norfolk, VA, which has an average cost of living, to four high-cost areas. For comparison, the dotted line shows the increase in basic pay resulting from the E-4 to E-5 promotion plus the longevity step at six years of service. Assignment to any of these areas essentially eliminates the pay increase earned through promotion and longevity.

Retention is also adversely affected by the standard-of-living reduction that occurs with a move to a high-cost area. Figure 4-17 summarizes the results of our analysis of E-3 through E-5 reenlistment rates from 1980 to 1990. We found that the average reenlistment rate was 2.5 percent lower in areas with costs of living 8 percent or more above Standard City. This reduction in reenlistment rates for high-cost areas translates into 265 fewer reenlistments in these pay grades. While this number appears small, it understates the total effect of cost-of-living differences in two ways: it does not include the entire career force, nor does it account for those who separate rather than accept an assignment to a high-cost area.

The services reported difficulty in filling positions in high-cost areas. The Navy, Marine Corps, and Coast Guard also confirmed that a significant number of personnel choose to separate rather than accept assignments to costly locations.

Precedents for Locality Pay

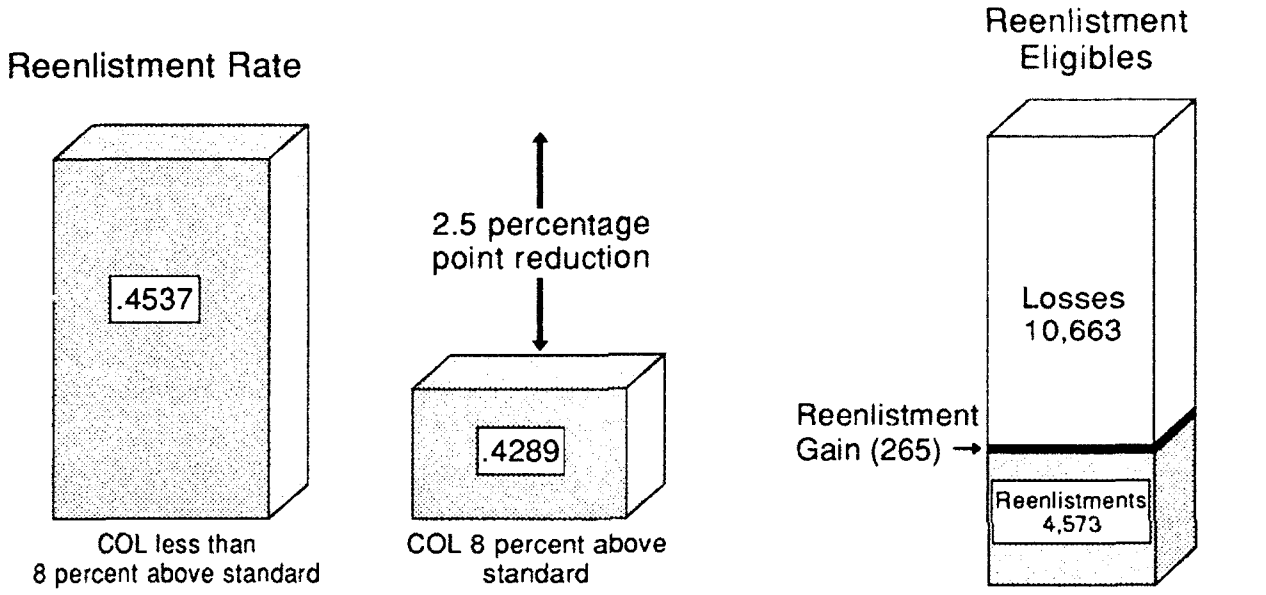
Providing a cost-of-living supplement to people employed in high-cost areas is a frequent practice.

RETENTION CONSEQUENCES

Figure 4-17

- Reduced Retention
  - Theory suggests retention loss in high-cost areas
  - Evidence consistent with theory

- 265+ separations
- Does not account for those who separate in lieu of assignment



Since 1942, service members have been compensated for the cost-of-living differences associated with overseas assignments through the overseas station allowance. Civilian agencies of the government provide cost-of-living supplements for employees located in foreign countries and selected high-cost areas of the United States. The application of locality-based compensation for Federal employees was recently expanded in the Federal Employees Pay Comparability Act of 1990 (FEPCA). Beginning in 1994, FEPCA will supplement the salaries of white-collar Federal civilian employees when an area's non-Federal average salary is more than 5 percent higher than the General Schedule salary.

Cost-of-living supplements are also prevalent in private industry. Many large corporations, such as Boeing and AT&T, routinely adjust compensation to maintain purchasing power for employees transferring to new locations. A recent survey indicates that the percentage of U.S. companies providing cost-of-living allowances increased from 37 percent in 1987 to 51 percent in 1989.[30]

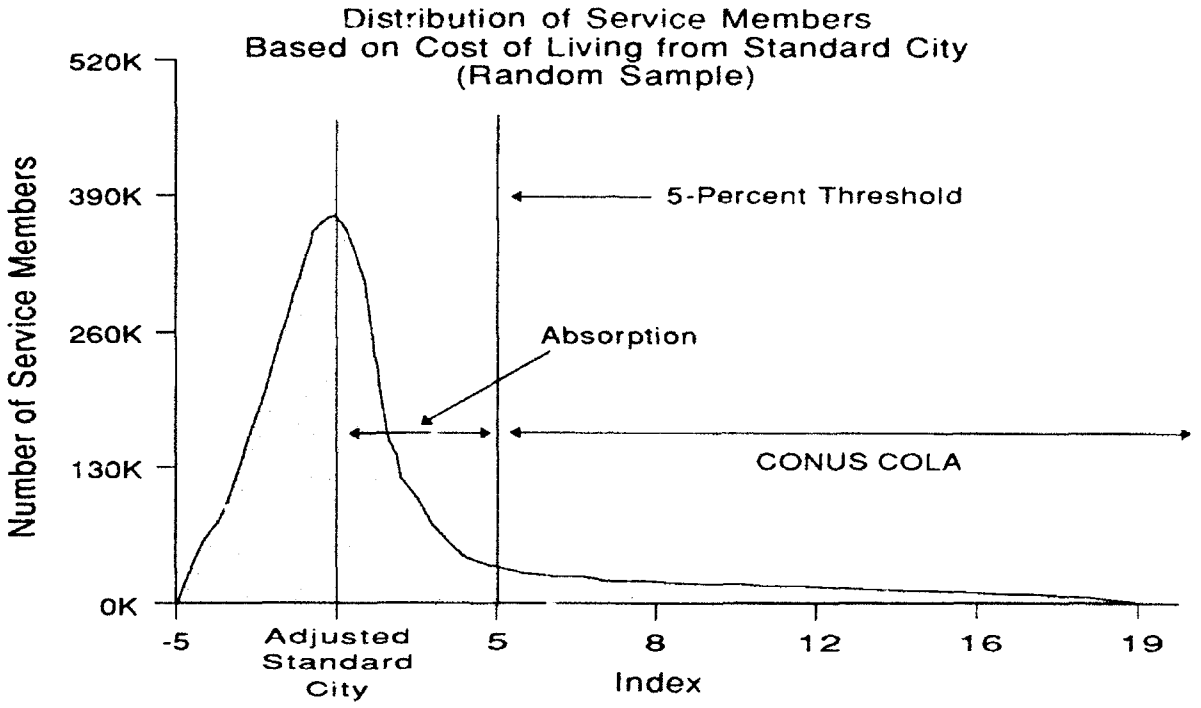
The 7th QRMC also reviewed the military compensation systems of five foreign countries: Australia, Canada, France, Germany, and the United Kingdom. Each has adopted a form of locality pay adjustment based on geographic variation in living costs.

CONUS COLA Proposal

The 7th QRMC recommends establishing a cost-of-living allowance for locations in the continental United States to defray the increased nonhousing costs of service members assigned to high-cost

FIVE-PERCENT THRESHOLD

Figure 4-18



locations. Our specific proposal, which is described in this section, protects members from extreme reductions in their standard of living, at a modest cost to the government.

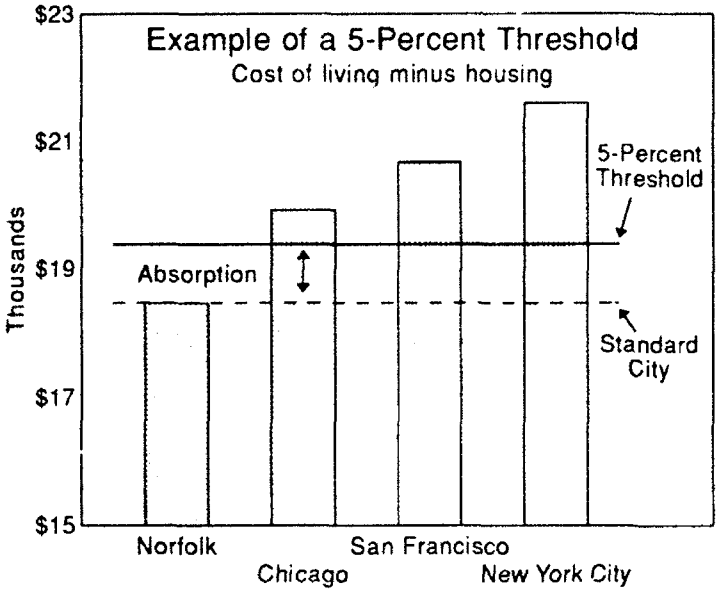
Threshold. To reduce program costs, cost-of-living supplements are often implemented with a threshold, paying a supplement only when the cost of living in an area exceeds the average cost of living by a certain percentage. The 7th QRMC believes that a 5-percent threshold is reasonable for the CONUS COLA. With this threshold, the 16 percent of members who are currently assigned to the highest-cost locations—the extreme right-hand tail in Figure 4-18—would absorb cost-of-living expenses no more than 5 percent above the average. Unlike the current situation, the typical service member could expect that, over a career, losses from assignments to high-cost areas would be balanced by gains from duty in low-cost locations. Some individuals, of course, will still not break even because of more frequent assignments to areas with higher-than-average costs; but their losses will be reduced.

Allowance Amounts. We propose calculating CONUS COLA values in the following four-step process:

- Using the adjusted cost-of-living numbers described above, calculate the percentage differential between the cost of living in each MHA versus Standard City.
- Subtract 5 percentage points from these differentials for the threshold. If the result is less than or equal to zero, no CONUS COLA is paid to members in that area.

CONUS COLA CALCULATIONS

Figure 4-19



5-Percent Threshold at Chicago

	Basic Pay	Standard City Differential	CONUS COLA Differential	CONUS COLA (Year)	Absorption (Year)
E-6	$18,749	8%	3%	$ 686	$937
O-3	$32,234	8%	3%	$1,179	$1,612

By pay grade calculation

- *Step 1*: Compute index: divide Chicago costs ($20,017) by Standard City costs ($18,475) = 1.08
- *Step 2*: CONUS COLA = index (1.08) - threshold (5 percent) = 3 percent times basic pay X 1.22 (tax adjustment)

- Members required to absorb loss in purchasing power equal to 5 percent of their basic pay regardless of location.

- For the remaining areas, multiply the net-of-threshold differential by basic pay to determine the amount of after-tax income required by grade to keep the member at a cost of living no more than 5 percent above Standard City.

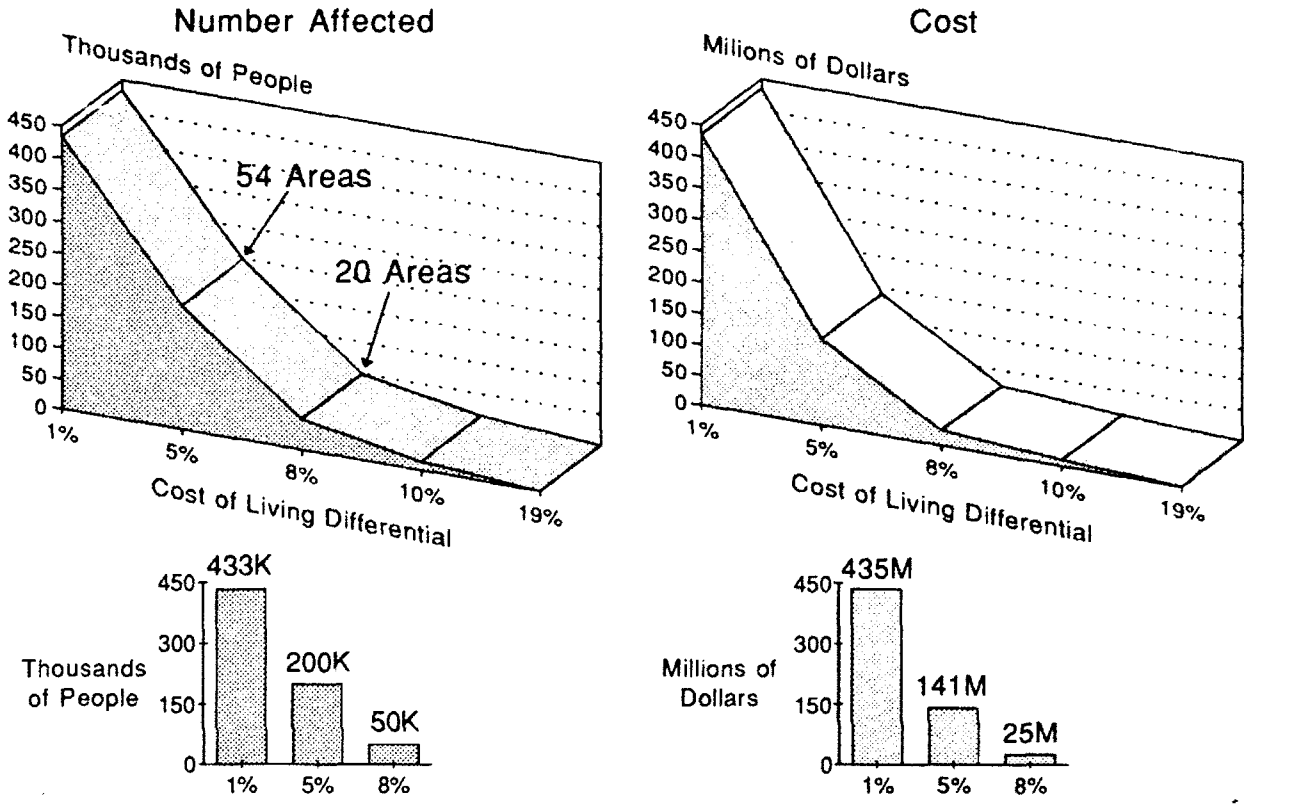
- Finally, multiply by a tax adjustment factor of 1.22 to determine the allowance amount. This adjustment is required to offset the Federal taxes that will be collected on the CONUS COLA.[31]

Figure 4-19 illustrates these calculations for an E-6 and O-3 assigned to the Chicago area. Based on the adjusted cost-of-living estimates, the Chicago MHA is 8 percent more expensive than Standard City. The allowance is equal to basic pay for each grade times the net differential (3 percent) and the tax adjustment factor, yielding a $686 annual allowance for the enlisted member and a $1,179 annual allowance for the officer. Both individuals would still face a 5-percent increase in their cost of living over the Standard City average.

Other Issues. The proposed CONUS COLA would be a single set of rates by grade for each area, regardless of dependency status or whether the member lives on- or off-base. This approach keeps the allowance relatively simple and parallels the Office of Personnel Management's method for computing cost-of-living allowances for Federal civilians employed in Alaska, Hawaii, and U.S. territories.

We also believe members of the Reserves should be entitled to CONUS COLA when on active duty, regardless of the duty period duration.

PROGRAM IMPACT AND DOD COST WITH ALTERNATIVE THRESHOLDS Figure 4-20



This is consistent with our recommendation with regard to Reserve eligibility for the full housing allowance.

CONUS COLA Costs. To estimate the costs of our proposal, we calculated CONUS COLA amounts for all high-cost military housing areas using the adjusted cost-of-living data from our analysis of cost variations and using basic pay values for FY 1991. These allowances were multiplied by the number of DoD and Department of Transportation (DoT—i.e., Coast Guard) personnel assigned to each of the MHAs in FY 1991. A CONUS COLA with a 5-percent threshold would pay an allowance to 212,000 service members assigned to 54 high-cost areas, distributed by service as follows: 33,500 in the Army, 50,400 in the Air Force, 88,500 in the Navy, 26,800 in the Marine Corps, and 12,600 in the Coast Guard. It would cost $157 million per year in total allowance payments—$141 million for DoD and $16 million for DoT.[32] We also estimated the number of recipients and program costs for alternative threshold values; Figure 4-20 summarizes these results.

The administrative cost to implement a CONUS COLA program would be low. It costs approximately $10,000 to obtain the cost-of-living data required for the high-cost MHAs; annual surveys should be commissioned. One or two employees would have to be added to the OSD staff to administer the details of the program.

OTHER ALLOWANCES

There are 31 other allowances provided to recognize the special conditions or requirements of

military service. These essentially pay or reimburse members for expenses incurred as a result of military duties. The 7th QRMC briefly reviewed these other allowances and generally found that they serve a useful purpose. However, procedural corrections generally appear warranted.[33]

In particular, many of the allowances are paid at a fixed rate, prescribed in law, with no mechanism for periodic review or adjustment. Consequently, they are typically allowed to fall well below actual costs before the law can be changed to adjust them.

Two additional areas of concern were identified. First, consideration should be given to eliminating partial BAQ. This allowance was established in 1976 and was paid to members without dependents in unaccompanied personnel housing (UPH) essentially as a rebate of a portion of basic pay that was reallocated to BAQ. Because it has not been adjusted since 1977, even during a similar reallocation of basic pay in 1989, its value has significantly eroded over the years. The vast majority of today's partial BAQ recipients were not on active duty during the 1977 reallocation. Hence, this payment has little or no meaning and perpetuates an unnecessary complexity in the compensation system.

Finally, because recommended improvements to the housing allowances would combine BAQ and VHA into a single allowance, a new *oasis* will therefore be needed to compute system elements now referenced to BAQ—the Dislocation Allowance (DLA) and Family Separation Allowance, Type-I (FSA-I).

DLA is a payment made in conjunction with a permanent change of station (PCS) and equals two months' BAQ. The 7th QRMC recommends establishing DLA at 120 percent of the national median housing cost for each grade—approximately the same as the current payment.

FSA-I supports maintenance of a second home for the member when serving at a dependent-restricted location overseas where quarters are unavailable. It currently equals BAQ plus the overseas housing allowance, both at the without dependents rate. The 7th QRMC recommends that FSA-I be equal to the total rent a member pays, up to the rental ceiling—plus the average utility and occupancy allowances—for members of the same grade without dependents.

SUMMARY OF RECOMMENDATIONS

Basic Allowance for Subsistence

The government intended BAS to compensate members of the uniformed services for the cost of their food when subsistence in kind is not available. Our review of the current BAS system identified three serious problems: (1) because changes in BAS are linked to pay raises, the allowance is no longer related to food costs; (2) different rates for enlisted BAS, officer BAS, and the charge for meals in government facilities produce inequities; and (3) the provisions for administering BAS have become unnecessarily complex.

The 7th QRMC recommends:

- ***Establishing a single BAS rate for all members, officer and enlisted; basing the rate on and indexing it to food costs calculated under the USDA Moderate Food Plan; and adjusting basic pay in all cases to preserve the present value of cash compensation.***

- ***Standardizing dining facility and BAS administrative policies by applying the current officer procedures to all members.***

- ***Eliminating the surcharge for all members except those in a temporary duty (TDY) status.***

Housing Allowances

The 7th QRMC agrees with the Joint Services Housing Allowance Study finding that housing allowances have become divorced from housing costs and endorses the principal recommendations for change, as described below. Focusing primarily

on the methodology used to set housing allowance rates by geographical areas, we found that reliance on a member survey of housing expenditures causes a number of serious problems. We propose immediate measures to ensure that a member's housing allowance is sufficient to procure adequate housing. As a more comprehensive solution, we developed an improved rate-setting methodology for future implementation.

The 7th QRMC recommends:

- ***Establishing a single housing allowance based on local housing costs as determined by an external survey of housing price data.***
- ***Implementing the following protective measures until a new rate-setting methodology is adopted:***
  - ***Creating a housing allowance floor to assure that junior enlisted members can afford adequate housing and basing the floor on an external survey of housing costs at the $20,000 annual income level.***
  - ***Using external housing price data to establish rates in resort areas and other duty locations where the current allowances are clearly inadequate.***
- ***Eliminating the 50-percent housing allowance offset.***
- ***Studying housing allowance entitlements for Reserve members on active duty for periods of less than 20 weeks.***

CONUS Cost-of-Living Allowance

The military compensation system offers no allowance to cover differences in nonhousing costs between duty areas. Service members can face nonhousing costs as high as 19 percent above the national average, with resulting negative effects on retention and the equity of military compensation. This problem is most severe for the Navy and the Coast Guard, whose members spend a disproportionate amount of their careers stationed in high-cost areas.

The 7th QRMC recommends establishing a CONUS cost-of-living allowance payable to members in locations where the cost of living not defrayed by other allowances, in-kind provisions, or military support facilities is more than 5 percent above the national average.

Other Allowances

The 7th QRMC briefly reviewed the remaining allowances and generally found that they serve a useful purpose. However, we did find several areas requiring attention.

The 7th QRMC recommends:

- ***Reviewing and periodically adjusting fixed-rate allowances.***
- ***Phasing out partial BAQ.***
- ***Establishing a new rate basis for BAQ drag-alongs when a single housing allowance is adopted.***

NOTES

1. President's Commission on Military Compensation (Zwick Commission), *Report of the President's Commission on Military Compensation* (Washington, 1978), 101-102.
2. This is not a new issue. The 3rd QRMC conducted the last major review of BAS in 1976 and recommended that BAS be linked more closely to food costs.

3. For further details, see the 7th QRMC Staff Analyses, GSP—A, *Foreign Military Compensation Systems Review*.

4. Because the USDA Moderate Food Plan cost exceeds the Basic Daily Food Allowance (BDFA), which is used to estimate the per-person food costs for military dining facilities, setting the DSMR equal to USDA food costs would have the added benefit of generating additional revenue for these facilities.

5. This exception would effect the necessary transfer of funds from the permanent to the temporary duty station. Currently, support for transient personnel is not included in an installation's operating budget.

6. This estimate includes the changes in BAS, basic pay, the retirement accrual, and government FICA payments associated with basic pay, mess collections and forfeitures, and federal income tax collections. See the 7th QRMC Staff Analyses, MTS—3, *Allowances*, Chapter 3 and its appendixes, for more details.

7. No such phase-in procedure is required for officers because they all receive BAS.

8. The adjusted basic pay changes were calculated at each year of service to keep the discounted present value of current and deferred compensation under the single-rate BAS system essentially equal to the value of current and deferred compensation under the existing basic pay and allowances. In these calculations, we assume an expected career length of 20 years for enlisted members and 26 years for officers.

9. This figure excludes the cost of government housing.

10. The term *adequacy* refers to the physical characteristics of the dwelling.

11. Another definition is that an individual's satisfaction, or utility, associated with consuming goods and services remains the same. This does not require purchasing the same market basket in all areas, as tradeoffs between the quantities of particular goods and services can be made to keep utility constant. We return to this issue in our discussion of the PHA.

12. The concept of price-based housing allowances has been recommended to the DoD previously. See Frank Camm, *Housing Demand and Department of Defense Policy on Housing Allowances*, R-3865-FMP (Santa Monica, CA; The RAND Corporation, September 1990).

13. Therefore, expenditure is more than price if one rents above the standard bundle of house, and lower than price if one rents below the standard bundle of house.

14. The mean adjusted expenditure for each area is the weighted sum of the mean expenditures within 16 categories defined by the interaction of the number of bedrooms (grouped as 1, 2, 3, and 4+) and the four housing types. The weights used in the summation are the *national* proportions of members in each category. Using the same weights across areas adjusts the expenditure data for differences in these two characteristics

15. *The Runzheimer Administrative Guide* and the 7th QRMC Staff Analyses MTS 3—*Allowances*, Chapter 4, describe the data collection procedures in more detail.

16. The Runzheimer rental profile is a 1,300 square foot apartment with five rooms (three bedrooms) and two baths. The price-based allowance for area i, PHA_i, is

$$PHA_i = P_i - .192P_m$$

where P_i is the price for the standard bundle (rental profile) of housing services in area i, .192 is the FY 1991 absorption rate for E-6s with dependents, and P_m is the national average price for the standard bundle.

17. If the member survey were expanded, more housing characteristics could be used in adjusting observed expenditures, making the adjusted expenditure data closer to price data. However, that would not solve the three problems just described.

18. The 7th QRMC reviewed all known sources of housing cost data, both public and private. Other sources could not provide the local detail required to set a floor for all MHAs.

19. This is due to data limitations, not methodological problems. HUD groups nonmetropolitan counties to ensure reliable samples are used for FMR calculations. Thus, DoD could not effectively use the raw HUD data to establish locality floors for more specific areas.

20. The JSHAS recommended converting to a single, cost-based housing allowance. However, the JSHAS went on to recommend that 60 percent of the NMHC, an amount approximately equal to BAQ, be used as a national floor. This perpetuates the BAQ minimum and its associated inequities.

21. In economics terminology, we set the housing allowance to keep the member's *consumer surplus* the same as he moves between duty areas. Consumer surplus is estimated from the prices of housing services by area and an assumed price-elasticity of demand for housing. For further details, see *Issues in the Design of Housing Allowances*, an appendix to the 7th QRMC Staff Analyses, MTS 3—*Allowances*.

22. Trend line differences were calculated using a weighted technical edit least-squares regression.

23. The results in Table 4-1 are based on housing costs for units matching the specified rental profiles. The application of rental equivalent profiles for homeowners may lead to higher program costs at the $30,000 income level.

24. Based on the cost of obtaining Runzheimer data for our analysis, we estimate that data collection would cost $500,000 in the first year, followed by $250,000 per year as MHA costs are updated on a three-year schedule. (The latter cost includes $100,000 for a triennial survey of member expenditures to validate the average housing profiles.) By comparison, the current member survey costs $300,000 per year, not including the substantial opportunity costs of the member time used to complete the survey.

25. If, prior to this recommended Reserve housing allowance study, BAQ and VHA are combined and tied to housing costs, Reservists with dependents should receive an amount equal to 60 percent of the national median housing cost for their grade.

26. A Runzheimer sample of 17 U.S. cities showed that, from 1980 to 1990, the cost-of-living range between the lowest and highest total cost-of-living widened over the period from 33 percent to 53 percent. Bureau of Labor Statistics (BLS) comparisons of food costs in five cities show differences between low- and high-cost areas of 7 percent in 1973 and 21 percent in 1988. See Mary F. Koloski, *New Research on Inter Area Consumer Price Differences* (Washington: BLS, July 1991).

27. In response to a January 1990 memorandum from the Assistant Secretary of Defense (Force Management and Personnel), the Army, Navy, and Coast Guard all expressed a need for a CONUS cost-of-living pay adjustment. Additionally, several services provided anecdotal evidence that confirms the financial hardships resulting from assignments to CONUS high-cost locations.

28. Because wages in areas with more amenities tend to be lower than wages in areas offering fewer amenities, some economists believe that wage differentials should be used rather than cost-of-living differentials. For example, relatively low wages in San Diego, CA, a high-cost-of-living area, reflect San Diego's favorable climate and good access to outdoor recreation. This hypothesis was recently reviewed by Margaret Barton, Systems Research and Applications (SRA) Corporation. Dr. Barton and others concluded that amenities cannot be accurately evaluated; therefore, it would be difficult to adjust the observed cost differential for amenities.

29. See note 26.

30. "Employee Relocation, Cost-of-Living and Housing Trends for the 1990's," *Relocation Journal* (Winter 1989): 8.

31. 26 U.S.C. § 134 requires any new allowance to be taxable unless excluded from taxation by a revenue act. The tax adjustment factor assumes a marginal tax rate of 18 percent.

32. These are the budget costs for the departments involved. The net cost to the government is lower because of the additional taxes that would be collected on the allowances. Cost for members of the Reserve components is estimated at $14 million.

33. For further details of our review of the other allowances, see the 7th QRMC Staff Analyses, MTS 3—*Allowances*, Chapter 6.

Chapter 5
Special and Incentive Pays

SPECIAL AND INCENTIVE PAYS

INTRODUCTION

Role of Special and Incentive Pays

Along with basic pay and allowances, special and incentive (S&I) pays are one of the three basic building blocks of a flexible, efficient military compensation system. The 7th QRMC concludes that these three pay components can support future force structure requirements by attracting and retaining qualified personnel. Although the proportion of total cash compensation allocated to the S&I component is relatively small (4.8 percent), 43.1 percent of uniformed members receive one or more of these pays.

The term *special and incentive pays* actually refers to a series of 55 separate pays identified in chapter 5 of title 37 of the United States Code. These pays include aviation career incentive pay (flight pay), career sea pay, the selective reenlistment bonus, and pay for those subject to hostile fire or imminent danger. S&I pays keep military pay flexible and competitive. They enable the services to attract and retain members with critical skills and to recognize members who perform hazardous duties. Among recipients of S&I pays, 72 percent of officers and 82 percent of enlisted members qualify for one of the six most common. (See Table 5-1.)

Applied selectively to members who qualify, these pays continue to be a powerful tool for management of experience and technical expertise in the uniformed services. The ability to target onerous or arduous duties or critical occupational specialties is an economical means to compete with the civilian labor market. This selective use of S&I pays produces pay differentials by specialty or duty assignment—one of the core dimensions that underlie the evolution and simplification of the military compensation system (see Chapter 2). The report of the 5th QRMC in 1983, as well as subsequent cost-benefit studies and service experience, document the successes and efficiencies of S&I pays in producing desired force levels.[1]

TOP SIX S&I PAYS BY NUMBER OF RECIPIENTS Table 5-1

Category	Largest	2nd	3rd	4th	5th	6th
OFFICERS (164,641)*	Aviation Career Incentive Pay (72,008)	Medical Officer Variable Special Pay (13,910)	Medical Officer Additional Special Pay (10,285)	Career Sea Pay (9,356)	Aviator Continuation Pay (7,361)	Medical Officer Certification Pay (6,406)
ENLISTED MEMBERS (777,268)*	Selective Reenlistment Bonus (260,518)	Career Sea Pay (146,240)	Certain Places Pay (103,876)	Special Duty Assignment Pay (56,574)	Enlistment Bonus (36,746)	Submarine Duty Pay (36,013)

Source: 1990 outlay data from the DoD Services' *Justification of Estimate for Fiscal Year 1992-1993 Budget*; does not include Reserve component personnel.

*Total members in this category who receive one or more S&I pays.

Review of Special and Incentive Pays

Scope of the Review. Given the demonstrated success of S&I pays, this review does not focus on the need for such pays nor does it evaluate the effects of any specific S&I pay amount. Instead, the President directed the 7th QRMC to evaluate the periodic adjustment mechanisms and procedures used for special pays and bonus programs.[2] The 7th QRMC's objectives were to review the existing system of S&I pays and to determine the most effective method for periodic adjustment of pay rates. We pursued these objectives by validating the purpose of each pay and classifying the pays into groups based on their purpose and management characteristics. We then proposed management procedures and adjustment mechanisms to make the pays more responsive to civilian labor market conditions.

Statement of the Problem. The term *special and incentive pays* implies an integrated, centrally managed, and coordinated system of special pays and bonuses. In fact, these pays are not classified into any coherent categories based on relevant purpose or management criteria. Rather, they are managed on an ad hoc basis, with little evidence of coordinated service and OSD management. Some pays, because their amounts have not changed or because they have not been paid to members for several years, may receive no management oversight.

Further, we documented the lengthy, complex procedures now required to adjust any one of these pays, and noted that this adjustment process may hinder corrections when shortfalls of critical skills are projected. Not only is the adjustment process agonizing, but it varies from pay to pay. With the exception of the selective reenlistment bonus program, no standard review and adjustment methodology exists.

These current problems—ad hoc pay management and lengthy, variable pay adjustment procedures—preclude the flexibility necessary to maximize the effectiveness and efficiency of S&I pays. DoD should be able to introduce new pays or modify existing pays quickly. All relevant parties (OSD, OMB, Congress, and the services) must be assured that the new or revised pays will be cost-effective in meeting accession and retention objectives. In addition, those pays provided for arduous or hazardous duty must remain equitable; that is, members must believe that compensation for such working conditions is fair when compared to the compensation of those not subject to such conditions. If hazardous duty pays remain unchanged for years, members may conclude this compensation, which has eroded in value, does not recognize their special circumstances. To illustrate the problems noted above with management of these pays, the special pay for members assigned to international military headquarters was erroneously codified and has never been paid. The special pay for nuclear-trained and qualified enlisted members has been subsumed by the selective reenlistment bonus and has not been paid for many years. These pays should be eliminated. Certain places pay is a good example of problems inherent in the adjustment process. It has not been adjusted since 1949, and the rates remain at $8.00–$22.50 per month. If it is still a useful pay, it should be restructured to restore its viability.

Chapter Organization. To describe our evaluation of special and incentive pays and their adjustment procedures, this chapter is organized into four sections. The first section presents a brief description of S&I pays and current management and adjustment procedures. Based on this knowledge, the 7th QRMC developed an S&I pay classification system that we consider to be the first step toward improved management of these pays. The next section describes the proposed adjustment procedures for those pays classified as career incentive pays and skill incentive pays. Three key features of our proposal are the creation of a single officer skill incentive bonus, the use of consistent cost-benefit methodology, and periodic review of these incentive pays by a DoD Incentive Pay Review Committee.

The third category of S&I pays proposed by the 7th QRMC—hazardous duty pays—is discussed

next. The 7th QRMC concluded that payment of such compensation is a moral decision, one we support, and that setting such compensation levels cannot be tied to cost-benefit methodology. To be meaningful, such compensation should maintain its relative value over time, but adjustments for that purpose should come through periodic review as opposed to indexing this pay to future military pay increases. The final section of Chapter 5 summarizes the 7th QRMC's recommendations, linking them to the principles of military compensation enunciated in the Appendix.

CLASSIFICATION OF SPECIAL AND INCENTIVE PAYS

Current S&I Pay Elements

Table 5-2 shows the special and incentive pays as listed in the table of sections for chapter 5 of title 37, United States Code. These pays are addressed in 38 different sections of the law, some of which treat more than one pay. All but 4 of the 38 sections listed in the table are labeled *special pays*. The broad use of this label does not communicate either the incentive or recognition purpose of the pays so denoted. Of the 4 exceptions, 3 are labeled *incentive pays*, and the fourth is called a *bonus*.

Associated with this multiplicity of sections in title 37 comes a complexity of implementing policies and procedures for these pays. Some S&I pay rates are fixed at specific dollar amounts (e.g., parachute duty); others are capped (e.g., foreign language proficiency pay), allowing the services flexibility in establishing actual rates paid. Some elements are paid monthly (e.g., flight pay); others are paid annually as a bonus (e.g., bonus for registered nurses). Finally, specific conditions for payment or limits for certain occupational specialties constrain some S&I pays while the service secretaries make this determination for others.

Making changes to these pays (increased amounts, new eligibility criteria) or instituting a new pay can be a lengthy process. Because such compensation changes are part of the Planning, Programming, and Budgeting System (PPBS), the cycle, from identification of a requirement to modify an S&I pay to the signing of a bill to authorize the pay change, may take up to 36 months. (See Figure 5-1 for a portrayal of the steps and time involved.)

Because the structure of these pays is so diverse and because the intended accession, retention, and recognition problems they are meant to solve are so varied, these pays have been managed one at a time on an as-needed basis. This management approach, combined with the lengthy adjustment process, has worked only because those personnel problems and associated S&I pays that are most important receive more management attention or heroic staff efforts to expedite the adjustment process. However, the 7th QRMC concluded that such a reactive form of management (and neglect for some pays) reduces DoD's flexibility in meeting civilian labor market competition, fails to ensure that needed pays are effective, and keeps obsolete pays on the books.

7th QRMC Classification of S&I Pays

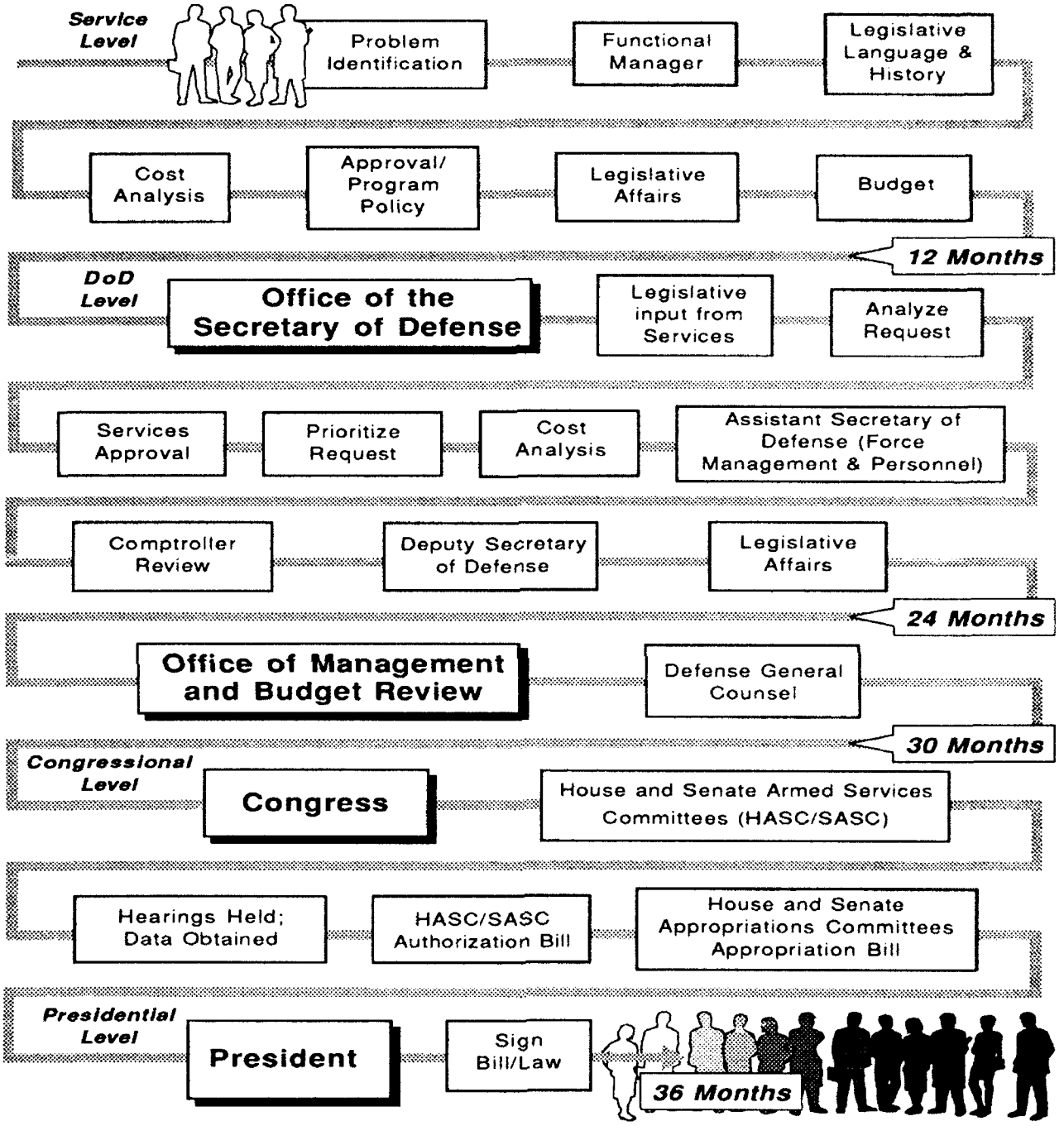
The 7th QRMC recognized that the first step toward improved management and adjustment of S&I pays is to improve efficiency within the existing system. Management efficiency of S&I pays will improve if (a) the elements to be managed can be reduced from 55 to a small number of pay groups defined by function, purpose, type, and recipients; and (b) the pay groups can be reviewed and evaluated periodically by one senior management group using a consistent set of methods to ensure their cost-effective application. If these two events occur, decision makers will be aware sooner that certain S&I pays must be adjusted to retain (or increase) their value, and the procedures to calculate and justify those adjustments need not be debated with each occurrence. The first step thus becomes the development of an S&I pay classification system to aid management decisions.

To classify S&I pays into useful groups, we sorted the pays into categories based upon the

SPECIAL AND INCENTIVE PAYS IDENTIFIED IN TITLE 37, UNITED STATES CODE Table 5-2

Section	Label	Purpose or Beneficiary
301.	Incentive pay	hazardous duty
301a.	Incentive pay	aviation career
301b.	Special pay	aviation career officers extending period of active duty
301c.	Incentive pay	submarine duty
301d.	Retention bonus	medical officers of the armed forces
302.	Special pay	medical officers of the armed forces
302a.	Special pay	optometrists
302b.	Special pay	dental officers of the armed forces
302c.	Special pay	psychologists and nonphysician health care providers
302d.	Special pay	accession bonus for registered nurses
302e.	Special pay	nurse anesthetists
303.	Special pay	veterinarians
303a.	Special pay	health professionals; general provisions
304.	Special pay	diving duty
305.	Special pay	while on duty at certain places
305a.	Special pay	career sea pay
306.	Special pay	officers holding positions of unusual responsibility and critical nature
306a.	Special pay	members assigned to international military headquarters
307.	Special pay	special duty assignment pay for enlisted members
308.	Special pay	reenlistment bonus
308a.	Special pay	enlistment bonus
308b.	Special pay	reenlistment bonus for members of the Selected Reserve
308c.	Special pay	bonus for enlistment in the Selected Reserve
308d.	Special pay	enlisted members of the Selected Reserve assigned to certain high priority units
308e.	Special pay	bonus for Reserve affiliation agreement
308f.	Special pay	bonus for enlistment in the Army
308g.	Special pay	bonus for enlistment in elements of the Ready Reserve other than the Selected Reserve
308h.	Special pay	bonus for reenlistment, or voluntary extension of enlistment in elements of the Ready Reserve other than the Selected Reserve
308i	Special pay	prior-service enlistment bonus
310.	Special pay	duty subject to hostile fire or imminent danger
312.	Special pay	nuclear-qualified officers extending period of active duty
312a.	Special pay	nuclear-trained and qualified enlistment members
312b.	Special pay	nuclear career accession bonus
312c.	Special pay	nuclear career annual incentive bonus
314.	Special pay	qualified enlisted members extending duty at designated locations overseas
315.	Special pay	engineering and scientific career continuation pay
316.	Special pay	foreign language proficiency pay
317.	Special pay	officers in critical acquisition positions extending period of active duty

THE CURRENT ADJUSTMENT PROCESS FOR S&I PAYS Figure 5-1



(The current adjustment process for special and incentive pays can delay implementation by three years after a shortfall is projected.)

purpose, method, or frequency of the pay. After multiple iterations, the 55 pays were classified into two groups that reflect their fundamental purpose (hazardous duty versus incentive), with incentive pays further divided into two subgroups based upon the method or frequency of payment. The three categories are:

- *Hazardous Duty Pays*—monthly cash payments to recognize members who perform hazardous duties.
- *Career Incentive Pays*—paid monthly on a long-term basis to attract and retain members in specific career fields; typically, no service obligation attached; characterized as stable and predictable.
- *Skill Incentive Pays*—lump-sum or annual cash bonuses paid to attract and retain qualified members who perform in critical skill specialties; typically, recipients incur a service obligation; characterized as short-term and more flexible.

The results of this classification exercise, along with the authorized amounts for each S&I pay, are presented in Tables 5-3 and 5-4.[3]

The 7th QRMC recognizes that these proposed categories are not clear-cut in all cases. For example, many pays whose primary purpose is to provide an incentive also recognize hazardous duty (e.g., aviation career incentive pay). Nonetheless, this schema, if implemented, would bundle multiple, like pays for periodic and consistent compensation reviews; would delete unneeded pays; would highlight the overlap of existing and proposed special pays; and would improve understanding of the S&I pay component.

ADJUSTMENT OF INCENTIVE PAYS

Current Adjustment Procedures

The current process for adjusting special and incentive pays is not well-defined. The 36-month bureaucratic process required to staff an adjustment recommendation (Figure 5-1) does not capture how and when the process should be initiated. Pay reviews do not occur at scheduled intervals. As a result, the average time between adjustments has ranged from 6 to 10 years, and the percentage of adjustment has ranged between 10 and 180 percent. Such large adjustments indicate that some pays were neglected for long periods and lost significant incentive or recognition value during that time.

7th QRMC CLASSIFICATION OF HAZARDOUS DUTY PAYS Table 5-3

Category	Name	Current Amount
Hazardous Duty	Flight Pay (Not as a Crew Member)	$110/Mo
	Parachute Duty, and	$110/Mo
	Parachute Duty (High Altitude-Low Opening, HALO)	$165/Mo
	Demolition Duty	$110/Mo
	Pressure Chamber Duty	$110/Mo
	Acceleration or Deceleration Experimental Subject	$110/Mo
	Thermal Stress Test Subject	$110/Mo
	Flight Deck Duty	$110/Mo
	Toxic Pesticide, Virus, or Bacteria Exposure	$110/Mo
	Handling Toxic Fuels, Propellants, or Chemicals	$110/Mo
	Duty Subject to Hostile Fire or Imminent Danger	$150/Mo

Category	Name	Current Amount
Career Incentive	Flight Pay (Crew Member)	$110-$250/Mo
	Aviation Career Incentive Pay	$125-$650/Mo
	Flight Pay (Air Weapons Controller)	$125-$350/Mo
	Diving Duty	$300 or $200/Mo
	Career Sea Pay, and	$50-$520/Mo
	Sea Pay Premium	$100/Mo
	Special Duty Assignment for Enlisted Members	$275/Mo
	Enlisted Members Extending Overseas	$80/Mo
*	Enlisted Members Assigned to High-Priority Units	$10/Period
	Submarine Duty	$75-$595/Mo
	Foreign Language Proficiency	$100/Mo
	Medical Officers Board Certification Pay	$208.33-$500/Mo
	Medical Officers Variable Special Pay	$83.33-$1000/Mo
	Dental Officers Board Certification Pay	$166.67-$333.33/Mo
	Dental Officers Variable Special Pay	$83.33 $500/Mo
	Optometrists Regular Special Pay	$100/Mo
	Psychologists	$2K-$5K/Yr
	Nonphysician Health Care Providers	$2K-$5K/Yr
	Veterinarians	$100/Mo
*	Reserve Medical Officers Special Pay	$450/Mo
***	While on Duty at Certain Places	$8-$22.50/Mo
	Officers Holding Positions of Unusual Responsibility	$50-$150/Mo
**	Assigned to an International Military Headquarters	Sep Scale
Skill Incentive	Selective Reenlistment Bonus	$45K
*	Reenlistment Bonus—Ready Reserve	$1500
*	Reenlistment Bonus—Selected Reserve	$2500
**	Nuclear Qualified Enlisted Members	$15K/Yr
	Nurse Anesthetists	$6K/Yr
	Optometrists Retention Special Pay	$6K/Yr
	Aviation Career Officers Extending Active Duty	$12K/Yr
	Engineering and Science Career Continuation	$3K
	Acquisition Corps Continuation Bonus	15%BP/Yr
	Medical Officers Multiyear Retention Bonus	$14K/Yr
	Medical Officers Incentive Special Pay	$36K/Yr
	Nuclear Qualified Officers Extending Active Duty	$12K/Yr
	Nuclear Career Annual Incentive Bonus	$10K/Yr
	Dental Officers Additional Special Pay	$6K-$10K/Yr
	Medical Officers Additional Special Pay	$15K/Yr
	Enlistment Bonus	$12K/Yr
	Army Enlistment Bonus	$4K/Yr
*	Bonus for Reserve Affiliation	$50/Mo
*	Enlistment Bonus—Ready Reserve	$1K
*	Enlistment Bonus—Selected Reserve	$2K
*	Prior Service Enlistment Bonus	$1250-$2500
	Accession Bonus for Registered Nurses	$5K/Yr
	Nuclear Career Accession Bonus	$8K

*Reserve Duty S&I Pays **Recommend Repealing ***Recommend Review

Career and Skill Incentive Pays. Long-term career incentive pays are designed to close the gap between military pay for specialists, such as pilots and physicians, and the low end of comparable civilian pay scales. The permanent nature of the pay and the predictability it provides recipients do not require the services and Congress to make immediate adjustments in the face of accession or retention problems. Skill incentive pays, on the other hand, must be responsive to cyclic conditions in civilian labor markets. Because these cycles affect retention of military personnel, short-term bonuses of to-be-determined amounts must be offered in addition to permanent compensation. Accession and retention will suffer, or unnecessary payments will be made, to the degree that problems are not identified early, bonus amounts and obligation lengths have not been justified, and the services do not have the flexibility to manage their bonus budgets.

For example, recruitment and retention of nurse specialists became a problem for all the services, and especially the Navy, in the late-1980s. Shortages were particularly chronic for Certified Registered Nurse Anesthetists (CRNAs), with the services achieving only 80 percent of authorized end-strength in 1987 and 1988. Legislative proposals to pay these nurses a skill incentive bonus were introduced in 1987, 1988, and 1989 (twice), but only with the passage of the FY 1990 National Defense Authorization Act was a CRNA bonus authorized.

Selective Reenlistment Bonus Program. Within the current S&I pay system, the services do have a flexible mechanism for adjusting enlisted skill incentive pays—the Selective Reenlistment Bonus (SRB) program. The 7th QRMC strongly supports the SRB program as a prototype for the adjustment of officer skill incentive pays. Congress retains control of the SRB budget and establishes the maximum incentive that a member can receive, but the services have the flexibility to direct bonuses toward occupational specialties in response to changes in supply and demand. To be eligible for an SRB, a skill area must meet the eligibility criteria defined in DoD instruction 1304.22 (e.g., serious undermanning for three or more adjacent years, high replacement costs, etc.). The eligible skill area is then divided into three zones based on length of continuous active duty, with bonus levels determined by the degree of difficulty in reducing the shortage in that zone.

The amount of a given SRB is determined by a standard formula where a recipient's monthly basic pay is multiplied by the number of years of the reenlistment obligation (three–six) with the product multiplied by a *multiple* between one and six. The multiple is determined by the service, which in effect gives each service control over the SRB rate. Service personnel specialists attempt to meet retention objectives in the skill area at the least cost, subject to an SRB budget for all skill areas. The multiples are reviewed and revised at least twice a year to achieve more efficient allocation of the fixed SRB budget.

Proposed Officer Retention Bonus Program. In contrast to a single SRB program where the services can tailor bonuses to multiple skill areas, officers have numerous single-skill incentive pays identified in law (see Table 5-2). Not only is a great deal of time required to adjust any one officer skill incentive pay, the total officer skill incentive pay budget may not reflect the most efficient allocation of these funds. Under the current set of laws, the services cannot shift money to skills where the incentives are most needed once the budget is established.

Based on the SRB experience, the 7th QRMC proposes the creation of a single bonus program that would encompass existing officer skill incentive pays as well as future requirements for officer retention bonuses.[4] In contrast to the current single-skill pays, this program would permit the services to determine eligible skills, set parameters for rates and service obligations in DoD instructions, and allow the services to change bonus rates. Like the SRB program, Congress would maintain overall control by providing the total budget amounts and setting individual incentive pay caps. Like the SRB program, this single officer retention bonus would

give the services flexibility, efficiency, and effectiveness in meeting officer management goals.

Cost-Benefit Methodology

The services must make one, and possibly two decisions when dealing with retention issues or required changes to force structure. The first is whether to (a) adjust retention rates directly through changes in incentive pays, or (b) alter the flow of people through the accession pipeline and train them for the appropriate skill and level of experience, or (c) pursue both alternatives. The issue involves the amount to pay and identification of the recipients to meet the required size and mix of the personnel inventory. In both cases, the services are seeking the most cost-effective alternative. The 7th QRMC recommends that the services uniformly employ a cost-benefit methodology to assist in making these decisions within a consistent and coherent framework.

As the name implies, the basic tenet of cost-benefit analysis is to weigh the projected cost of an action against the estimated benefit to be gained. Although this sounds simple in theory, its application to the domain of incentive pays requires a very sophisticated analytical and modeling effort. The 7th QRMC believes this effort is worthwhile for three reasons:

- To keep existing incentive pays effective at the least cost, more frequent and timely adjustments will be required than in the past. A standard adjustment approach in other areas of military compensation—linking pay changes to the civilian Employment Cost Index—would not respond to the shifting supply-demand conditions that these pays were designed to control.

- OMB and Congress require justification for pay adjustments, and the rigor of the method would establish that justification.

- Finally, cost-benefit analysis would establish a systematic, consistent approach for adjustment of all incentive pays.

The proposed methodology is not intended to replace any model currently in place, including service models that support managers making budget allocation decisions for the SRB program. Rather, the proposed methodology would furnish macro-level guidance on incentive pay adjustments.

Incentive Pay Review

The 7th QRMC believes that a periodic review of incentive pays is necessary to provide a structured overview of the adjustment process. An established review process would reduce the six ten-year periods between adjustments and would support the development of a cost-benefit methodology within DoD. Such a review would be performed by a DoD Incentive Pay Review Committee. A proactive, influential committee would bring consistency and responsiveness to the incentive pay analysis process. A notional description of how this yearly review process would function is displayed in Figure 5-2.

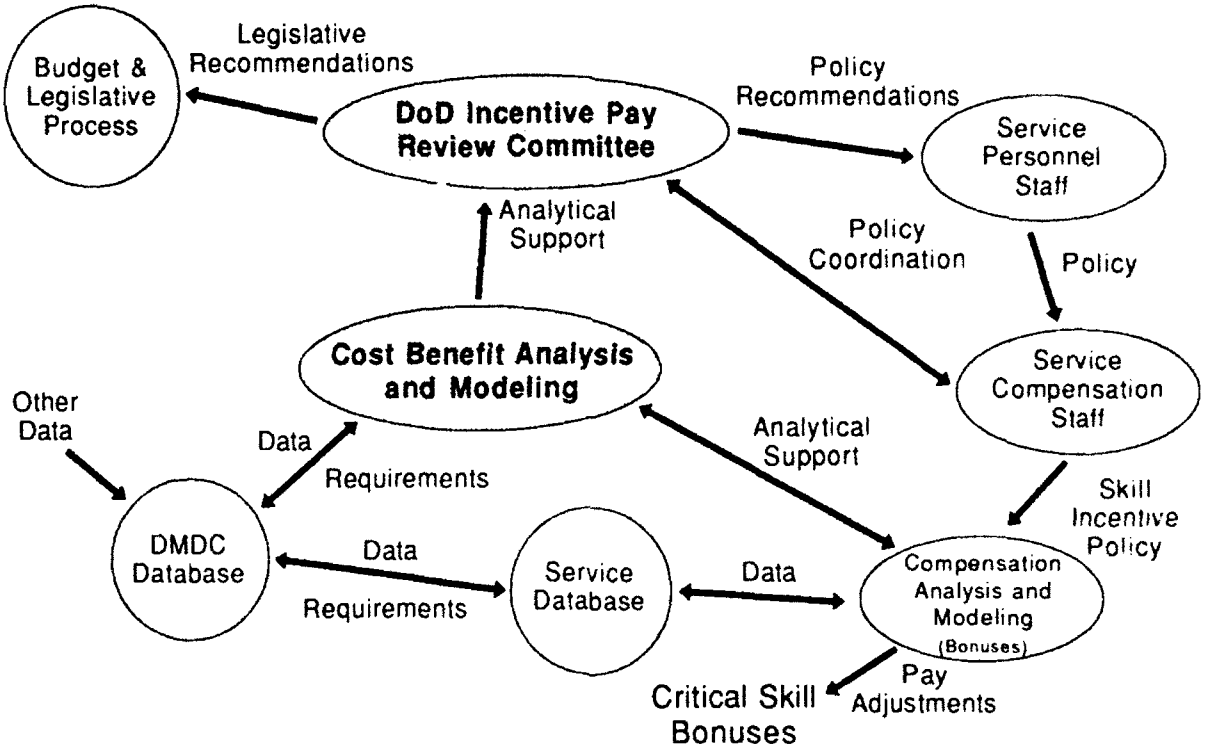
The focal point of the process would be the Review Committee. This group would direct and coordinate incentive pay analyses performed by the services, review results, and formulate service-coordinated proposals for input to the budget process. In addition, the Review Committee would act as the DoD proponent for the application of cost-benefit modeling to incentive pays throughout DoD. The Defense Manpower Data Center (DMDC) would provide timely updates of the incentive pay databases extracted from existing DMDC and service files. These data would serve as the indicators, or early warning signals, that retention or accession problems might be on the horizon. In addition, these and other data would be used in cost-benefit studies if the Review Committee decided such studies were necessary.

ADJUSTMENT OF HAZARDOUS DUTY PAYS

Confirmation of Purpose

Hazardous duty pays, such as flight deck duty pay and demolition duty pay, recognize military

NOTIONAL INCENTIVE PAY REVIEW PROCESS Figure 5-2



personnel who perform hazardous functions. Most of these pays are quite small, the modal figure being $110 per month (see Table 5-3). Congress has supported the payment of this type of compensation over the last century based on the principle that certain duties within the military are clearly hazardous and warrant additional pay. However, because these pays were routinely established without provision for their periodic adjustment, their value—and hence, their underlying recognition—have eroded in relation to other elements of compensation. At their present amounts, these pays represent a token recognition for duty performed and have no measurable impact on accession, retention, or job choice within the services.

The 7th QRMC recognizes that the basis for this form of compensation is a moral judgment and not an intent to effect changes in behavior in response to increased pay. After a review of the complete history of hazardous duty pays since 1886, and with an awareness of Congressional action that raised hostile fire and imminent danger pay during Operation Desert Storm from $110 to $150, the 7th QRMC affirmed the validity of such pays.

Continuing to recognize members financially for performing hazardous duties is congruent with the military compensation principle of equity—fair rewards for risks unshared with other members not subject to the same peril. A similar application of equity is evident in private sector compensation systems. Employees subject to extra risk of death or injury usually receive a wage premium compared to like-skilled employees in comparable jobs that do not pose such hazards.

These premiums are paid, in part, to attract workers to hazardous jobs, but they continue to be paid as labor market conditions decline. Civilian employers view this wage differential as reasonable, or fair, given the employee's circumstances.[5]

Method and Amount of Adjustment

Given the decision to pay members for hazardous service, then the questions to be answered are how much to pay and how should these pays be adjusted. Although hostile fire pay was set at $150 per month by Congress in 1992, hazardous duty pays remain at $110 per month, a figure established by Congress in 1986. The 7th QRMC concluded that hazardous duty pays should retain their relative value over the years and, using 1986 as the base year, explored methods to restore the value of the pay and institute periodic adjustments thereafter.

The 7th QRMC confirmed that the military pay index (MPI),[6] as opposed to the Consumer Price Index (CPI), is the rational method to adjust hazardous duty pays. Had these pays been tied to this index since 1986, the hazardous duty pay rate would be $150 today—the same figure now authorized for hostile fire or imminent danger pay. Therefore, the 7th QRMC recommends that all hazardous duty pays be raised to $150 per month. However, subsequent analysis revealed that, once the pay value has been restored, using the MPI in the future would be a relatively costly approach, given current DoD budget constraints. Hence, the 7th QRMC recommends that DoD review the hazardous duty pay rate on a four-year basis. The review will permit DoD the flexibility to set new pay rates, by whatever algorithm, to prevent unintended future erosion.

SUMMARY AND RECOMMENDATIONS

Although the 55 special and incentive pays account for less than 5 percent of the total compensation paid to members, these pays are critical for staffing and maintaining the force structure needed by DoD. Unlike basic pay and allowances, these pays allow the services to tailor compensation to retain members with particular skills or to attract recruits with desired qualifications. S&I pays remain the services' primary means of pay differentiation for competing in labor markets.

That these pays work is undisputed, but like the other forms of military compensation, they can work better. The goal of the 7th QRMC was to determine how to make these pays more effective and better embody relevant principles of military compensation, within the constraints of the military institution. The 7th QRMC evaluated these pays against three compensation principles—flexibility, equity, and efficiency—and discovered that current management procedures and pay adjustment mechanisms could be improved.

The 7th QRMC recommends:

- ***Amending title 37 of the United States Code to organize the 55 special and incentive pays into three explicit categories for more efficient management:***
  - ***Career Incentive Pay—monthly cash payments paid on a long-term basis to attract members to certain career fields, duty positions, or locations.***
  - ***Skill Incentive Pays—lump-sum or annual cash bonuses paid to attract and retain qualified members to perform in a critical skill area for a specific term of service.***
  - ***Hazardous Duty Pays—monthly cash payments paid to recognize members who perform hazardous duties.***
- ***Using the Selective Reenlistment Bonus (SRB) Program as a model to develop an officer continuation bonus for nonmedical specialties.***
- ***Developing cost-benefit models to assist management decisions on the adjustment of incentive pays.***

- ***Establishing an Incentive Pay Review Committee to perform an annual review of incentive pays, promote cost-benefit modeling, and ensure consistency and timeliness of compensation adjustments.***
- ***Restoring the value of hazardous duty pay by setting the monthly payment at $150 and reviewing the hazardous duty pay rate every four years.***
- ***Repealing provisions for special pay for members assigned to international military headquarters and for nuclear-trained and qualified enlisted members, and restructuring certain places pay.***

The 7th QRMC has also developed a road map for further simplification where the 55 current S&I pays are reduced to eight. These would consist of an enlisted and officer skill incentive pay for accession; and enlisted and officer skill incentive pay for retention; three career incentive pays based on purpose and duty location; and one hazardous duty pay. As with our first-step recommendations, the streamlined menu of eight S&I pays will give the services more flexibility to target pays and the ability to set rates quickly and efficiently.

NOTES

1. U.S. Department of Defense, Office of the Secretary of Defense, *Fifth Quadrennial Review of Military Compensation, Volume III, Special and Incentive Pays* (Washington, November 1983).
2. President, Memorandum for the Secretary of Defense, Subject: The Seventh Quadrennial Review of Military Compensation (QRMC), November 6, 1990.
3. For details of a legislative proposal that embodies the classification system depicted in Table 5-4, see Appendix G to the 7th QRMC Staff Analyses, MTS 4—*Special and Incentive Pays*.
4. The three incentive pays authorized for physicians are excluded from this program because of the relatively high bonus rates required to attract these specialists as compared to other officer skills.
5. See, for example, Stuart Dorsey and Norman Walzer, "Workers' Compensation: Job Hazards and Wages," *Industrial and Labor Relations Review* 36 (July 1983): 642-654; and J. Garen, "Compensating Wage Differentials and the Endogensity of Job Riskiness," *Review of Economic Statistics*, 70,1 (February 1988): 9-16.
6. The Military Pay Index (MPI) is the annual rate of change in military pay pursuant to 37 U.S.C. § 1009.

Chapter 6
Annual Pay Adjustment

ANNUAL PAY ADJUSTMENT

INTRODUCTION

To keep military pay attractive relative to civilian incomes, periodic adjustment (typically in the form of annual pay raises) is necessary. This clearly was the intent of Congress as noted in the report language accompanying the military pay statute of 1967:

> [I]nsure that uniformed services personnel will, in the future, be given increases in the level of their compensation comparable to that enjoyed by their civilian contemporaries (House Report No. 90-787, 1967, 3).

The volunteer military competes directly with the private sector to attract and retain the number of dedicated, skilled, and experienced people necessary to man the force. While the decision to begin or to continue a military career is based on more than pay, pay is clearly an important factor. It is equally clear that military pay would be most effective and efficient as a recruitment and retention tool if maintained over time at a level predictably attractive compared with civilian employment opportunities.

Long-term pay competitiveness mandates annual adjustments comparable to civilian sector wage growth. Failure to make these adjustments means that, over time, military service will become financially uncompetitive, and the force will suffer as trained, experienced people are lured away from military service to pursue other opportunities.

An exodus of experienced military members, combined with poor results in the recruiting market, clearly signals that military pay requires adjustment. However, waiting for this form of evidence prior to adjusting pay can be quite costly, in terms of both the budget dollars necessary to recruit and train replacements, and the security risk of reduced readiness.

Key Elements of a Pay Adjustment Process

The key issues in military pay adjustment stem from the objective of maintaining attractive compensation vis-à-vis civilian peers. These issues are:

- Who are the civilian peers of the military?
- What is the best measure of civilian peer income growth?
- What is the best way to apply that income growth measure to military compensation?

Civilian Peers. Because the uniformed services have two million members working in many diverse fields, peers cannot be identified in terms of a small, organizationally defined population. Rather, for the purposes of compensation management, one must consider those members of the general population who have the same prospects for earnings that service members would enjoy, were they in private life. Generally, studies of incomes and labor markets have found that the best observable predictors of income are age, education, gender, race, and occupation. Because the armed services do not differentiate in pay by race and gender, the appropriate dimensions for comparing military and civilian pay growth are age, education, and occupation.[1] Compared to the general U.S. work force, the military is a good deal younger, with almost half of its members under 25, and very few members over 50. It also has very few members who did not finish high school, and somewhat fewer members who have completed college. A measure of the income change of civilian peers should look to high-school graduates for the enlisted corps and college graduates for the officer corps, and it should focus on the population between 22 and 40 years old.

Peer Income Measures. Measuring the trends in peer incomes is a critical component of the pay management process. One would like a summary

indicator—such as an index—for simplicity and ease of use in the annual budgetary process. The measure should be reflective of the experience of military peers, based on the observable criteria of age, education, and occupation. Finally, for a profession marked by a midlife vocational transition, one would like an indicator that influences lifetime pay to reflect the trend, rather than transitory effects (e.g., the business cycle), and that particularly allows focus on the career segment of the force. Finally, one would like the measure to signal the need for structural review by illustrating changes in the labor market opportunities for different force segments.

No single index now available provides this information. In the public data bases, the Employment Cost Index (ECI) is the best single measure of growth in overall wages, along the trend; it has been named in the Federal Employees Pay Comparability Act of 1990 (FEPCA) as the measure to guide civil service pay management. The ECI is a reasonable near-term measure to guide the annual military pay raise. In the longer term, an alternative measure developed by the 7th QRMC and RAND, the Defense Employment Cost Index (DECI), shows promise for meeting the full range of measurement objectives: measurement based on peers, stable career force focus, and sensitivity to structural changes. It weights data from the Current Population Survey (CPS) based on demographic matches between the military and respondents to the CPS. While not yet operational, the DECI merits further development by DoD.

Application of the Raise to Military Pay. Regular military compensation (RMC) is the best single measure of military pay for the purposes of maintaining comparable income growth. In practice, recent pay increases have been directed at and applied in equal proportion to the principal elements of RMC: basic pay, the subsistence allowance (BAS), and the basic allowance for quarters (BAQ); the variable housing allowance (VHA) has been adjusted separately. This process has contributed to some of the problems already noted in management of the major allowances.

Management of the annual pay raise for the pay and allowances system is best predicated on the nature of that system. Three major points stand out. First, RMC should change apace with growth of civilian peer incomes. Second, the major allowances should be updated annually based on prices of food and housing. Third, basic pay should be increased annually as needed for RMC growth to equal civilian pay growth.

Overview of Chapter 6

The next section of this chapter considers the current pay adjustment system, its evolution, and its strengths and weaknesses. In the remainder of the chapter, we outline an alternative annual pay adjustment process better suited to the circumstances and operation of the pay and allowances system.

Our proposed adjustment process will help ensure that military pay remains competitive with private sector pay in the long term, is predictable by the member, and affordable. In particular, our proposal:

- Advances RMC, including VHA, as the measure of military compensation to be kept abreast of civilian incomes.
- Recognizes price change as the appropriate basis for adjusting allowances, while insuring that RMC as a whole grows by measured civilian wage growth.
- Endorses interim use of the ECI to measure civilian wage growth, pending development of a promising, tailored index—the DECI—that estimates pay growth for a civilian population that more closely matches the demographic mix of the services.

Our full recommendation for a new pay adjustment process can be effected only after the recommendations in Chapter 4 for a cost-based allowance system are implemented. In the interim, we recommend a technical amendment to 37 U.S.C. so that military pay will keep pace with civilian pay.

THE ANNUAL PAY ADJUSTMENT PROCESS

Current Procedure

In 1967 the annual military pay adjustment process was established and tied to the adjustment of General Schedule (GS) pay for Federal civilian employees. The key features of the annual military pay adjustment mechanism (prior to the FEPCA of 1990) were the following:

- *Elements of compensation.* The current system applies to RMC excluding VHA. VHA has been annually adjusted according to an independent set of rules.[2]

- *Allocation among elements.* Over the 17 years between FY 1975 and FY 1991, the pay raise has been allocated uniformly to all elements of RMC on 14 occasions. The BAQ allocation has exceeded the average rate of increase on three occasions, and BAS has exceeded the average percentage increase on one occasion.[3] This history is not inconsistent with the notion that the underlying allowances—BAQ and BAS—should bear a relationship to prices; however, the current mechanism does not consistently provide for this.

- *Linkage to the GS pay raise.* The linkage between the military pay increase and that of Federal workers has prevailed in 20 out of 25 years since 1967, but in 6 of the 9 years since 1983. In every case where the linkage was broken over the last 25 years, the military pay raise exceeded the GS pay raise.

- *Adherence to an index.* Until the FEPCA of 1990, no reference index for the annual pay raise was recognized in legislation.[4] For the military adjustment process, the Professional, Administrative, Technical, and Clerical (PATC) survey was the informal reference index, through the linkage to the GS pay raise, at least through FY 1982. Arguably, the ECI replaced the PATC, informally, thereafter. In any case, there are no instances where the actual military pay raise was the same as either the rate of increase implied by the PATC or by the ECI in the last 25 years. This does not mean, of course, that these indexes did not influence the pay raise.[5]

- *Differential allocations within the basic pay table.* There are some instances where the military pay raise was allocated differentially by grade, year of service, or both. Most notably, this occurred during transition to the all volunteer force in the early 1970s (larger increases to first-term members) and in the early 1980s (larger raises for career noncommissioned officers). However, differential allocations by grade and year of service have been relatively infrequent.

A clearly articulated, rational policy for making annual pay adjustments could avoid uncertainty and misunderstanding by those most affected by these decisions—the military members. Because some members live in government housing while others do not, and because of linkages between the elements of RMC and retired pay, income taxes, and social security taxes, it is important that military personnel understand the reasons for a given allocation. This is not to suggest an inflexibly tied set of rules. However, there is value to the compensation system of having an explicit framework for pay raise allocations, and, when discretionary authority is exercised, that the reasons for the exceptions be explained in terms of the underlying framework. A review of the history of the system, both in legislation and its application, suggests that no such framework for adjustment has been articulated or followed.

Federal Employees Pay Comparability Act of 1990

The FEPCA (Public Law 101-159) changed the pay raise mechanism for Federal civilians. For the first time, GS pay raises were legislatively linked directly to a specific index of private sector pay, the ECI.

Because of the linkages established in the 1967 legislation, and left in place by FEPCA, these changes will affect increases in military pay. For FY 1992 and FY 1993, the GS pay raise was set equal to the full increase measured by the ECI. Beginning in FY 1994, the GS pay increase is to be set at ECI minus one-half percent. At the same time, GS employees in high-wage areas will get a locality adjustment to bring them more in line with local wage rates. These additional payments will have the effect of making the average GS pay raise an amount approaching the full ECI.[6] This result is explicitly the intent of Congress.[7] Thus, military pay increases will fall behind civilian wage increases, due to the mechanics of the pay linkages. The President retains the discretionary authority he has held since 1967 to recommend an alternative pay raise if he determines that it is in the national interest.

In the short run, establishing the principle that military pay should be adjusted at a rate less than needed to keep pace with the civilian sector may send the wrong signal to the men and women in the armed forces already facing a great deal of uncertainty because of force reductions. In the long run, the small gap between civilian wage changes and military pay adjustments created each year by this process will grow into significant differences in pay levels and begin to cause recruiting and retention problems.

The remainder of this chapter will be devoted to developing recommendations regarding how the pay adjustment process should work. We first discuss alternative indicators of civilian wage growth, from the perspective of measuring the pay changes of military peers. We then turn to the topic of allocating the raise among the elements of compensation based on making the adjustment to total RMC equal the rate of civilian wage growth.

THE INDEX OF CIVILIAN WAGE GROWTH

The Employment Cost Index

Description of the ECI. The ECI measures the change in what employers nationwide pay for labor. It is produced by the Bureau of Labor Statistics (BLS) from a quarterly survey of employers. In addition to the single index representing private, non-farm workers that was chosen in the FEPCA, BLS publishes a series of sub-indexes by industry and occupation.

The sample of jobs is selected to represent the work force of the entire nation. Currently BLS collects data for 23,000 occupations at approximately 4,400 establishments, excluding farms, households and the Federal Government. These sampled occupations and establishments represent over 90 percent of the non-Federal, nonfarm employment in the United States.

Data are collected each March, June, September, and December; and the resultant quarterly series are released by BLS approximately one month later. Thus, the September data are available in late October, in time to be used to prepare the DoD budget request.

The ECI measures changes in employers' costs for wages and salaries for a comparable set of jobs. Additional data on employer benefit costs are also gathered and processed, but they are not included in the specific series used to adjust Federal pay levels. Wages and salary include straight-time wage rates for workers paid on an hourly basis or earnings divided by normal hours (non-overtime) for workers not paid on an hourly basis. Wages and salary are reported before all payroll deductions, and include production bonuses, incentive earnings, commissions, and cost-of-living adjustments, but exclude nonproduction bonuses and shift pay, pays that tend to vary depending on the state of the economy.

The fixed employment weights of the ECI are based on the decennial census. The advantage of a fixed-weight index is that the effects of people changing jobs or occupations, or moving to industries with different pay levels, are minimized. This means that the index is more likely to measure pure wage change independent of changes in job and occupation distributions that result from the

introduction of technology or other market changes (e.g., employment shifts over the business cycle).[8]

Assessment of the ECI. The ECI has four principal strengths as a measure to guide annual military pay raises. First, it furnishes timely data representative of wage and salary change in the broad U.S. economy. Second, its accuracy and stability are widely acknowledged by labor economists and compensation specialists. Third, because it is regularly produced by the Bureau of Labor Statistics, no additional cost is associated with its use. Finally, both the FEPCA and the Ethics Reform Act of 1989 use the ECI to set pay raises for Federal government civilian workers, including members of Congress.

However, a number of questions have been raised concerning the continued use of the ECI as an index for adjusting military pay. Since 1981, civilian pay growth as measured by the ECI has outstripped military pay raises by 12 percent. Yet, the last decade has been one in which the armed forces have had remarkable success maintaining a high-quality force. One possible explanation for this pay paradox is that the measure of civilian wages, the ECI, does not really capture the civilian wage growth relevant to members and potential members of the military.

A related argument is that the composition of the military work force differs markedly from the component of the civilian work force whose wages are captured in the ECI. Specifically, the military tends to be younger and has a lower percentage of non-high school graduates than the civilian work force. Furthermore, whereas the military is almost 90 percent male, over 40 percent of the civilian work force is female. These demographic differences are often associated with differences in wage levels and pay growth rates. This suggests that an index of civilian pay changes weighted to represent the military population on key demographic characteristics might do a better job of measuring civilian sector pay changes most relevant to military members.

The Defense Employment Cost Index

Description of the DECI. The 7th QRMC has explored the development of an alternative index of civilian pay growth, the DECI, that more closely matches the demographics of the military population. We have worked closely with its originator, the RAND Corporation, in the development and evaluation of the DECI over the course of our investigations.

The DECI differs from the ECI in two important ways:

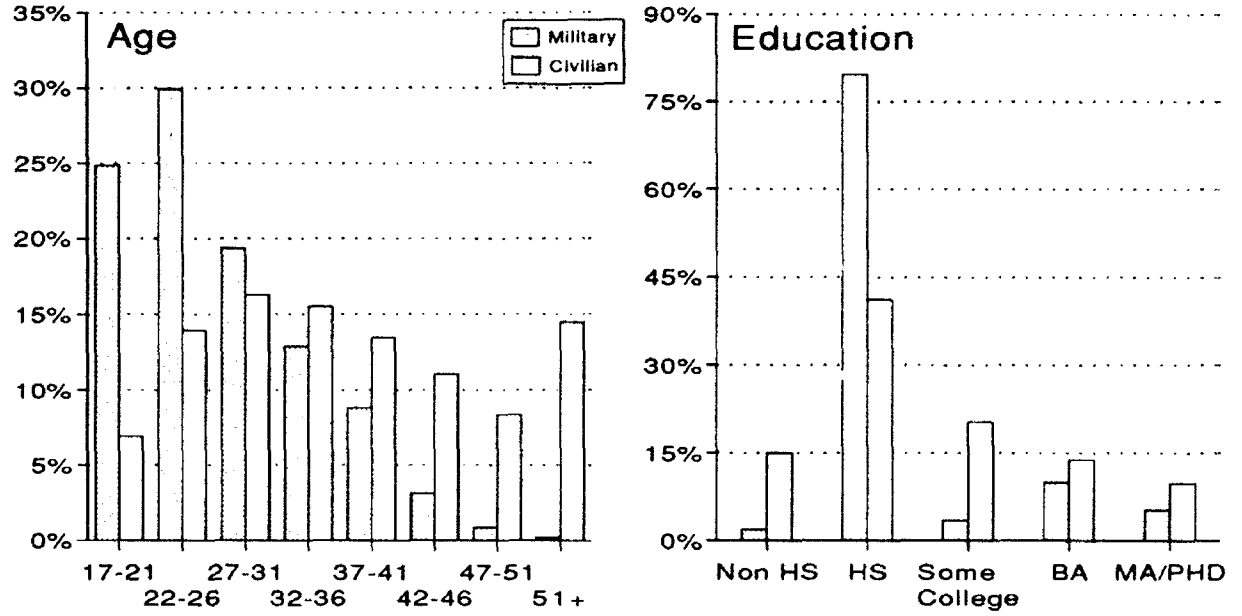
- It uses data from the CPS, which polls individuals to determine earnings, rather than business establishments to determine employment costs.
- It weights the civilian earnings data to reflect the demographic characteristics of the military population.

The CPS data on which the DECI is based can be disaggregated into multiple demographic groups. Thus, wage change information can be constructed for a sample of the civilian population that matches the military population in key dimensions. This ability to mirror the demographic characteristics of the military population—age, education, gender, and minority status—is the major advantage of the proposed DECI that distinguishes it from the ECI.

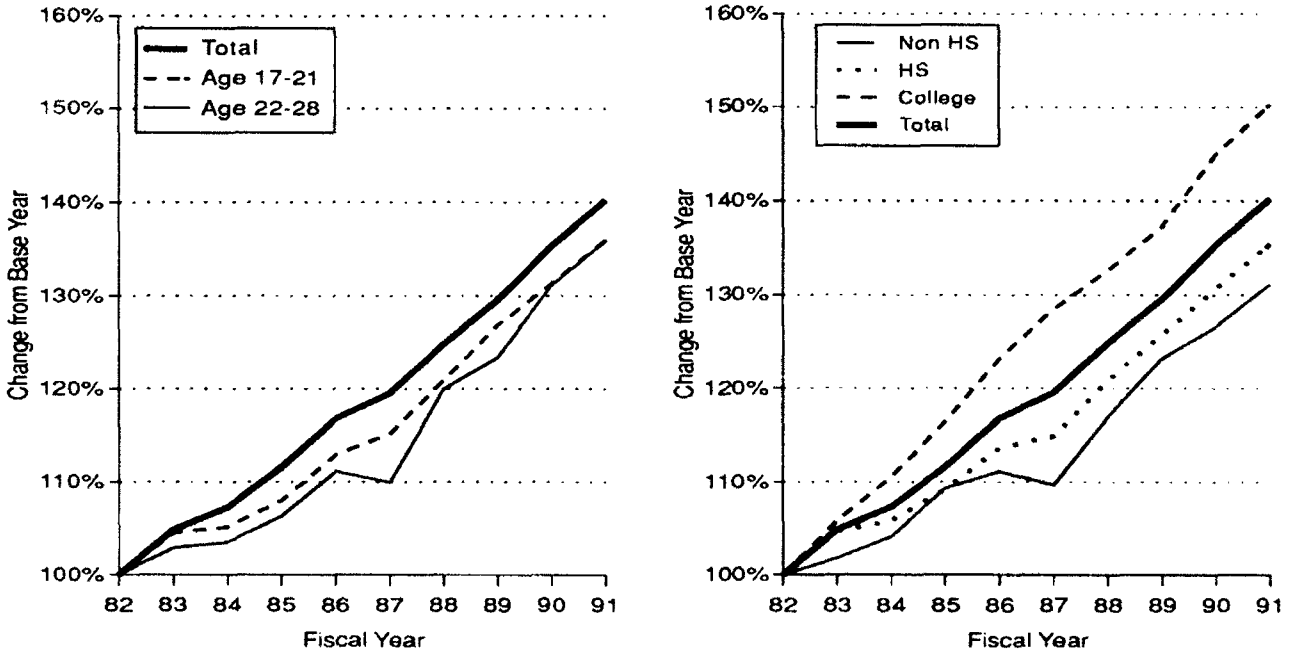
Figure 6-1 shows that the age and education of the military and civilian populations differ significantly.

The importance of accounting for these characteristics is illustrated in Figure 6-2, which portrays the differences in wage growth, as measured by the CPS, for different age and education groups. The charts indicate that, for the period from 1982 to 1991, wage growth has been slower for the younger segments of the population than for the entire population, and that the college-educated population has experienced faster wage growth than less educated segments.

AGE AND EDUCATION OF THE MILITARY AND CIVILIAN POPULATIONS IN 1990 Figure 6-1



CPS-MEASURED WAGE GROWTH FOR AGE AND EDUCATION GROUPS Figure 6-2



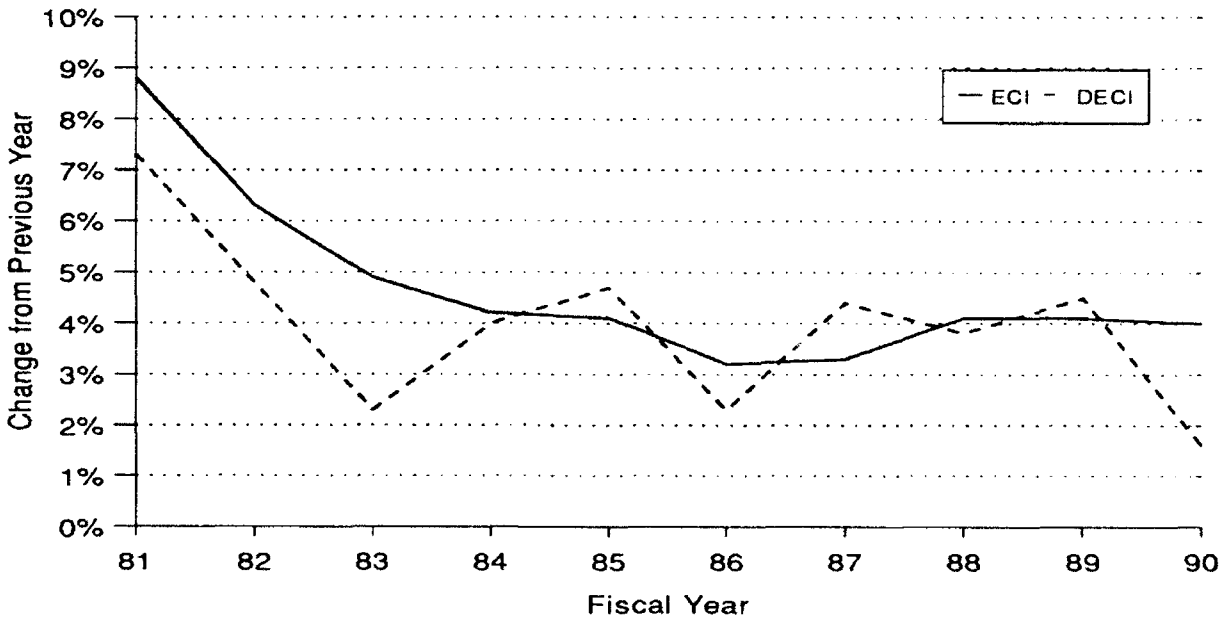
A final note concerns trend measurement. Because the DECI is based upon wage data that represent the income of an individual, rather than the cost of a job (as in the ECI), the results will be more cyclically sensitive. This is because the composition of employment changes over the business cycle. Hence, the wage changes reflected by the DECI will vary more significantly with the business cycle. The differences in the behavior of the two indexes are displayed in Figure 6-3.

Assessment of the DECI. Other indexes of civilian wage growth have been criticized because of their inability to match the atypical demographic characteristics of the military population. The primary advantage of the DECI is that it was designed precisely to reflect wage growth in a portion of the civilian population that most closely resembles the military population.

However, this important advantage of the DECI carries an equally important drawback. Wage growth of young, relatively inexperienced workers in the civilian sector would tend to induce cyclical variations in the pay increases received by more experienced, better trained, and more highly educated career members.

In fact, youth wages rose at a slower rate than those of more experienced workers in the civilian sector over the 1980s. Thus, the DECI helps explain why recruiting remained strong in the last decade. However, use of the DECI raises the possibility that pay levels of career members would lag their civilian peers, perhaps resulting in a lower-quality career force in the future. Moreover, individuals in both the military and private sector consider not only current wages, but expected future wages, in making decisions to enter or

COMPARISON OF DECI AND ECI VARIABILITY Figure 6-3



remain in an occupation. Hence, an inappropriately low rate of wage growth of high quality career members may affect their continuation decisions.

There are further ramifications to the DECI's sensitivity to cyclical fluctuations. Over the long run, cyclical fluctuations in pay growth should roughly even out. However, members who must retire during a period of cyclically low growth in wages may perceive the adjustments to be less than fair, particularly compared with those fortunate enough to retire in a period of cyclically high growth in the index.

Apart from its potential use in the actual pay adjustment process, the DECI promises to become a valuable new tool for personnel management. It can enable managers to better understand the growth in wage opportunities for different segments of the officer and enlisted force. DECI results can be disaggregated to reflect the earnings growth for the civilian population that represents, demographically, first-term enlisted members, senior officers, and so forth. For example, the youth component of the DECI explains the recruiting success of the 1980s better than alternative indexes, because it reflects the slower growth in civilian youth wages over the period. Hence, selected use of the DECI in personnel management could improve understanding of factors affecting military personnel retention, leading to improved policies, particularly with regard to special and incentive pays (e.g., enlistment bonuses).

Because its method allows flexible applications, the DECI should be refined as a career force-focused indicator of the annual pay raise, with subindexes developed as tools to aid management of pay going to segments of the force and to signal pending need for structural review.

ALLOCATING THE ANNUAL ADJUSTMENT ACROSS ELEMENTS OF RMC

Establishing a Basis for Allocation

Civilians usually receive an overall salary that they use to pay for food, housing, and other goods and services and to save for the future. In the military compensation system, basic pay, allowances, and the tax advantage associated with these allowances, which taken together are defined as regular military compensation, most closely correspond to this concept. It is eminently reasonable that the pay adjustment process, matching growth of pay in the private sector, be applied to the elements of RMC.

Less clear is how the annual pay raise should be allocated among the elements of RMC. Both the legislative history and the historical application of the process, reviewed above, indicate the lack of a logical process or consistent rationale for allocating the annual pay raise among its elements.

If the price of food or housing rises in the national economy, the value of food and housing provided in kind to the member likewise increases. Those members not receiving subsistence and housing in kind must now, on average, pay more for the same quantities consumed. Increasing the allowances of these members by the growth of food and housing prices restores the internal parity in real income—income adjusted for differences in costs of food and housing—between members who receive housing and subsistence in kind and those who receive it in cash.[9] Hence, equity among military members, as well as efficient compensation policy, suggests that allowances be adjusted to reflect changes in underlying prices.

A Method of Allocating the Annual Pay Adjustment[10]

In the preceding section, we argued that:

- Total RMC should grow at the rate of civilian wage growth.
- Allowances should grow at a rate that reflects the growth in underlying prices.

Here, we recommend a simple, logical method for the allocation of the pay adjustment among the elements of RMC in a way that satisfies these

criteria. First, increases should be allocated to allowances to reflect average cost growth in food and housing prices. Then, basic pay should be increased such that the growth in RMC is equal to the rate of growth in civilian wages. When cost growth in housing and subsistence lags behind civilian wage growth, the growth in basic pay will exceed the growth in civilian wages, and vice versa. All members would receive the same rate of increase in basic pay. All members receiving subsistence in cash would receive the same increase, and the housing allowance increase would vary by cost growth at the member's location.

The actual computations are as follows. A weighted average RMC is calculated for the entire military. RMC includes basic pay, a housing allowance that is the equivalent of BAQ and VHA, BAS, and the tax advantage associated with the allowances.[11] In-kind allowances are treated as if they were received in cash, for this computation. The tax advantage is allocated between housing and subsistence in proportion to the dollar amounts of the allowances.

The proportions of basic pay, housing allowance, and subsistence allowance and the pro-rated tax advantage of these allowances are calculated. From the percentage increase in RMC, which is equal to the percent growth in civilian pay, a weighted average of the measured growth rate in housing costs and the average increase in subsistence costs is subtracted. The weights are the proportions of housing and subsistence allowances making up average RMC— their *shares* of RMC. This is divided by the share of basic pay in RMC to provide the percentage raise in basic pay.

In mathematical notation, we can write:

$$BP_{raise} = \frac{ECI_{growth} - \pi_H \alpha_H - \pi_S \alpha_S}{\alpha_{BP}}$$

where π_H and π_S represent the cost growth rate in housing (H) and subsistence (S); and α_{BP}, α_H, and α_S are the shares of basic pay, housing allowances, and subsistence in RMC.

The following numerical example will help illuminate these ideas. For FY 1991, the component shares of RMC were:

Basic pay (α_{BP})	65.8 percent
Housing (α_H)	24.6 percent
Subsistence (α_S)	9.6 percent
RMC	100.0 percent

We combine these with wage and cost change indicators from 1991 as follows:

ECI	3.7 percent
Housing $(MHCI)(\pi_H)$	2.8 percent
Subsistence $(USDA)(\pi_S)$	5.38 percent

In this example, USDA food costs and the military housing cost index (MHCI)[12] are used to estimate cost increases. Using these percent increases and each element's share of RMC, the basic pay raise to be applied to all service members can be calculated as follows:

$$\frac{ECI - (HA\% * MHCI) - (BAS\% * USDA)}{Basic\ Pay\%} = Basic\ Pay\ Raise$$

$$\frac{.037 - (.246 * .028) - (.096 * .0538)}{.658} = .038$$

The 3.7-percent increase in the ECI results in a 3.8-percent increase in basic pay for all members. On average, members would receive a 2.8-percent increase in the housing allowance and a 5.38-percent increase in BAS. The actual housing allowance increase would vary based on location-specific measures of housing cost change. The overall increase in RMC would equal the ECI increase, but the actual change in food and housing cost growth would be reflected in the changes to the allowances. All members would receive the same basic pay raise, which in this example was slightly greater than measured civilian wage growth.

In the event that the RMC pay raise is below the full increase implied by civilian wage growth (full ECI), basic pay should not bear the full

amount of the reduction. Instead, the percent increase allocated to each element would be computed as if the full ECI pay raise applied to RMC. Then, each element would be reduced proportionately. In our example, if the actual pay raise were capped at 3.0 percent, the percentage increase allocated to each element would be approximately 81 percent of the percentage increases calculated under the full ECI growth assumption (3.0/3.7), or a reduction of 19 percent.

If implemented, this mechanism would provide a logical basis for systematic allocation of the annual pay raise. It would allow RMC to grow at a rate matching civilian wage growth, allowances to keep pace with cost growth, and all members to receive the same basic pay increase. Military members would better understand how their pay raises are allocated and what to expect in the future.[13]

SUMMARY AND RECOMMENDATIONS

Based on our review of all of these aspects of the annual adjustment mechanism for military pay, ***the 7th QRMC recommends:***

- ***Continuing to use full ECI as the target amount of the annual military pay adjustment. The Office of the Secretary of Defense should underwrite further development of the DECI as a personnel management tool and as a candidate index for future use in the pay adjustment process.***

Section 1009 of title 37, United States Code, should be amended to set the military pay raise equal to ECI growth, with retention of the President's authority to submit an alternative amount when he determines it is in the national interest.

The 7th QRMC further recommends:

- ***Applying the military pay raise (full ECI) to average total RMC when price-based allowance adjustments are fully implemented.***

  - All service members would receive the same percentage adjustment to their subsistence allowances.

  - The housing allowance adjustment would be based on local housing costs.

  - The change in basic pay would be that amount necessary to bring change in total RMC equal to civilian pay growth. All service members would receive the same percentage increase in basic pay.

  - If the annual pay raise is held below the full increase implied by civilian pay growth, the percentage changes for each element should be reduced proportionately in the actual pay raise.

Our interim recommendations preserve the current pay adjustment process, with a technical modification to current law so that the members' pay raises will match civilian pay growth, as measured by the ECI. This recommendation reflects the fact that the ECI is accepted by the services and that it preserves linkage with Federal civilians, both of which are especially important in light of the current level of uncertainty among military personnel.

Over the longer term, when price-based allowances are implemented, our recommendation would ensure that the goals of equity and efficiency are met through the modifications proposed. Moreover, it would, for the first time, establish a consistent, logical basis to guide the allocation of the pay raise across the elements of RMC.

The result of these changes would be a coherent system for pay adjustments that would be sensitive to the cost changes in food and housing that the allowances are intended to reflect while allowing total RMC to grow at rates that reflect growth in the civilian economy.

NOTES

1. Occupational matches between military and civilian positions are approximate.

2. When VHA was introduced, RMC was redefined to include it. RMC exclusive of VHA is now called *Basic Military Compensation* (BMC). We will use *RMC*, with the understanding that the current adjustment process does not include VHA.

3. The one time that BAS exceeded the average increase (September 15, 1980) was, in fact, a separate raise apart from the normal annual adjustment.

4. The law did not specifically mention any particular index. It required only that GS pay be adjusted considering "...the rates of pay for the same levels of work in private enterprise as determined on the basis of appropriate annual surveys that shall be conducted by the Bureau of Labor Statistics" (5 U.S.C. § 5305). The PATC is the survey of these levels of work.

5. Moreover, the indexes were also used to estimate *catch-up* pay raises, once GS or military pay had fallen behind the rate of growth implied by the annual rate of change in the index.

6. During a transition period, the funding of locality pay would not necessarily be limited to funds implied by the one-half percentage point reduction from full ECI.

7. The Federal Employees Pay Comparability Act of 1990, § 101(e), 104 Stat. 1427, 1443, provided that: "It is the sense of the Congress that the total funds dedicated to adjustments under sections 5303 [Annual adjustments to pay schedules] and 5304 [Locality-based comparability payments] for any year be no less than the total funds that would have been dedicated to adjustments under such section 5303 for such year had the full change in the ECI been applied to pay rates for such year."

8. In technical terms, the ECI is a Laspeyres index. If expanding occupations are associated with high wage growth, and contracting occupations low wage growth, a Laspeyres index will underestimate the aggregate wage growth.

9. This does not mean that members are indifferent between in-kind and cash compensation for these items. Rather, the relative value a member placed on in-kind and cash compensation before the price increase is approximately restored by increasing cash allowances by the amount of the price increases.

10. A more detailed exposition of the calculations of this adjustment method is in the 7th QRMC Staff Analyses, MTS 5—*Annual Pay Adjustment.*

11. The overseas housing allowance (OHA) is not considered in this computation. This is because the VHA imputation procedure in the selected military compensation tables does not include OHA recipients.

12. The MHCI is the housing component of the CPI adjusted for military characteristics.

13. In addition, if food and housing were the only goods and services with price variation, all members would receive the same *real* growth rate in RMC—the percentage increase in RMC after accounting for cost growth.

Chapter 7
Integration and Transition

INTEGRATION AND TRANSITION

INTRODUCTION

The preceding chapters describe the 7th QRMC findings and recommendations with respect to the various elements of military compensation. In this chapter, we outline our proposals for combining these recommendations and for moving to a revised set of pay and allowances. The goal was to develop an integrated plan that would enhance the recruitment, retention, and performance of top-quality service members.

To analyze the effects of integrating our recommendations, we use regular military compensation (RMC) to represent the pay of the average service member. Because of differences in dependency status, availability of government quarters, location, and special and incentive pays, a given service member's actual pay does not necessarily equal RMC. However, it is a generally accepted measure of average total income for members.

The integration of RMC elements demonstrates the essential cohesiveness and consistency of our recommendations by examining their combined effects on member compensation and DoD personnel costs. Each of the recommended changes in RMC elements has been analyzed to ensure that it makes sense from the perspective of the compensation system as a whole. While our proposals call for significant changes to the individual RMC elements, they result in total levels of RMC that would not differ much over a career from today. The difference lies in *when*, *how much*, and *for what reason* a member receives an increase in pay as he or she moves through a career.

Any changes to military compensation must be planned with due care to meet the transition challenges. We developed several transition options to ensure that current members are not harmed by a move to restructured pay and allowances. Our transition analysis includes *save-pay* for current members, which precludes any pay reductions when the recommendations are implemented. In analyzing the transition options, we evaluated the total costs of implementing the recommendations for each of the transition plans. While we did not restrict ourselves to no-cost solutions, we searched for ways to better focus existing resources by targeting the right people to be paid the right amount of money.

The next section briefly reviews our RMC proposals and presents the combined effects of the integrated plan. The feasibility of alternative transition options is evaluated in the following section. The pros and cons of the transition options are discussed, along with the estimated costs.

INTEGRATION OF RECOMMENDED PAY AND ALLOWANCE REVISIONS

Review of Proposed Changes to RMC Elements

Under the 7th QRMC's recommendations, RMC would change as a result of proposed changes to basic pay, the total of basic allowance for quarters (BAQ) and average variable housing allowance (VHA), and basic allowance for subsistence (BAS). The specific near-term changes to each RMC component, discussed in earlier chapters, are key to our integration analysis and are briefly summarized here:

- **Basic Pay.** We propose to restructure the basic pay table to achieve a better balance between promotion and longevity raises over a career. Basic pay would vary by about $100 per month for enlisted members, although for most years of service, the differences would be less than half that amount. For officers, the range of monthly changes in basic pay would be about twice as great as for enlisted personnel. Of all the proposed component changes, these would have the largest impact on RMC.

- **Housing Allowance**. We recommend that a housing allowance floor be established to ensure that junior enlisted members can obtain adequate housing. Enlisted members between the grades of E-1 and E-5 will be most affected. The allowance would increase by an average of more than $120 per month, including the associated tax advantage, for the most junior members.

- **Subsistence Allowance**. We propose a single-rate BAS system that is linked to a government food cost standard. This standard would decrease BAS for enlisted members and increase it for officers. Changes in basic pay were proposed to offset new BAS rates. We adjusted for the tax advantage, and made discounted trade-offs between current and deferred income where appropriate. The approximate magnitude of the BAS-basic pay transfers are indicated by the BAS changes—enlisted BAS is reduced by about $22 per month, and officer BAS is increased by about $40 per month.

Table 7-1 shows the proposed pay table projected to 1994, if the above recommendations are fully implemented. Note that all members would receive the same BAS and that the indicated housing allowance is actually an average of the regional allowances.

Methodology

Our analysis is tailored to reveal changes in RMC arranged in the format of the basic pay tables—that is, by pay grade and time in service. However, it is often more informative to present the results for a *typical* career, illustrating the effects on compensation by years of service, with pay grade changes incorporated according to normal promotion timing. To analyze the combined effects of the near-term recommendations, we must account for changing force structure, normal career paths, intervening annual pay adjustments, family status, and forecasts of the value of allowances. With reasonable for each of these factors affecting RMC, we compare proposed basic pay and RMC levels with the amounts that are currently paid.

- **Force Structure.** The number of active duty enlisted members and officers is obtained from each of the service's projections for FY 1994. The pay grade distributions by years of service for these members are derived from data provided by Defense Manpower Data Center for all the services.

- **Career Patterns.** Typical career patterns are defined for enlisted members and officers by using estimates of normal promotion timing. For enlisted members, the pattern is derived from projected average promotion timing across all services. For officers, promotion points are based on established Defense Officer Personnel Management Act (DOPMA) guidelines. There is no typical career pattern for prior-service and warrant officers. For these officers, pay changes are computed using a weighted average of the recent pay grade distributions by years of service.

- **Annual Pay Adjustments.** Compensation comparisons are made for FY 1994, the first year in which our recommendations could be implemented. Pay rates are projected to 1994 from 1992 under the existing pay adjustment mechanism by applying the Department of Labor's forecasted change in the Employment Cost Index (ECI) to basic pay, BAQ, and BAS. These projected pay raises for 1993 and 1994 are 3.7 and 4.3 percent, respectively.

- **Family Status.** The average 1991 family status distributions for enlisted members and officers are used to determine qualification for housing allowances at the *with dependents* rate. The weighted average of the *with* and *without* dependents rates is used for each pay grade.

- **Allowances.** Forecasted values of the Consumer Price Index are used to adjust the average variable housing allowance and the Department of Agriculture food cost elements. The adjustment factors are 3.8 and 3.6 percent for 1993 and 1994, respectively.

PROPOSED PAY TABLE AND ALLOWANCE RATES (PROJECTED TO 1994)

Table 7-1

	<1	>1	>2	>3	>4	>6	>8	>10	>12	>14	>16	>18	>20	>22	>24	>26	>28
O-10	6901.20	6901.20	7088.10	7088.10	7275.60	7463.10	7650.30	7837.20	8025.00	8212.20	8399.70	8607.00	8795.40	8984.10	9172.50	9360.90	9549.60
O-9	6111.60	6111.60	6274.80	6274.80	6438.00	6601.50	6764.70	6927.90	7091.10	7254.90	7418.10	7601.10	7765.50	7930.20	8094.60	8259.30	8423.70
O-8	5531.70	5531.70	5685.30	5685.30	5839.20	5992.50	6146.10	6299.40	6453.00	6606.60	6760.20	6933.60	7088.70	7243.50	7398.30	7552.80	7707.90
O-7	4589.40	4589.40	4752.30	4752.30	4915.20	5078.10	5241.00	5403.90	5566.50	5729.70	5892.60	6075.60	6239.70	6403.50	6567.90	6732.00	6896.10
O-6	3115.50	3286.80	3458.10	3629.40	3800.70	3972.00	4143.30	4314.60	4485.90	4657.20	4828.50	5096.70	5345.70	5487.90	5629.80	5772.00	5913.90
O-5	2744.70	2916.00	3087.30	3258.60	3429.90	3600.30	3770.70	3941.10	4111.50	4281.90	4405.80	4550.10	4675.20	4800.30	4800.30	4800.30	4800.30
O-4	2306.40	2477.70	2649.00	2820.30	2991.60	3228.30	3464.70	3588.90	3712.80	3836.70	3960.60	4054.20	4054.20	4054.20	4054.20	4054.20	4054.20
O-3	2001.90	2193.60	2385.00	2576.70	2700.60	2824.80	3072.60	3196.50	3320.70	3388.20	3388.20	3388.20	3388.20	3388.20	3388.20	3388.20	3388.20
O-2	1857.60	1970.40	2083.20	2195.70	2308.50	2421.30	2421.30	2421.30	2421.30	2421.30	2421.30	2421.30	2421.30	2421.30	2421.30	2421.30	2421.30
O-1	1587.30	1666.20	1745.10	1824.00	1824.00	1824.00	1824.00	1824.00	1824.00	1824.00	1824.00	1824.00	1824.00	1824.00	1824.00	1824.00	1824.00
O-3E	0.00	0.00	0.00	0.00	2700.60	2824.80	3072.60	3196.50	3320.70	3444.60	3568.50	3712.50	3712.50	3712.50	3712.50	3712.50	3712.50
O-2E	0.00	0.00	0.00	0.00	2308.50	2421.30	2533.80	2646.60	2759.40	2871.90	2871.90	2871.90	2871.90	2871.90	2871.90	2871.90	2871.90
O-1E	0.00	0.00	0.00	0.00	1824.00	1936.50	2049.30	2162.10	2274.60	2387.40	2387.40	2387.40	2387.40	2387.40	2387.40	2387.40	2387.40
W-5	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	3743.10	3873.90	4004.70	4135.50	4266.30
W-4	2168.70	2236.50	2304.00	2371.50	2439.30	2551.80	2664.60	2777.40	2889.90	3002.70	3115.50	3248.40	3362.10	3476.10	3590.10	3703.80	3817.80
W-3	1853.10	1920.90	1988.40	2056.20	2123.70	2225.10	2326.50	2427.90	2529.30	2630.70	2732.40	2853.90	2956.50	3059.10	3161.70	3264.30	3366.90
W-2	1627.80	1695.30	1763.10	1830.60	1898.40	1988.40	2078.70	2168.70	2259.00	2349.00	2439.30	2549.40	2640.90	2732.10	2823.60	2823.60	2823.60
W-1	1393.50	1461.00	1528.50	1596.30	1663.80	1836.30	1920.90	2005.20	2089.80	2174.40	2259.00	2363.40	2363.40	2363.40	2363.40	2363.40	2363.40
E-9	0.00	0.00	0.00	0.00	0.00	0.00	0.00	2522.10	2601.90	2687.10	2766.60	2851.80	2931.60	3016.80	3108.30	3199.80	3291.30
E-8	0.00	0.00	0.00	0.00	0.00	0.00	2100.90	2179.20	2252.40	2330.70	2403.90	2482.20	2555.10	2633.70	2736.00	2838.00	2940.30
E-7	1479.90	1541.70	1612.20	1683.00	1753.50	1815.00	1876.80	1938.30	1994.70	2056.20	2112.60	2174.10	2230.20	2292.00	2410.20	2528.70	2646.90
E-6	1267.20	1328.70	1399.50	1470.00	1540.80	1602.30	1663.80	1725.60	1781.70	1843.50	1882.80	1916.40	1916.40	1916.40	1916.40	1916.40	1916.40
E-5	1132.80	1194.30	1265.10	1335.60	1406.10	1467.90	1529.40	1591.20	1619.40	1641.90	1641.90	1641.90	1641.90	1641.90	1641.90	1641.90	1641.90
E-4	1032.00	1093.50	1164.30	1234.80	1305.30	1367.10	1367.10	1367.10	1367.10	1367.10	1367.10	1367.10	1367.10	1367.10	1367.10	1367.10	1367.10
E-3	936.60	998.40	1068.90	1139.70	1139.70	1139.70	1139.70	1139.70	1139.70	1139.70	1139.70	1139.70	1139.70	1139.70	1139.70	1139.70	1139.70
E-2	853.80	915.30	915.30	915.30	915.30	915.30	915.30	915.30	915.30	915.30	915.30	915.30	915.30	915.30	915.30	915.30	915.30
E-1	780.90	780.90	780.90	780.90	780.90	780.90	780.90	780.90	780.90	780.90	780.90	780.90	780.90	780.90	780.90	780.90	780.90

	BAS	THA* with	THA* without
O-10	185.60	1251.18	1030.17
O-9	185.60	1251.18	1030.17
O-8	185.60	1251.18	1030.17
O-7	185.60	1251.18	1030.17
O-6	185.60	1114.55	926.28
O-5	185.60	1061.41	884.12
O-4	185.60	935.49	821.33
O-3	185.60	770.16	653.27
O-2	185.60	655.63	516.42
O-1	185.60	589.68	446.73

	BAS	THA* with	THA* without
O-3E	185.60	828.85	708.63
O-2E	185.60	752.46	600.52
O-1E	185.60	688.28	511.06
W-5	185.60	818.71	741.81
W-4	185.60	818.71	741.81
W-3	185.60	756.08	618.87
W-2	185.60	701.43	551.59
W-1	185.60	602.83	460.60

	BAS	THA* with	THA* without
E-9	185.60	794.03	608.03
E-8	185.60	731.81	561.57
E-7	185.60	680.36	496.69
E-6	185.60	631.09	474.32
E-5	185.60	574.94	454.72
E-4	185.60	526.77	381.99
E-3	185.60	509.72	388.33
E-2	185.60	504.68	377.94
E-1	185.60	499.60	366.64

* THA = average Total Housing Allowance with and without dependents

Integration of RMC Proposals for Enlisted Members

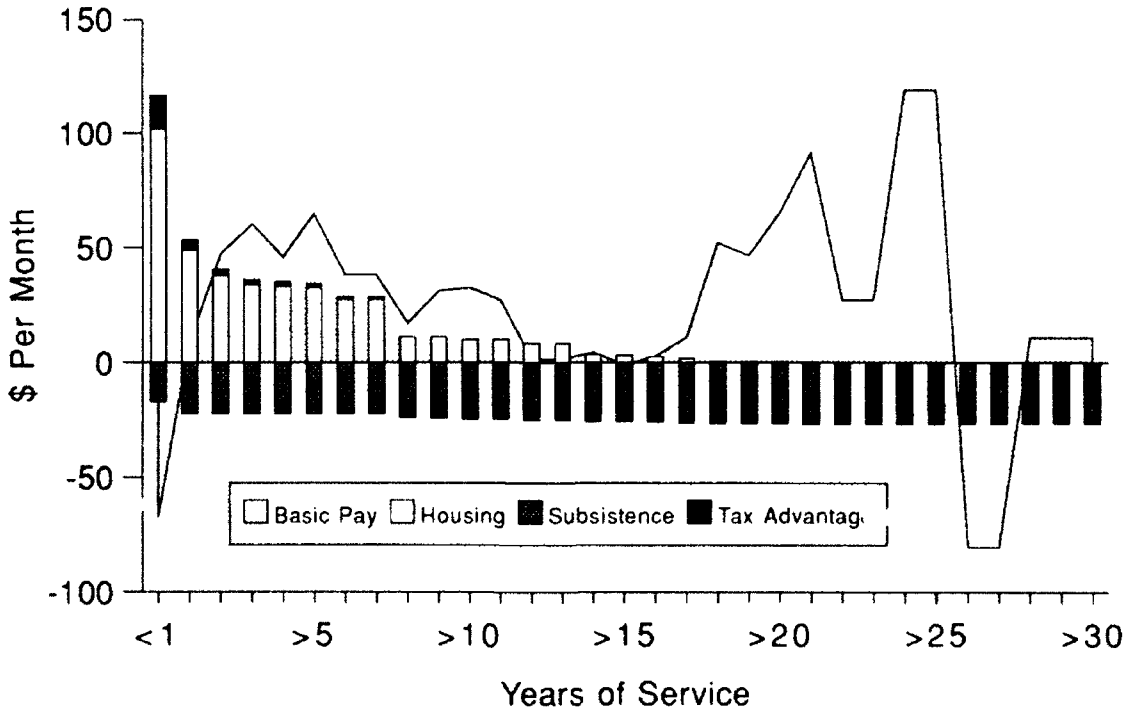
Figure 7-1 shows the estimated change in each component of RMC for enlisted members, as proposed by the 7th QRMC. Basic pay is greater than under the current table throughout a 30-year career, with minor exceptions. Members with less than one year of service have lower basic pay because of the reduction in the size of the E-2 raise.

Part of the large 26-year longevity raise is redistributed over the 24- and 28-year longevity points. The sawtooth pattern of changes in basic pay between 24 and 30 years of service reflects the changes required to achieve uniform longevity raises throughout the years of retirement eligibility. This smoothing of the over-26 pay raise is addressed in the transition analysis because of its implications for the level of retired pay.

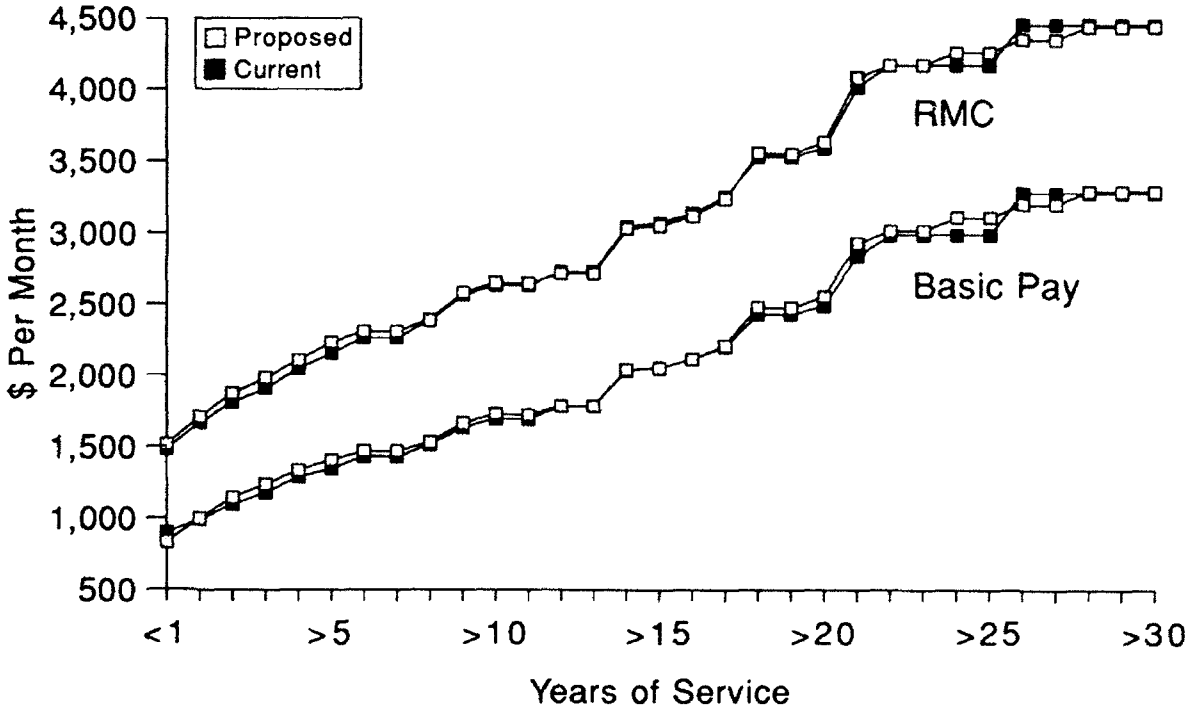
The reduction in an enlisted member's BAS and tax advantage is included in the basic pay amounts in Figure 7-1. Implementing the housing floor has its greatest effect in the first eight years of service. Members in the lower ranks and corresponding levels of income will benefit the most from the floor proposal.

The net effect of these changes is shown in Figure 7-2, which compares monthly pay under the current and proposed systems. Total pay levels are roughly the same over a career as today's. The significance of our proposals lies in when, how much, and for what reason each element of RMC

CHANGE IN COMPONENTS OF RMC FOR ENLISTED MEMBERS (1994) Figure 7-1



DIFFERENCES IN ENLISTED MEMBERS' RMC (1994) Figure 7-2



is paid or increased. Promotion will be weighted over longevity, while allowances will provide an appropriate amount to procure the member's food and adequate housing.

Integration of RMC Proposals for Officers

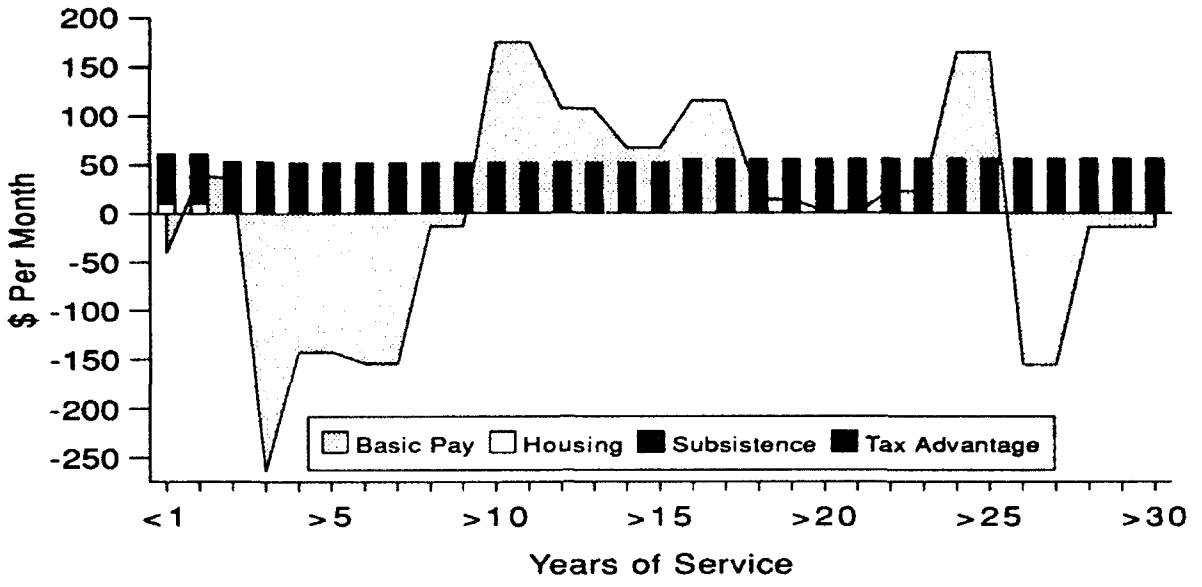
Changes to basic pay again dominate the other revisions of RMC for officers, as shown in Figure 7-3. Officer basic pay raises are shifted away from relatively large longevity increases to create a pattern of progressively larger pay raises for each successive promotion.

Basic pay is shifted from the period covering years 3 to 7 to the career phase between years 8 to 17. Two reasons are responsible for this shift: (1) substantial reduction in the large longevity raises at the year 3 and 4 points, and (2) the large increase in the O-4 raise normally occurring during the tenth or eleventh year. The second significant basic pay change occurs as a result of redistributing the large over-26 year raise across the over-24, over-26, and over-28 year completion points. The change resembles the sawtooth pattern we observed for enlisted members and results in a smoothing of longevity raises between 20 and 30 years of service.

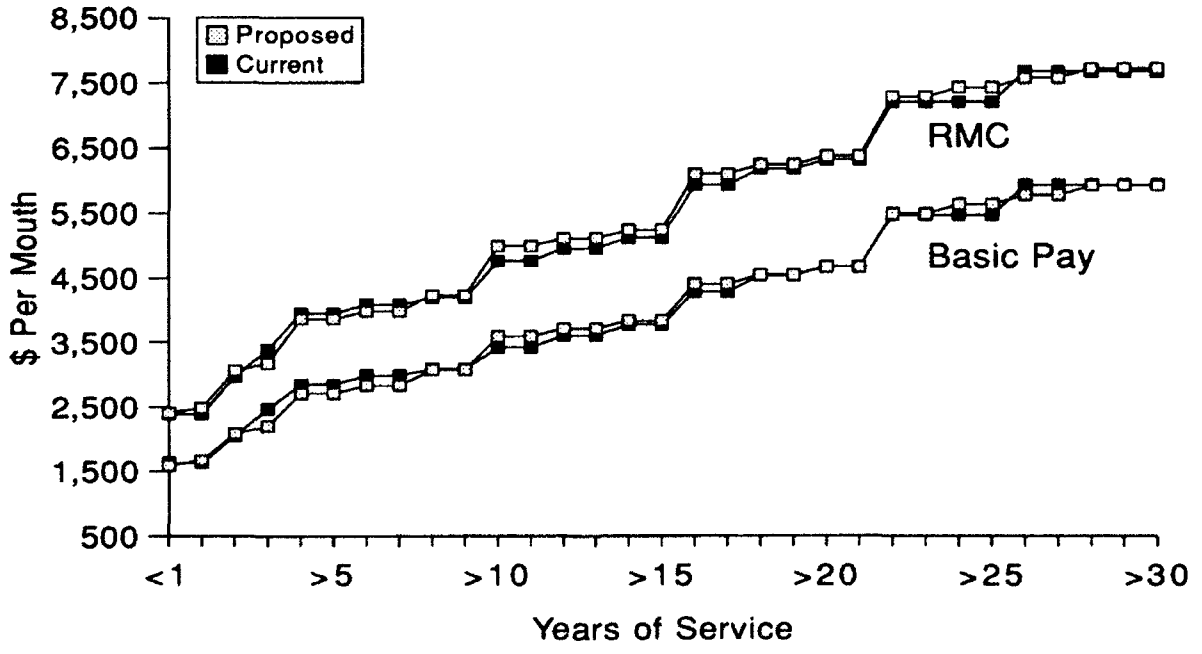
The housing floor would have a small positive impact on officers, and then only during the first two years of service. The increase in BAS is offset with reductions in basic pay. The changes in basic pay shown in the figure reflect this offset. Furthermore, the increased BAS results in an increased tax advantage.

Figure 7-4 shows that for officers, as well as enlisted members, total pay over a career is similar to today's. Again, the significance of the proposed

CHANGES IN COMPONENTS OF RMC FOR OFFICERS (1994) Figure 7-3



DIFFERENCES IN OFFICERS' RMC (1994) Figure 7-4



changes lies in when and for what reason the elements of RMC are paid or increased.

Integration of RMC Proposals for Prior-Service and Warrant Officers

Officers who have at least four years of prior service have a special basic pay table with pay grades O-1E through O-3E. They may enter this pay scale at any point after the fourth year. When promoted to O-4, these prior-service officers transfer to the officer pay scales. Basic pay changes for prior-service officers reflect the inherent linkage to the officer basic pay table. The changes in subsistence allowance and tax advantage are similar to those for other officers, while the housing floor is not a factor because the average prior-service officer's housing allowance is above the floor level.

Warrant officers, like prior-service officers, enter their pay table at varying years of service. Once in the warrant officer table, however, they generally continue to use that pay table throughout their careers. The changes in the components of RMC for warrant officers are similar to those for officers. The housing floor has little or no effect. BAS and the associated tax advantage increase and appropriate offsets are applied to basic pay. The pattern of basic pay reflects our proposals for progressive large pay raises for promotion and smaller uniform longevity raises.

The net results for prior-service and warrant officers are small RMC reductions in the early years that are more than offset by increases in the later years.

Summary

Several patterns emerge from the integration analysis. It is clear that our basic pay proposals dominate the overall changes in RMC. The pattern of basic pay changes is to reduce the size of large longevity differentials and some promotion differentials that occur in the early years of service and to shift these resources to progressively larger promotion raises for the middle to higher grades. As a result, individuals who make a career in the military would generally be better off as they are promoted through typical careers. The housing floor would provide considerable help to junior enlisted members. Changes to the subsistence allowance are managed with basic pay adjustments to be essentially neutral with respect to RMC.

TRANSITION OPTIONS

A transition plan that controls costs and prevents members from experiencing pay cuts is a necessary complement to our recommendations. Implementing our near-term pay recommendations without a transition plan means that some current members would receive pay increases, while others would suffer unanticipated pay losses. We evaluate several transition options that preclude any such pay reductions. The options are designed to be implemented in conjunction with annual pay raises. Save-pay provisions are applied where necessary to maintain current levels of pay.

Our four transition options demonstrate the feasibility, in terms of cost and timing, of implementing our proposals. Each of the transition alternatives includes the RMC proposals analyzed in the integration section above—restructured basic pay, a housing allowance floor, and a cost-based subsistence allowance. Our transition plans differ primarily in the number of years it takes to accomplish the full set of recommended pay changes. The options are as follows:

- One-year: Incorporates all changes when the annual pay raise is implemented on January 1, 1994.
- Two-year: Incorporates the housing floor in the first year. Phases in basic pay and BAS adjustments in roughly equal increments over 1994 and 1995 pay raises.
- Three-year: Incorporates the housing floor in the first year. Phases in basic pay and BAS adjustments in roughly equal increments over 1994, 1995, and 1996.

- Modified one-year: Incorporates most changes at the January 1994 pay raise. Phases in selected large changes in the basic pay table over multiple years.

A transition of more than three years is not necessary, and is, in fact, undesirable because of the long adjustment period. The methodology used to evaluate these options is outlined in the next section. In general, the trade-offs between the transition options compare the benefits of more immediate implementation against the higher cost of additional save-pay for current members.

Methodology

For the one-year transition plan, the recommended changes in basic pay, housing floor, and BAS are incorporated at the time of the January 1994 pay raise. Then, members who would experience RMC reductions are identified and save-pay adjustments are computed.[1]

The multi-year plans require interpolation of basic pay tables, and BAS changes, for each intervening year. In all cases, the final year of the transition contains the complete set and amount of pay adjustments. The intermediate years contain prorated percentage changes in basic pay, after appropriately accounting for expected annual adjustments over the full transition period. The BAS offset to basic pay is then added to or subtracted from each year's basic pay table, making appropriate adjustments for the tax advantage and retirement linkage. Complete descriptions of the data, methodology, and interpolated tables appear in the 7th QRMC Staff Analyses, MTS 6—*Integration and Transition.*

For each transition option and year, the percentage changes in basic pay and RMC are compared to the projected annual pay raise for the transition year. The projected pay raises for 1994, 1995, and 1996 are the full forecasted ECI percentages: 4.3, 4.1, and 4.0 percent, respectively. Comparisons of basic pay between current and proposed compensation show the direct effects for members who receive housing and subsistence in kind. They also show the effects on items linked to basic pay such as retired pay. Because most members receive cash allowances, a better measure of how the transition options would affect members overall is based on comparing current and proposed RMC.

The transition analysis evaluates the total cost of implementing the RMC package under each option. The cost of the CONUS COLA and the adjustment of hazardous duty pay are included to provide the total cost of all QRMC recommendations for each option.

One-Year Transition

The primary benefit of a one-year transition is its immediacy: the impact of all the changes would occur at once, and subsequent pay raises would proceed as usual. However, a one-year transition would require the largest amount of save-pay of any option. We examine, in turn, the changes in basic pay and RMC for enlisted members, officers, prior-service officers, and warrant officers. The discussion below focuses on identifying members whose pay would decrease under this option. The QRMC advocates a save-pay provision to protect these members from pay decreases during transition and beyond, as necessary. Tables 7-2 and 7-3 show the percentage changes in basic pay and RMC, respectively, for the one-year transition option. The shading indicates a typical career progression.[2]

Enlisted Members. Basic pay raises will be larger than the projected 4.3 percent along the typical career path, with two exceptions. Enlisted members in the bottom three pay grades with less than one year of service would experience a decrease in basic pay. While this will be offset to some degree by relatively rapid promotion and the new one-year longevity raise, save-pay provisions are appropriate for members currently in the force. In addition, senior members who are at or near the over-26 year point may receive less basic pay and, hence, less retired pay, than they are anticipating. Current members who are between 26 and 28 years

ONE-YEAR TRANSITION (1993 TO 1994) BASIC PAY RAISE

Table 7-2

Officer Basic Pay

	<1	>1	>2	>3	>4	>6	>8	>10	>12	>14	>16	>18	>20	>22	>24	>26	>28
O-10	3.70%	3.70%	2.89%	2.89%	5.61%	8.33%	6.94%	9.56%	6.29%	8.77%	3.83%	6.39%	1.90%	4.08%	6.27%	2.09%	4.15%
O-9	3.62%	3.62%	3.67%	1.51%	4.15%	6.79%	6.72%	9.30%	7.40%	9.88%	3.70%	6.26%	2.86%	5.04%	7.22%	2.10%	4.13%
O-8	3.55%	3.55%	3.33%	0.93%	3.66%	6.39%	1.55%	4.08%	1.80%	4.23%	2.39%	0.64%	-0.91%	-1.18%	0.93%	3.04%	5.16%
O-7	3.39%	3.39%	0.25%	0.25%	3.68%	2.52%	5.81%	3.12%	6.22%	4.13%	-2.64%	-6.08%	-3.54%	-1.01%	1.53%	4.07%	6.60%
O-6	-5.31%	-0.10%	-4.33%	-5.77%	-1.32%	3.12%	7.57%	12.02%	16.47%	16.94%	4.69%	5.14%	7.92%	4.72%	7.43%	1.56%	4.05%
O-5	4.31%	10.82%	-0.07%	-1.35%	3.83%	8.99%	14.15%	15.81%	14.64%	11.89%	7.11%	4.63%	4.34%	3.51%	3.51%	3.51%	3.51%
O-4	3.99%	11.71%	-1.92%	-2.11%	3.83%	10.01%	13.08%	9.65%	7.40%	6.14%	4.96%	4.56%	4.56%	4.56%	4.56%	4.56%	4.56%
O-3	-2.87%	6.43%	3.49%	4.59%	-0.92%	-1.10%	3.85%	2.49%	1.46%	1.04%	1.04%	1.04%	1.04%	1.04%	1.04%	1.04%	1.04%
O-2	3.36%	9.63%	6.14%	-6.89%	-5.29%	-2.69%	-2.69%	-2.69%	-2.69%	-2.69%	-2.69%	-2.69%	-2.69%	-2.69%	-2.69%	-2.69%	-2.69%
O-1	1.71%	6.77%	7.58%	-7.06%	-7.06%	-7.06%	-7.06%	-7.06%	-7.06%	-7.06%	-7.06%	-7.06%	-7.06%	-7.06%	-7.06%	-7.06%	-7.06%

Prior-Service Officer Basic Pay

	<1	>1	>2	>3	>4	>6	>8	>10	>12	>14	>16	>18	>20	>22	>24	>26	>28
O-3E	N/A	N/A	N/A	N/A	-0.92%	-1.10%	3.85%	2.49%	1.46%	1.22%	4.86%	9.09%	9.09%	9.09%	9.09%	9.09%	9.09%
O-2E	N/A	N/A	N/A	N/A	-5.29%	-2.69%	-1.30%	-2.01%	-1.60%	-0.32%	-0.32%	-0.32%	-0.32%	-0.32%	-0.32%	-0.32%	-0.32%
O-1E	N/A	N/A	N/A	N/A	-7.06%	-7.65%	-5.75%	-4.03%	-2.43%	-2.06%	-2.06%	-2.06%	-2.06%	-2.06%	-2.06%	-2.06%	-2.06%

Warrant Officer Basic Pay

	<1	>1	>2	>3	>4	>6	>8	>10	>12	>14	>16	>18	>20	>22	>24	>26	>28
W-5	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	4.45%	4.15%	7.66%	3.69%	6.97%
W-4	3.27%	6.50%	2.26%	5.26%	5.84%	5.91%	5.93%	5.96%	3.05%	2.32%	2.57%	4.16%	4.43%	4.47%	7.90%	3.27%	6.45%
W-3	-2.91%	0.64%	-3.96%	-0.68%	1.27%	4.89%	2.19%	0.77%	1.65%	2.48%	3.36%	4.70%	4.40%	4.24%	7.74%	7.47%	10.84%
W-2	-2.62%	1.42%	-2.50%	1.23%	2.00%	1.31%	0.41%	0.92%	1.40%	1.93%	2.25%	3.48%	3.92%	3.35%	6.81%	6.81%	6.81%
W-1	0.06%	4.91%	-4.28%	-0.04%	-3.83%	1.54%	1.85%	2.17%	2.25%	2.50%	2.66%	3.81%	3.81%	3.81%	3.81%	3.81%	3.81%

Enlisted Member Basic Pay

	<1	>1	>2	>3	>4	>6	>8	>10	>12	>14	>16	>18	>20	>22	>24	>26	>28
E-9	N/A	N/A	N/A	N/A	N/A	N/A	N/A	3.23%	4.17%	5.19%	5.88%	6.75%	7.64%	5.25%	8.45%	1.75%	4.66%
E-8	N/A	N/A	N/A	N/A	N/A	N/A	2.55%	3.42%	4.15%	5.04%	5.55%	6.54%	7.04%	4.21%	8.26%	1.05%	4.69%
E-7	3.48%	7.80%	4.41%	5.12%	5.81%	5.92%	6.14%	6.21%	5.99%	4.53%	4.43%	4.57%	5.90%	1.99%	7.25%	0.06%	4.74%
E-6	2.97%	7.97%	4.34%	5.22%	5.79%	6.04%	6.29%	6.32%	4.39%	4.74%	3.62%	3.89%	3.89%	3.89%	3.89%	3.89%	3.89%
E-5	4.92%	10.61%	7.63%	8.35%	9.33%	7.09%	7.21%	7.30%	5.33%	4.89%	4.89%	4.89%	4.89%	4.89%	4.89%	4.89%	4.89%
E-4	2.47%	8.58%	9.45%	9.64%	7.59%	8.40%	8.40%	8.40%	8.40%	8.40%	8.40%	8.40%	8.40%	8.40%	8.40%	8.40%	8.40%
E-3	-1.30%	5.22%	6.77%	9.48%	9.48%	9.48%	9.48%	9.48%	9.48%	9.48%	9.48%	9.48%	9.48%	9.48%	9.48%	9.48%	9.48%
E-2	-6.50%	0.23%	0.23%	0.23%	0.23%	0.23%	0.23%	0.23%	0.23%	0.23%	0.23%	0.23%	0.23%	0.23%	0.23%	0.23%	0.23%
E-1	-4.16%	-4.16%	-4.16%	-4.16%	-4.16%	-4.16%	-4.16%	-4.16%	-4.16%	-4.16%	-4.16%	-4.16%	-4.16%	-4.16%	-4.16%	4.16%	-4.16%
E-1 <4	3.62%	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

ONE-YEAR TRANSITION (1993 TO 1994) RMC RAISE

Table 7-3

Officer RMC	<1	>1	>2	>3	>4	>6	>8	>10	>12	>14	>16	>18	>20	>22	>24	>26	>28
O-10	4.51%	4.51%	3.86%	3.86%	5.98%	8.11%	7.02%	9.08%	6.50%	8.48%	4.50%	6.57%	2.89%	4.67%	6.46%	3.00%	4.70%
O-9	4.53%	4.53%	4.55%	2.88%	4.90%	6.92%	6.86%	8.83%	7.38%	9.30%	4.46%	6.48%	3.76%	5.50%	7.23%	3.09%	4.74%
O-8	4.53%	4.53%	4.34%	2.53%	4.58%	6.62%	2.91%	4.84%	3.06%	4.93%	3.48%	2.07%	0.80%	0.55%	2.23%	3.91%	5.60%
O-7	4.55%	4.55%	2.23%	2.23%	4.70%	3.83%	6.22%	4.22%	6.51%	4.93%	-0.31%	-3.10%	-1.12%	0.84%	2.82%	4.79%	6.76%
O-6	-0.95%	2.50%	-0.55%	-1.72%	1.39%	4.49%	7.59%	10.69%	13.80%	14.19%	5.47%	5.78%	7.85%	5.43%	7.48%	2.94%	4.87%
O-5	5.62%	9.69%	2.59%	1.60%	5.11%	8.61%	12.10%	13.27%	12.55%	10.70%	7.30%	5.47%	5.24%	4.60%	4.60%	4.60%	4.60%
O-4	5.56%	10.44%	1.37%	1.10%	5.20%	9.47%	11.65%	9.25%	7.63%	6.70%	5.80%	5.48%	5.48%	5.48%	5.48%	5.48%	5.48%
O-3	1.21%	7.33%	5.25%	5.94%	1.89%	1.67%	5.24%	4.17%	3.33%	2.98%	2.98%	2.98%	2.98%	2.98%	2.98%	2.98%	2.98%
O-2	5.61%	9.81%	7.40%	-2.22%	-1.16%	0.69%	0.69%	0.69%	0.69%	0.69%	0.69%	0.69%	0.69%	0.69%	0.69%	0.69%	0.69%
O-1	5.22%	8.69%	9.21%	-1.74%	-1.74%	-1.74%	-1.74%	-1.74%	-1.74%	-1.74%	-1.74%	-1.74%	-1.74%	-1.74%	-1.74%	-1.74%	-1.74%

Prior-Service Officer RMC	<1	>1	>2	>3	>4	>6	>8	>10	>12	>14	>16	>18	>20	>22	>24	>26	>28
O-3E	N/A	N/A	N/A	N/A	1.89%	1.67%	5.19%	4.14%	3.31%	3.08%	5.82%	9.00%	9.00%	9.00%	9.00%	9.00%	9.00%
O-2E	N/A	N/A	N/A	N/A	-0.99%	0.80%	1.72%	1.09%	1.31%	2.20%	2.20%	2.20%	2.20%	2.20%	2.20%	2.20%	2.20%
O-1E	N/A	N/A	N/A	N/A	-1.71%	-2.37%	-1.15%	-0.02%	1.04%	1.21%	1.21%	1.21%	1.21%	1.21%	1.21%	1.21%	1.21%

Warrant Officer RMC	<1	>1	>2	>3	>4	>6	>8	>10	>12	>14	>16	>18	>20	>22	>24	>26	>28
W-5	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	5.45%	5.18%	7.89%	4.77%	7.33%
W-4	5.13%	7.24%	4.37%	6.38%	6.76%	6.78%	6.76%	6.76%	4.64%	4.06%	4.20%	5.33%	5.51%	5.52%	8.09%	4.54%	6.97%
W-3	1.23%	3.54%	0.31%	2.50%	3.79%	6.22%	4.29%	3.21%	3.78%	4.32%	4.92%	5.86%	5.61%	5.46%	8.06%	7.85%	10.38%
W-2	1.72%	4.29%	1.58%	4.03%	4.48%	3.94%	3.22%	3.51%	3.78%	4.10%	4.27%	5.12%	5.40%	4.94%	7.48%	7.48%	7.48%
W-1	3.86%	6.92%	0.66%	3.47%	0.71%	4.28%	4.41%	4.57%	4.55%	4.68%	4.74%	5.53%	5.53%	5.53%	5.53%	5.53%	5.53%

Enlisted Member RMC	<1	>1	>2	>3	>4	>6	>8	>10	>12	>14	>16	>18	>20	>22	>24	>26	>28
E-9	N/A	N/A	N/A	N/A	N/A	N/A	N/A	2.83%	3.48%	4.20%	4.69%	5.32%	5.97%	4.32%	6.61%	1.80%	3.94%
E-8	N/A	N/A	N/A	N/A	N/A	N/A	2.30%	2.89%	3.39%	4.00%	4.37%	5.07%	5.44%	3.51%	6.36%	1.26%	3.91%
E-7	2.84%	5.40%	3.44%	3.89%	4.35%	4.45%	4.63%	4.70%	4.59%	3.66%	3.61%	3.72%	4.62%	1.97%	5.62%	0.58%	3.94%
E-6	2.72%	5.58%	3.54%	4.09%	4.47%	4.65%	4.84%	4.90%	3.69%	3.93%	3.20%	3.39%	3.39%	3.39%	3.39%	3.39%	3.39%
E-5	4.67%	7.91%	6.28%	6.75%	7.39%	6.06%	6.17%	6.25%	4.99%	4.70%	4.70%	4.70%	4.70%	4.70%	4.70%	4.70%	4.70%
E-4	4.02%	7.62%	8.17%	8.34%	7.10%	7.63%	7.63%	7.63%	7.63%	7.63%	7.63%	7.63%	7.63%	7.63%	7.63%	7.63%	7.63%
E-3	2.94%	6.80%	7.69%	9.34%	9.34%	9.34%	9.34%	9.34%	9.34%	9.34%	9.34%	9.34%	9.34%	9.34%	9.34%	9.34%	9.34%
E-2	3.56%	7.69%	7.69%	7.69%	7.69%	7.69%	7.69%	7.69%	7.69%	7.69%	7.69%	7.69%	7.69%	7.69%	7.69%	7.69%	7.69%
E-1	7.45%	7.45%	7.45%	7.45%	7.45%	7.45%	7.45%	7.45%	7.45%	7.45%	7.45%	7.45%	7.45%	7.45%	7.45%	7.45%	7.45%
E-1 <4	14.14%	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

of service would see only a small increase in basic pay because of the smoothing of the 26-year longevity raise. Those approaching the 26-year point will receive a substantial pay increase from the new over-24 longevity raise, but the net benefit of this would depends on how long they have to go before reaching 26 years of service. A special transition is appropriate for those members at or near the 26-year point to ensure that they do not lose anticipated retirement income.

Officers. The potential for adverse effects on current officers is concentrated in pay grades O-2 and O-3 with years of service between three and seven. These members have recently received large basic pay raises under the current structure: the three- and four-year longevity raises, as well as the O-2 raise. Under the proposed structure, these levels would be lower. The increase in BAS, and associated tax advantage, offsets many of the reductions; but some members, particularly O-2s in the over-3 years pay cell will require save-pay. The smoothing of the over-26 longevity raise, with its implications for anticipated retired pay, implies that O-6s between 24 and 28 years of service also require special consideration.

Prior-Service and Warrant Officers. These pay tables reflect the BAS offset of basic pay and, for prior-service officers, the linkage to the bottom three grades of the proposed officer table. The RMC tables, which include the increased BAS, show that only a few cells will require save-pay provisions, primarily in the early part of the prior-service officer table.

The one-year option requires estimated save-pay costs of about $37 million in 1994. Though the save-pay costs are relatively high, the disruption of normal procedures is limited, and the improved compensation elements would begin generating benefits sooner than the multi-year options.

Multi-Year Transitions

Implementing our recommendations over several years would reduce the need for save-pay. While save-pay prevents losing money, affected members would not receive a pay raise on January 1, 1994. Thus, our two- and three-year transition options are designed to phase in the new pay structure and reduce the need to apply save-pay provisions. However, distributing smaller pay reductions over multiple years prolongs the time before some members would receive a full annual pay raise. Both the two- and three-year options incorporate the full housing floor in 1994. Basic pay and BAS changes are phased in over the remaining year or two, as appropriate.

By design, a two-year transition would produce about half the effect on member pay as a one-year transition. Members whose pay raise would be 2 percentage points lower than the ECI adjustment under the one-year option would receive a raise only one percentage point lower under the two-year transition. The effects are similarly proportional for a three-year transition.

To provide an overview of the multi-year options, we discuss the effects of the three-year plan. Tables 7-4 and 7-5 show the percentage changes in basic pay and RMC, respectively, for the first year. A major difference between the one-year option and the three-year option is that no save-pay provisions for any cell would be needed in a three-year transition. Some junior enlisted members in their first-year of service would receive raises of less than half the normal pay adjustment. However, they can generally expect to receive at least two pay raises associated with either longevity or promotion as they rapidly move through the pay table during their first year. For senior members of the force approaching retirement, the three-year transition option provides for most of the otherwise projected pay raise. An advantage of the three-year transition is its effect on enlisted BAS. The incremental shift of money from BAS to basic pay is balanced each year by the projected increase in the allowance. Enlisted BAS would be held constant throughout the three transition years, eliminating the need having to reduce the enlisted rate.

THREE-YEAR TRANSITION (1993 TO 1994) BASIC PAY RAISE (YEAR 1)

Table 7-4

Officer Basic Pay	<1	>1	>2	>3	>4	>6	>8	>10	>12	>14	>16	>18	>20	>22	>24	>26	>28
O-10	4.09%	4.09%	3.82%	3.82%	4.73%	5.64%	5.18%	6.05%	4.96%	5.79%	4.14%	5.00%	3.50%	4.23%	4.95%	3.56%	4.25%
O-9	4.06%	4.06%	4.08%	3.36%	4.24%	5.12%	5.10%	5.95%	5.33%	6.15%	4.09%	4.95%	3.81%	4.55%	5.27%	3.56%	4.24%
O-8	4.04%	4.04%	3.97%	3.17%	4.09%	4.99%	3.38%	4.22%	3.46%	4.27%	3.66%	3.08%	2.56%	2.47%	3.18%	3.88%	4.58%
O-7	3.99%	3.99%	2.94%	2.94%	4.08%	3.70%	4.80%	3.90%	4.93%	4.24%	1.98%	0.83%	1.68%	2.53%	3.37%	4.22%	5.06%
O-6	1.09%	2.83%	1.41%	0.93%	2.41%	3.89%	5.38%	6.86%	8.34%	8.50%	4.42%	4.57%	5.50%	4.44%	5.34%	3.38%	4.22%
O-5	4.29%	6.45%	2.83%	2.41%	4.13%	5.86%	7.57%	8.13%	7.74%	6.82%	5.23%	4.40%	4.31%	4.04%	4.04%	4.04%	4.04%
O-4	4.18%	6.75%	2.21%	2.14%	4.13%	6.20%	7.21%	6.07%	5.32%	4.90%	4.52%	4.38%	4.38%	4.38%	4.38%	4.38%	4.38%
O-3	1.89%	4.99%	4.01%	4.38%	2.54%	2.49%	4.14%	3.68%	3.34%	3.20%	3.20%	3.20%	3.20%	3.20%	3.20%	3.20%	3.20%
O-2	3.96%	6.06%	4.89%	0.56%	1.08%	1.95%	1.95%	1.95%	1.95%	1.95%	1.95%	1.95%	1.95%	1.95%	1.95%	1.95%	1.95%
O-1	3.42%	5.09%	5.36%	0.49%	0.49%	0.49%	0.49%	0.49%	0.49%	0.49%	0.49%	0.49%	0.49%	0.49%	0.49%	0.49%	0.49%

Prior-Service Officer Basic Pay	<1	>1	>2	>3	>4	>6	>8	>10	>12	>14	>16	>18	>20	>22	>24	>26	>28
O-3E	N/A	N/A	N/A	N/A	2.54%	2.49%	4.14%	3.68%	3.34%	3.26%	4.48%	5.89%	5.89%	5.89%	5.89%	5.89%	5.89%
O-2E	N/A	N/A	N/A	N/A	1.08%	1.95%	2.42%	2.18%	2.32%	2.75%	2.75%	2.75%	2.75%	2.75%	2.75%	2.75%	2.75%
O-1E	N/A	N/A	N/A	N/A	0.49%	0.29%	0.94%	1.50%	2.03%	2.17%	2.17%	2.17%	2.17%	2.17%	2.17%	2.17%	2.17%

Warrant Officer Basic Pay	<1	>1	>2	>3	>4	>6	>8	>10	>12	>14	>16	>18	>20	>22	>24	>26	>28
W-5	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	4.34%	4.24%	5.41%	4.09%	5.18%
W-4	3.94%	5.01%	3.60%	4.61%	4.80%	4.82%	4.82%	4.84%	3.87%	3.63%	3.71%	4.24%	4.33%	4.35%	5.49%	3.96%	5.02%
W-3	1.87%	3.07%	1.52%	2.62%	3.26%	4.48%	3.57%	3.11%	3.40%	3.68%	3.97%	4.42%	4.32%	4.27%	5.44%	5.35%	6.48%
W-2	1.97%	3.32%	2.01%	3.25%	3.51%	3.29%	2.99%	3.16%	3.31%	3.50%	3.60%	4.02%	4.16%	3.98%	5.13%	5.13%	5.13%
W-1	2.84%	4.46%	1.41%	2.84%	1.58%	3.35%	3.45%	3.56%	3.60%	3.69%	3.74%	4.12%	4.12%	4.12%	4.12%	4.12%	4.12%

Enlisted Member Basic Pay	<1	>1	>2	>3	>4	>6	>8	>10	>12	>14	>16	>18	>20	>22	>24	>26	>28
E-9	N/A	N/A	N/A	N/A	N/A	N/A	N/A	4.02%	4.31%	4.65%	4.88%	5.15%	5.44%	4.64%	5.70%	3.46%	4.44%
E-8	N/A	N/A	N/A	N/A	N/A	N/A	3.79%	4.10%	4.31%	4.61%	4.76%	5.10%	5.23%	4.30%	5.64%	3.24%	4.45%
E-7	4.03%	5.45%	4.37%	4.65%	4.92%	4.95%	5.01%	5.03%	4.94%	4.45%	4.40%	4.44%	4.86%	3.55%	5.30%	2.91%	4.46%
E-6	3.85%	5.53%	4.36%	4.70%	4.90%	5.00%	5.08%	5.08%	4.41%	4.52%	4.13%	4.23%	4.23%	4.23%	4.23%	4.23%	4.23%
E-5	4.50%	6.39%	5.44%	5.74%	6.13%	5.36%	5.40%	5.42%	4.74%	4.60%	4.60%	4.60%	4.60%	4.60%	4.60%	4.60%	4.60%
E-4	3.66%	5.72%	6.06%	6.18%	5.54%	5.80%	5.80%	5.80%	5.80%	5.80%	5.80%	5.80%	5.80%	5.80%	5.80%	5.80%	5.80%
E-3	2.43%	4.62%	5.18%	6.14%	6.14%	6.14%	6.14%	6.14%	6.14%	6.14%	6.14%	6.14%	6.14%	6.14%	6.14%	6.14%	6.14%
E-2	0.72%	2.96%	2.96%	2.96%	2.96%	2.96%	2.96%	2.96%	2.96%	2.96%	2.96%	2.96%	2.96%	2.96%	2.96%	2.96%	2.96%
E-1	1.47%	1.47%	1.47%	1.47%	1.47%	1.47%	1.47%	1.47%	1.47%	1.47%	1.47%	1.47%	1.47%	1.47%	1.47%	1.47%	1.47%
E-1 <4	4.10%	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

THREE-YEAR TRANSITION (1993 TO 1994) RMC RAISE (YEAR 1)

Table 7-5

Officer RMC

	<1	>1	>2	>3	>4	>6	>8	>10	>12	>14	>16	>18	>20	>22	>24	>26	>28
O-10	4.37%	4.37%	4.15%	4.15%	4.86%	5.57%	5.21%	5.89%	5.03%	5.69%	4.37%	5.06%	3.83%	4.43%	5.02%	3.87%	4.43%
O-9	4.37%	4.37%	4.38%	3.83%	4.50%	5.17%	5.15%	5.81%	5.33%	5.97%	4.35%	5.03%	4.12%	4.70%	5.28%	3.90%	4.45%
O-8	4.38%	4.38%	4.31%	3.71%	4.40%	5.07%	3.84%	4.48%	3.89%	4.51%	4.03%	3.56%	3.13%	3.05%	3.61%	4.18%	4.74%
O-7	4.38%	4.38%	3.61%	3.61%	4.43%	4.14%	4.94%	4.27%	5.04%	4.51%	2.76%	1.84%	2.49%	3.15%	3.81%	4.47%	5.12%
O-6	2.55%	3.70%	2.68%	2.29%	3.33%	4.36%	5.40%	6.43%	7.46%	7.60%	4.69%	4.79%	5.48%	4.68%	5.36%	3.85%	4.49%
O-5	4.74%	6.09%	3.72%	3.40%	4.57%	5.74%	6.90%	7.29%	7.05%	6.43%	5.30%	4.69%	4.61%	4.40%	4.40%	4.40%	4.40%
O-4	4.72%	6.35%	3.33%	3.23%	4.61%	6.03%	6.75%	5.95%	5.41%	5.10%	4.81%	4.70%	4.70%	4.70%	4.70%	4.70%	4.70%
O-3	3.27%	5.31%	4.62%	4.85%	3.50%	3.43%	4.61%	4.26%	3.97%	3.86%	3.86%	3.86%	3.86%	3.86%	3.86%	3.86%	3.86%
O-2	4.76%	6.16%	5.35%	2.15%	2.50%	3.12%	3.12%	3.12%	3.12%	3.12%	3.12%	3.12%	3.12%	3.12%	3.12%	3.12%	3.12%
O-1	5.01%	6.16%	6.32%	2.62%	2.62%	2.62%	2.62%	2.62%	2.62%	2.62%	2.62%	2.62%	2.62%	2.62%	2.62%	2.62%	2.62%

Prior-Service Officer RMC

	<1	>1	>2	>3	>4	>6	>8	>10	>12	>14	>16	>18	>20	>22	>24	>26	>28
O-3E	N/A	N/A	N/A	N/A	3.49%	3.42%	4.59%	4.24%	3.96%	3.89%	4.81%	5.87%	5.87%	5.87%	5.87%	5.87%	5.87%
O-2E	N/A	N/A	N/A	N/A	2.54%	3.14%	3.45%	3.23%	3.31%	3.61%	3.61%	3.61%	3.61%	3.61%	3.61%	3.61%	3.61%
O-1E	N/A	N/A	N/A	N/A	2.32%	2.09%	2.51%	2.88%	3.23%	3.29%	3.29%	3.29%	3.29%	3.29%	3.29%	3.29%	3.29%

Warrant Officer RMC

	<1	>1	>2	>3	>4	>6	>8	>10	>12	>14	>16	>18	>20	>22	>24	>26	>28
W-5	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	4.68%	4.60%	5.50%	4.46%	5.31%
W-4	4.58%	5.28%	4.32%	4.99%	5.12%	5.12%	5.11%	5.12%	4.41%	4.22%	4.27%	4.65%	4.70%	4.71%	5.56%	4.39%	5.20%
W-3	3.27%	4.05%	2.96%	3.70%	4.12%	4.94%	4.29%	3.94%	4.12%	4.31%	4.51%	4.82%	4.74%	4.69%	5.56%	5.49%	6.33%
W-2	3.44%	4.30%	3.39%	4.21%	4.36%	4.18%	3.94%	4.04%	4.13%	4.24%	4.29%	4.58%	4.67%	4.52%	5.37%	5.37%	5.37%
W-1	4.18%	5.20%	3.12%	4.06%	3.14%	4.32%	4.36%	4.41%	4.41%	4.46%	4.47%	4.74%	4.74%	4.74%	4.74%	4.74%	4.74%

Enlisted Member RMC

	<1	>1	>2	>3	>4	>6	>8	>10	>12	>14	>16	>18	>20	>22	>24	>26	>28
E-9	N/A	N/A	N/A	N/A	N/A	N/A	N/A	3.81%	4.02%	4.26%	4.42%	4.62%	4.83%	4.28%	5.04%	3.44%	4.16%
E-8	N/A	N/A	N/A	N/A	N/A	N/A	3.64%	3.85%	3.99%	4.20%	4.31%	4.55%	4.65%	4.01%	4.96%	3.27%	4.15%
E-7	3.83%	4.67%	4.04%	4.22%	4.40%	4.43%	4.48%	4.50%	4.46%	4.15%	4.12%	4.15%	4.43%	3.55%	4.76%	3.09%	4.20%
E-6	3.96%	4.93%	4.26%	4.47%	4.60%	4.67%	4.72%	4.73%	4.31%	4.38%	4.12%	4.19%	4.19%	4.19%	4.19%	4.19%	4.19%
E-5	5.27%	6.34%	5.78%	5.96%	6.19%	5.71%	5.72%	5.73%	5.28%	5.18%	5.18%	5.18%	5.18%	5.18%	5.18%	5.18%	5.18%
E-4	5.65%	6.86%	7.03%	7.07%	6.62%	6.77%	6.77%	6.77%	6.77%	6.77%	6.77%	6.77%	6.77%	6.77%	6.77%	6.77%	6.77%
E-3	6.14%	7.43%	7.69%	8.22%	8.22%	8.22%	8.22%	8.22%	8.22%	8.22%	8.22%	8.22%	8.22%	8.22%	8.22%	8.22%	8.22%
E-2	9.06%	10.44%	10.44%	10.44%	10.44%	10.44%	10.44%	10.44%	10.44%	10.44%	10.44%	10.44%	10.44%	10.44%	10.44%	10.44%	10.44%
E-1	12.02%	12.02%	12.02%	12.02%	12.02%	12.02%	12.02%	12.02%	12.02%	12.02%	12.02%	12.02%	12.02%	12.02%	12.02%	12.02%	12.02%
E-1 <4	14.73%	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

Modified One-Year Transition

The transition plans analyzed thus far have applied the same computations to every cell of the pay table. In contrast, the modified one-year transition selects only those cells where members may be adversely affected for phased-in pay adjustments, and applies the full basic pay adjustments to the other cells in 1994. BAS changes and the housing floor are implemented in the first year. Hence, this plan immediately converts most of the pay table to the proposed rates. It includes a combination of one-, two-, and three-year adjustments for different cells of the pay table. The cells with the longest adjustment period are those with the greatest potential for adverse effects on members.

Transition and Retired Pay

Even with save-pay and phased-in changes, members nearing 26 years of service may suffer losses in retired pay associated with the new basic pay table. They may be planning the timing of their retirement based, in part, on the large over-26 longevity raise in the current pay table. Our recommendations would spread this longevity raise across three adjacent longevity points: over-24, over-26, and over-28 years. Thus, the over-26 basic pay level is lower in the proposed table than in the current table. The most equitable protection for affected members would be to implement the proposed change in the over-24 raise, but delay the change at over-26 for two years. This would ensure that any current member with 24 or more years of service will be able to achieve the full anticipated benefit of the over-26 longevity raise. Members with less than 24 years will obtain the full benefit of the new over-24 longevity raise and be better off whether they choose to retire or not.

Costs of Implementing the 7th QRMC Recommendations

The costs of implementing the integrated RMC recommendations vary with the different transition options. To facilitate comparing the transition options, the FY 1994 projected force strength and structure are maintained for 1995 and 1996.

Four components of additional costs are estimated for each of the transition options: (1) basic pay, (2) BAS, (3) housing allowance floor, and (4) save-pay requirements. The cost of the housing floor assumes a full 1994 implementation in each transition, reflecting the high priority that we assign to this recommendation. The recommendations to establish a CONUS COLA and to revise the hazardous duty pay rate are also considered. These are independent of the transition option and are costed separately. Additionally, the saving associated with the QRMC recommendations to phase out partial BAQ and eliminate the BAQ minimum are included.

Table 7-6 shows the estimated costs, by element, for each of the transition options. The base-year column represents our estimates of the 1994 costs, if the package were implemented at the beginning of the fiscal year rather than on January 1. The costs of implementing all the recommendations on January 1, 1994 would be about $403 million for the one-year option during the nine remaining months of FY 1994.

Summary and Recommendations

We present the options in Table 7-6 as a menu of feasible and reasonable choices. We compare the alternatives on their ability to hold members harmless, control cost, and minimize disruption to the annual pay adjustment process. Our transition options differ in three crucial ways as shown in Table 7-7.

The modified one-year option is by far the most expensive because the option was developed to disadvantage the smallest number of members. The heavy costs stem from the fact that potential pay reductions are phased in to ensure that all members receive some raise each year. While save-pay costs are virtually eliminated in the modified one-year option, they are much more than offset by additional basic pay going to

COST SUMMARY ($ MILLIONS) Table 7-6

	BASE YEAR $	1994 $	1995 $	1996 $
1-YEAR				
Pay table	117	88	122	127
Save-pay	50	37	14	0
BAS	95	71	96	100
Floor	135	101	136	142
Total RMC	397	298	368	369
MODIFIED 1-YEAR				
Pay table	364	273	238	127
Save-pay	2	1	0	0
BAS	95	71	96	100
Floor	135	101	136	142
Total RMC	596	447	470	368
2-YEAR				
Pay table	60	45	122	127
Save-pay	4	3	6	0
BAS	47	35	96	100
Floor	135	101	136	142
Total RMC	246	184	361	369
3-YEAR				
Pay table	40	30	83	127
Save-pay	0	0	0	0
BAS	32	24	64	100
Floor	135	101	136	142
Total RMC	207	155	283	369
CONUS COLA	140	105	141	147
PARTIAL BAQ	(32)	(8)	(22)	(34)
BAQ MINIMUM	(57)	(14)	(38)	(56)
S&I	30	23	30	32
TOTALS				
1-YEAR	478	403	480	457
MODIFIED 1-YR	677	553	582	457
2-YEAR	327	290	473	457
3-YEAR	288	261	395	457

TRANSITION CRITERIA Table 7-7

Transition Alternative	Adverse Impact on Current Members	Cost	Disruption
One-Year	Moderate	Moderate	Low
Modified One-Year	Low	High	Low
Two-Year	Moderate	Moderate	Moderate
Three-Year	Low	Low	High

members in otherwise adversely affected portions of the basic pay table. The two-year option would cost about $113 million less during FY 1994 than the one-year plan, but still about $29 million more than the FY 1994 portion of the three-year option. The three-year option is also $78 million less expensive than the two-year plan in FY 1995. Although the three-year option is the least expensive transition plan, it takes the longest to achieve the benefits of the new structure and keeps the system in a state of flux the longest.

All of the options rely on the annual pay adjustment process. The mathematical adjustments in the pay table require an overall annual increase of at least 3.0 percent. Any lower level will not provide the range of values necessary to adjust all individual pay cells. Recent economic trends indicate that the ECI may drop below 3.0 percent in the near future. If that should happen while we are in the middle of a multi-year transition, it could result in a misaligned pay table with an incomplete, intermediate structure.

It is feasible to implement our near-term recommendations beginning in January 1994. Transition options ranging from one to three years in length have been developed to control costs and prevent current members from experiencing pay cuts. They differ in three ways that are important for policy makers: cost, adverse effects on members, and disruption of the normal pay adjustment process. Generally, longer transitions to the new pay elements have lower costs and less impact on current members, but entail the greatest disruption to the pay process.

The 7th QRMC recommends using a one-year transition to implement our near-term proposals.

The value of completing the transition in a single year outweighs the costs. All disruption and turbulence will be put behind us within a few months, with no possibility of the plan being derailed in a subsequent transition year.

NOTES

1. Save-pay calculations do not take into consideration pay increases resulting from the housing floor. We consider the housing floor, targeted to junior enlisted members, to be necessary for them to procure minimum adequate housing.

2. In the enlisted table, the shading spans the range of average promotion timing across services. In the officer table, the shading represents promotion at the midpoints of the DOPMA windows.

Chapter 8
Issues for Future Review

ISSUES FOR FUTURE REVIEW

INTRODUCTION

At the end of a major study, the investigator typically offers suggestions for further effort. The 7th QRMC Report is no exception. We have four recommendations for follow-on work under the auspices of the Office of the Secretary of Defense (OSD).

First of all, the linkages among the elements of military compensation thwart structural evolution of the system. These linkages should be reviewed, particularly those involving basic pay. Two additional areas that we came upon have near-term policy content. One is to build on and extend a QRMC conceptual framework for compensating a substantially reduced force. The other is to improve understanding of how the recent reductions in retirement benefits will influence recruiting and retention. The final recommendation is more general: to develop an ongoing means to preserve the modeling and other research tools developed by each QRMC, for use during the next review and for application within OSD.

COMPENSATION LINKAGES

The major difficulty facing any meaningful change in the structure of current cash compensation is the relationship among the elements of the existing pay and allowance system. The salient link is between basic pay and retired pay, though there are others of importance (e.g., drill pay to basic pay). One of our recommendations, therefore, is that the DoD evaluate ways to relax the constraints on compensation structure that these linkages impose. The remainder of this section is devoted to amplifying the motivation, rationale, and limits to that recommendation, and (in the broadest terms) sketching some ways of approaching the problem.

The 7th QRMC's review focused on structure, not level. That is, the question was primarily how to improve a system to provide building blocks for specifying individual current cash incomes. Based on the intensive review and major changes to the retirement system in 1985, the QRMC took that retirement system as given. QRMC recommendations for changes to basic pay and the major allowances are based on the continuation rates implied by existing retirement programs. However, in the process of evaluating the structural strength of the allowances, it became clear that linkages between basic pay and retirement should be reviewed. In this regard, we call into question the fashion in which the mechanisms for determining the amount of retired pay impede compensation management, not the retirement system itself.

If the links to basic pay were changed, there are two ways in which the retired pay entitlement could be calculated. First, it could be referenced to RMC (or to expanded basic pay); the Canadian system works something like this. The major barrier to this, as noted in MTS 1, is that it tends to change the relative weights on active duty and retired pay, depending on grade at retirement. The result would tend to be (unless separate retirement terms were specified by grade) gains and losses to individuals or to the Treasury.

The second possibility is a stand-alone retirement table, of the sort used by the United Kingdom. If this avenue were pursued, it would preserve current relationships (and continuation rates), and, of course, have the effect of making retirement visible in detail. To preserve value, such a stand-alone pay table would have to increase annually by the amount of the pay raise (as it does now, as a consequence of the linkage). The 7th QRMC envisions the latter approach.

In any event, the key challenge is to design a compensation system that supports the desired force. The retirement system is a critical part of that system. However, it is its value, not its admin-

istrative details, that governs attraction and retention patterns. Alternative forms, with the same substance, should be sought to facilitate change to a more functional and greatly simplified pay and allowances system.

LONG-TERM DRAWDOWN: IMPLICATIONS FOR MILITARY COMPENSATION

Background

The services face a force reduction of 25 percent, from a strength of 2.1 million members in 1989 to 1.6 million by 1995.[1] At the same time, retention is good,[2] the economy is in recession, and the services may have to force people out.[3] Why, then, should we pay members as much as we do now? The 7th QRMC reviewed this question from a force readiness perspective, first looking at pay for career members, then at pay for new recruits.[4]

The Career Force

In the case of career members, the key consideration is the military's *closed* personnel system. Beyond the entry points for enlisted and officer personnel, the military is confined to its internal manpower pool to fill vacancies. The availability of career members is limited to individuals within the services. Specifically, the number of military members in a given year of service (and, hence, with a given experience level) can be no greater than the number on hand in the previous year with one year less of experience. In the long term, a balanced reduction in force means not only a reduction in the desired number of career members, but also in the pool from which continuing members are drawn.[5] Therefore, the services will need the same continuation *rates* among high quality personnel.[6] Thus, the force drawdown itself implies neither an opportunity for nor advantage to reducing career compensation. Career force sustainment of high-quality personnel during and after the drawdown may well depend on a policy of pay growth commensurate with the experiences of civilian counterparts.

Recruits

In the case of recruits, on the other hand, the applicant pool is the general civilian youth population meeting service entry qualifications. The 7th QRMC applied previously estimated elasticities (measures of responsiveness to pay and other inducements) to estimate the typical change in the level of first-term pay that might be consistent with force reductions of different magnitudes. Important assumptions included the levels of spending on recruiting programs, the responsiveness of recruiting to changes in spending, and forecasts of civilian unemployment rates and population changes.

Recruits are drawn from the population as a whole, through the single entry port in the closed system. This implies that the uniformed services compete for new members—recent high school and college graduates—with other employers. In this case, one can think of the problem as being one of reduced recruiting in conjunction with a potentially stable pool of high school and college graduates. *There is a pay level sufficient* to attract a given person to military service, given that each person has unique tastes, preferences, skills, and alternative employment opportunities. At low pay, relatively few will want to join the military; improve pay and more will be attracted. Aside from the fact that there are some who may not under any circumstances choose military service, the youth population is limited, so there is some point at which additional recruits would not be available at any level of pay.

Recruiting levels also depend on a variety of other inducements, including bonuses, education funds, advertising, and the recruiting effort (number of recruiters, their quotas and other incentives, etc.).[7] Economic and demographic forecasts suggest, if anything, a somewhat more difficult recruiting environment for the mid-1990s and beyond. Cuts have already been imposed on recruiting budgets, especially on advertising.[8]

The upshot is that with proportionate reductions in advertising, education funds, bonuses, etc., one

can expect a less favorable recruiting environment. Thus, while the theory suggests that entry-level pay could potentially be reduced in response to a drawdown, it also cautions us that concomitant cuts in other accession efforts could overcorrect the situation.

Estimates of Entry-Level Pay Changes

We estimated how much the proportion of entry-level pay could be reduced while maintaining high-quality accessions at today's level, given forecasted changes in the civilian unemployment rate and the youth population.[9] We assumed that a force reduction of 25 percent from 1991 levels would allow a steady-state reduction in high-quality accessions of 25 percent as well. If higher quality is desired in a smaller force, then the reduction in high-quality accessions would be less. In addition, we assumed that DoD would reduce spending proportionally in all areas affecting accessions. Table 8-1 lists variables for which elasticities have been recently estimated.[10] Table 8-2 shows results under three different assumptions regarding the long-term reduction in high-quality accessions required.

ARMY RECRUITING ELASTICITIES—1989 Table 8-1

Pay	2.00 *
Unemployment	0.59
Recruiting	0.34
Army College Fund (ACF)	0.14
Advertising	0.05
Population	0.66

* The pay elasticity is an estimate from a survey of the literature (Paul Hogan, unpublished manuscript, 1991).

RESULTS OF REDUCING ACCESSIONS Table 8-2

Reduction in High-Quality Accessions	Change in Pay
25%	-6.2%
20%	-4.2%
15%	-2.2%

Conclusions

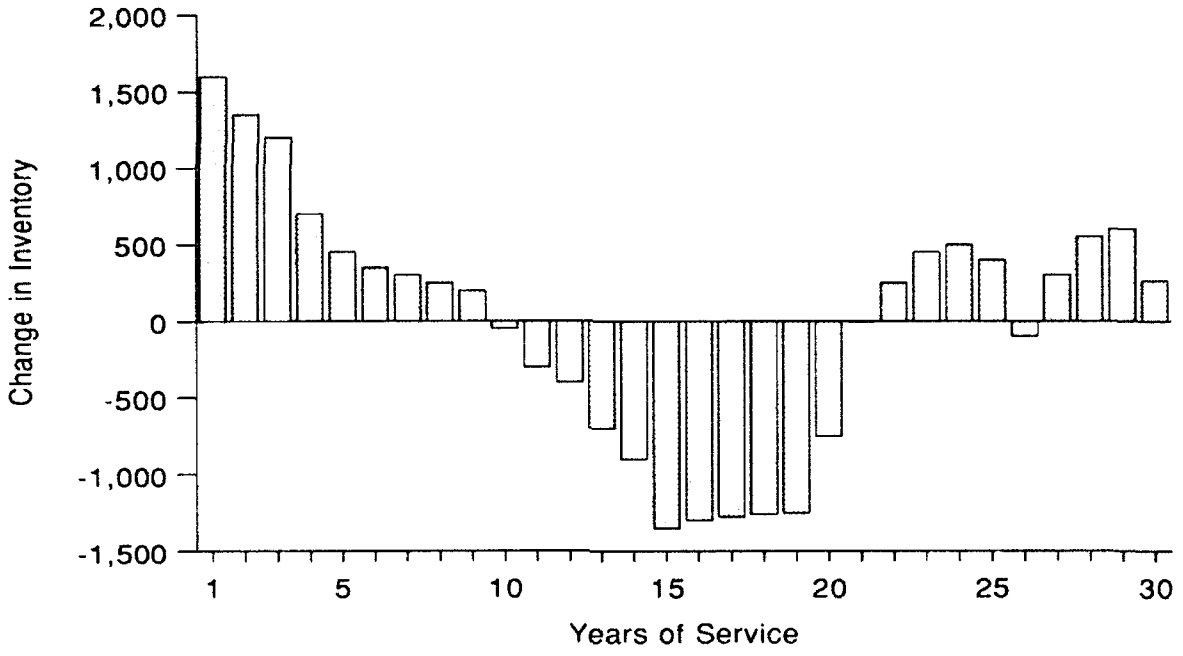
The analysis suggests that while there are theoretical grounds for reducing entry-level pay in response to a sustained drawdown, that conclusion is very sensitive to assumptions and forecasts of other factors. The forecasts and assumptions the 7th QRMC used in the example presented here would support a slowdown in the growth of first-term pay approximately equal to the size of one annual military pay raise. Growth in entry pay should not be retarded based on this kind of analysis alone, however. Not only are estimates very sensitive to assumptions of future events such as the size and permanence of the drawdown, desired quality content of the force, and forecasted unemployment and labor force changes, but also any changes should take into account the likely impacts of actual changes to recruiting programs such as advertising and bonuses. The DoD should develop an integrated policy for accessions encompassing the entire spectrum of management tools.

In contrast, there are theoretical grounds for maintaining the levels of career-force pay through a drawdown. Given a closed personnel system, a post-drawdown experience mix similar to today's implies today's continuation rates,[11] and therefore today's pay levels.

REDUCED RETIREMENT BENEFIT (REDUX)

Effective August 1, 1986, reduced retirement benefit rules, referred to as the REDUX program, became effective. These rules provide for stipends

CHANGE IN STEADY-STATE INVENTORIES UNDER REDUX—DOD ENLISTED Figure 8-1



on the order of 21 percent or more below the levels afforded those currently retiring. When the benefit was reduced, there was no offset provided in any form.

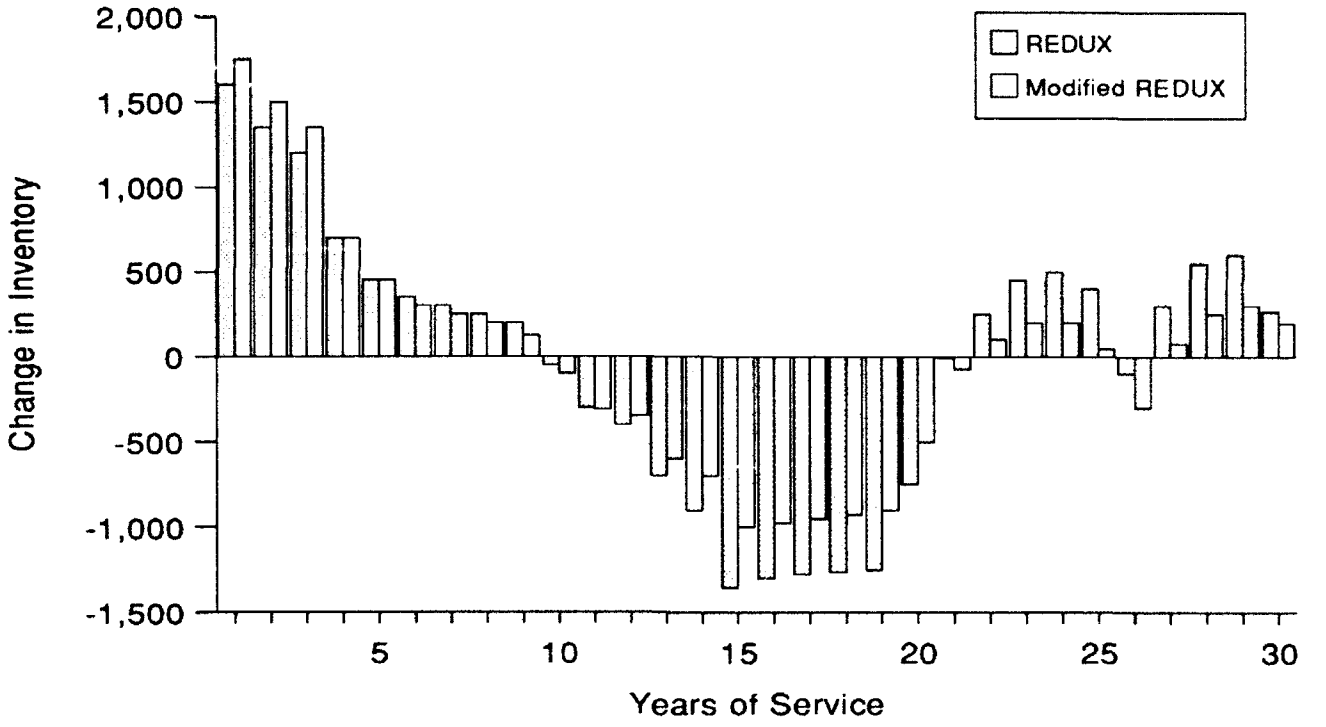
This raises three issues. First, what are the implications of having two individuals who entered the service only days apart, working in the same specialty, unit, and rank, but with dramatically different retirement options, particularly as the vesting point draws near? Clearly, there seems to be some potential for compensation policy to divide the force. Moreover, it would be difficult to offer the REDUX population enhanced current pay as an offset to reduced retirement, for a variety of reasons.[12]

Second, what are the implications for the motivational value of the compensation system? The role of deferred compensation as an element of the incentive structure was pointed out in Chapter 2; what is not clear is the extent to which its substantial reduction will materially influence behavior.

Third, retention will be affected in terms of quality as well as quantity. The analysis below focuses on the quantitative aspects of retention. However, it also offers a possible transition to a system without BAS and reduces the stark cutoff date posed by the current implementation of the REDUX retirement system.

Figure 8-1 illustrates the implications for enlisted retention patterns and force composition implied by the REDUX system, in comparison to the current system. The salient effects are the reduced numbers of midcareer members, leading to increases in the first term population and to some extent to increases in members with more than 20 years of service. These changes reflect the reduced pull of retirement through the midcareer years, and conversely the increased incentive to

CHANGE IN STEADY-STATE INVENTORIES—MOD REDUX—DOD ENLISTED Figure 8-2



continue service after having attained 20 years.[13] Note that these estimates of the impact may be conservative.[14]

The BAS Alternative

An alternative would be to add BAS to basic pay and monetize its tax advantage. This would have the effect of restoring about 5 to 8 percent of retirement losses for members at 20 years of service. However, it poses problems of its own in compensation differentials between adjoining cohorts. Specifically, it would allow REDUX members, while still receiving less retired pay at 20 years of service, to actually retire at higher rates than the high-three population, for 29 to 30 years of service. A way to prevent this anomaly would be to modify the rules governing the percentage of basic pay going to retirement to preserve retired pay levels.

This creates, of course, unintended windfall gains to members who entered the service under earlier retirement plans, and a corresponding increase in cost to the Treasury. Since both of the earlier systems may now be viewed as transitory phenomena, temporizing measures may be most practical. One such measure would be simply to establish independent, temporary retirement tables for these populations, to be updated annually by the same percentage increase as applied to basic pay.[15] These tables would specify the retirement benefit for affected members until those populations had exited the service, and then would terminate.

Conclusions

Overall, this variant eliminates BAS by combining it with basic pay, while simultaneously reducing the compensation differential currently separating adjacent entry cohorts. Benefits include elimination of a questionable allowance and reduction of some of the dependency differential in the current system. They also include partial restoration of midcareer experience content, as shown in Figure 8-2; note that

the earlier qualification regarding the accuracy of the simulation forecasts remains in force.

The costs of the change are, in addition to increased Social Security contributions, increases in pay to members currently living in the barracks and, especially, to retirement costs (compared to the existing REDUX baseline).

MAINTAINING ANALYTIC TOOLS BETWEEN QRMCs

The 7th QRMC used a variety of computer tools and technologies in its analyses. The members of the QRMC invested a considerable amount of time and effort in start-up, investigating potential computer models, evaluating them, and learning their capabilities and operation. Necessarily, because of time constraints, a QRMC is limited to off-the-shelf analytic capabilities. As a result, there could be general value to the compensation community of maintaining and improving force projection and recruiting modeling frameworks on an active basis between QRMCs. These tools would better serve not only subsequent QRMCs, but also DoD's policymaking needs on a day-to-day basis.

The value of this approach is clear. The 7th QRMC benefited at its start from a year's progress in two key areas of RAND research: development of the Defense Employment Cost Index (DECI) and a spreadsheet-based ACOL model. The DECI figured prominently in this report; while the ACOL model's development continued throughout the QRMC, our analysis relied most heavily on a version of the existing OSD ACOL model, updated during the QRMC. In addition, within this QRMC, an officer ACOL model applicable to each service was developed under contract. The upshot is that the 7th QRMC benefited from foresight in this area; and that the recent investment in model development poises DoD for better support of its future policy decisions and of the next QRMC.

The 7th QRMC recommends that DoD maintain and continue development of these models.

NOTES

1. *Report on the National Defense Authorization Act for Fiscal Year 1991*, H.R. Conf. Rep. No. 923, 101st Cong., 2d Sess., § 1116, 159 (1990).

2. The 1990 first-term reenlistment rate was 50 percent; career, 84 percent—DMDC data.

3. Air Force and Army face reductions in force (RIFs), in addition to other involuntary separation measures, according to Deputy Chief of Staff for Personnel (DCSPER) testimony to the Manpower and Personnel Subcommittee of the Senate Armed Services Committee hearing on Manpower Overviews, March 25, 1992.

4. Another question is whether we need to pay members as much *during* the drawdown as we pay now, as opposed to after the drawdown. Because the services wish to maintain quality during the drawdown, it is probably not a good idea to encourage departures by making compensation less attractive. Note that major U.S. corporations, in recent personnel reductions, have attempted to avoid using negative compensation incentives—see Don Lee Bohl, "Responsible Reductions in Force," *American Management Association Report on Downsizing and Outplacement*, (New York: American Management Association, 1987), 24-28.

5. Assuming reductions in force are proportionate across years of service.

6. Those who would voluntarily leave if pay were less attractive are those who perceive better opportunities elsewhere; the supposition is that the individuals who are most productive in the military are also those who expect to be most productive (and hence highest paid) in civilian employment.

7. This discussion is based on the Lawrence Goldberg report, "Recent Estimates of Enlisted Supply Models," submitted to the Office of the Assistant Secretary of Defense (Force Management and Personnel)(OASD(FM&P)), (Reston, VA: Economic Research Laboratory, Inc., April 1991). See also James N. Dertouzos, *Recruiter Incentives and Enlistment Supply*, Rand Report R-3065-MIL. (Santa Monica, CA: The RAND Corp., 1985).

8. *Report on the Department of Defense Appropriations Act, 1992*, H. Conf. Rep. No. 328, 102d Cong., 1st Sess., 52 (1991).

9. Sources: Civilian unemployment rate forecast—Wharton Econometric Forecasting Associates (WEFA), 3rd Quarter, 1991; U.S. population forecasts—U.S. Bureau of the Census, Current Population Reports, Series P-25, No. 1018, *Projections of the Population of the United States, by Age, Sex, and Race: 1988 to 2080* by Gregory Spencer (Washington, 1989), 44-82.

10. Except for the pay elasticity, these are the Army recruiting elasticities reported by Lawrence Goldberg (see note 7).

11. See the 7th QRMC Staff Analyses, GSP B—*The Target Force*, for the 7th QRMC's post-drawdown force structure assumptions.

12. Simulation modeling analyses suggest retention impacts as early as the sixth year of service. It would be equally awkward to offer increased current cash to the REDUX population starting now, given the likelihood that many of the current members, both those pre- and those post-REDUX, will exit the service short of retirement.

13. The increased propensity to continue beyond 20 years of service is principally due to the steeper gradient in the increase in deferred income for continuing: 3.5 percent for each additional year, as opposed to 2.5 percent per year prevailing under preceding systems.

14. The ACOL model simplifies complex considerations by predicating its estimates on the values involved in, in essence, a single future year; that is the year in which the annualized cost of leaving military service is greatest—for a more complete discussion, see the 7th QRMC Staff Analyses, GSP C—*Modeling, Logic, and Theory*. For many midcareer years, this maximum ACOL point appears to be around 28 years of service, when the difference between the retirement systems is modest (it essentially vanishes at 30 years of service). This ignores other years in which the cost of leaving will be quite different from preceding retirement systems, contributing (in an uncertain world) to potentially significant differences in outcomes. Other, much more complex, modeling approaches (e.g., dynamic retention models) would capture this, but at the expense of much simplicity. The significance of this is that it is difficult to determine if the selection of the 28th year of service provides an accurate portrayal of human behavior, or

if the results are to an extent an artifact of the model; on the surface, these problems would appear to contribute toward underestimating the effect of the new retirement system, if anything.

15. The practice of stand-alone retirement tables is followed, e.g., by the United Kingdom; see the 7th QRMC Staff Analyses, GSP A—*Foreign Military Compensation Systems Review.*

Appendix A
Principles of Military Compensation

PRINCIPLES OF MILITARY COMPENSATION

The men and women of the United States Armed Forces are the nation's most valuable defense asset, and their compensation makes up a major share of the defense budget. Yet the Department of Defense has never formally adopted a set of principles to guide compensation policy making. The 7th QRMC presents six principles as guideposts, and their rationales as the criteria, for compensation program development and management. A full discussion of principles is in the 7th QRMC Staff Analyses, GSP F—*Principles of Military Compensation.*

Compensation principles should serve a long-term purpose much like that of military doctrine: a foundation of theory, philosophy, and widely held enduring beliefs to guide both policy and management. Support for written, official statements of principles can be found in studies throughout the public and private sector literature. In 1964, for instance, a Department of Defense Study of Military Compensation noted that private sector enterprises usually stated their compensation concepts as a part of the overall objectives of the organization. The study went on to recommend that DoD's concepts be clearly expressed in writing to ensure compensation is governed by basic considerations, not expediency; to foster uniformity and stability; to inform each employee about the policy; and to check current decisions against long-range goals.

Development of compensation principles should be based both on experience and on logic. The 7th QRMC has drawn both on the work of the 5th QRMC, which offered a set of principles in its final report, and upon extensive research into the fairly substantial body of literature concerning private sector experience. One of the salient findings from this review is the need for compensation systems and personnel systems and policies to act in concert; success requires that they be mutually supporting or at least consonant. Thus, we modified our recommendations to accommodate evolving personnel policies within DoD and the services, to recognize the maturing concept of a volunteer force, and to delineate a clear framework for developing a compensation strategy through the force drawdown for the 1990s and beyond.

Experience and logic suggest that compensation systems and their governing principles be aligned with the organization being supported and facilitate its activities. That is, compensation principles should take into account the nature and operation of the organization being supported, work in parallel with its personnel system, and recognize the environment in which the personnel system recruits and retains its members.

Several quite distinct aspects of military service merit special recognition in this regard. These include acceptance of military discipline, surrender of some personal freedoms, liability to engage in combat, and training under difficult and dangerous circumstances. Modern U.S. military service also requires its members to make frequent moves. Remote assignments and deployments entail substantial family separation, and operational requirements impose long and irregular hours. The technology and tactics of modern warfare change together, mandating the acquisition of new skills and the redesign of force structures.

The nature of the organization and its operations dictate some unique aspects of the military personnel system. The military personnel system by and large has a single entry port, limited to the young; there is no lateral entry. Discipline and operational requirements limit members' options to exit freely. To assure high-quality people in a demanding profession, the system requires its members to advance continuously in grade, skill, and responsibility, or to exit. Taken together, the premium on youth and the up-or-out system threaten every member with the probable transition to an alternative career at midlife. Yet the members' hard-won skills, often

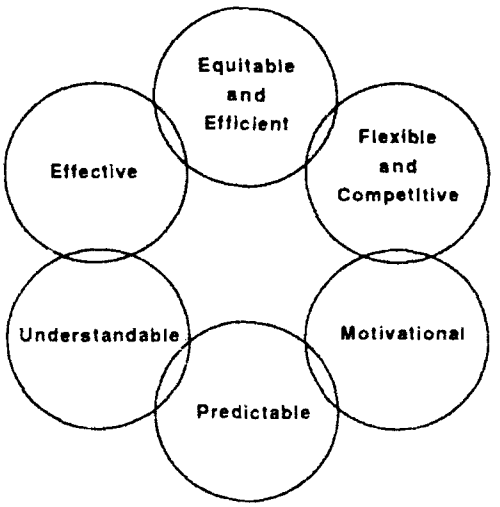
combat-related, in many cases are not fully transferable to civilian employment at the end of a military career. In other cases, skills acquired in the military have immediate and lucrative civilian application.

The military personnel system must, then, recruit high-quality young men and women, train and retrain them in demanding skills, retain many of them over the period of their most productive military service, and then help them make the transition to alternative employment at middle age. This must be done in the context of a pluralistic society where individuals have free choice over occupation, and where there are many attractive alternatives (taking into account both pay and lifestyle) for the individuals most sought after for military service.

The compensation system must recognize the choices available to members and potential members, and offer an attractive compensation package that recognizes these exigencies of service and in particular, the need to make the transition to an alternative career at some future point. Finally, the system must take into account the variability in marketplace demands for military specialties.

Taken together, the above circumstances and requirements suggest the general principles shown in Figure A-1 and explained individually below.

7th QRMC PRINCIPLES OF MILITARY COMPENSATION Figure A-1



PRINCIPLES

Effective in Peace and War

The compensation system must allow for the smooth transition of active, Reserve, and retired forces from peacetime to mobilization status. The system also must be designed to accommodate the rapid expansion and contraction of forces resulting from changes in national security posture.

Equitable and Efficient

The compensation system must be perceived to be equitable by the member and efficient by the taxpayer. It must sufficiently reward the member over a lifetime, taking into account the exigencies of the service. At the same time, it must assure the taxpayer that neither more nor less is being spent than required for a balanced, effective force.

Flexible and Competitive

The compensation system must provide the flexibility necessary to sustain skill and force mix objectives; to compete with the private sector under changing market conditions; and to deal with revised manpower goals that result from changes in mission, technology, or tactics.

Motivational

The compensation system must encourage productivity and reward advancement. Because the military is a closed personnel system whose members perform highly specialized tasks, the compensation system must adequately recognize the value added by experience to force mobilization and readiness.

Predictable

The compensation system, to remain attractive over time, must generally provide the lifetime remuneration promised at the outset of a member's career. Predictability entails both system design at a given time and policy commitment over time.

Understandable

The compensation system should be as easy to understand as possible to foster national support and member commitment. It is important for members to appreciate how the elements interact to guarantee consistent remuneration to balance the unique hardships attendant upon military service.

Appendix B
Service Perspectives

SERVICE PERSPECTIVES

This report reflects the findings and recommendations of the 7th QRMC, acting as an independent body. The process was participative, however, with a continuing and very beneficial liaison with the services throughout the study, via working level, Advisory Panel, and Coordination Council meetings. The autonomy provided by the Assistant Secretary of Defense (Force Management and Personnel) allowed the QRMC to communicate freely with the uniformed services while producing its own objective assessment without requiring, or indeed expecting, full consensus. As part of the review process, the Assistant Secretary sought service and other Coordination Council member comments on the draft QRMC report. These comments again proved very useful.

The service responses indicated strong support for the majority of the key findings and recommendations for change. Note that recommendations for improving the pay and allowances system were well received, including generally the proposed changes to the basic pay table and the revisions to repair BAS. Service response was particularly enthusiastic over the recommendations for improved provisions to deal with regional cost-of-living variations. These include improvements to the housing allowances and the proposal to shore up pay, where it is eroded by non-housing price differences in high cost areas, through a CONUS COLA.

As would be expected in any participative forum, views differ. Those points raised by two or more Coordination Council members, and remaining unresolved, are discussed below, in capsule form. Coverage begins with a tabular summary of the major criticisms by service or other Coordination Council member (Table B-1), followed by a topic by topic synopsis of the services' main points and a brief rejoinder from the QRMC perspective. Noted in the table are those matters on which two or more Coordination Council members had exceptional comments, and which were not revised from the draft.

Service viewpoints are both summarized and documented in detail in the 7th QRMC Staff Analyses, GSP H–*Service Perspectives*.

ANNUAL PAY RAISE ALLOCATION

All the services agreed with the concept of price-based increases to the major allowances (housing and subsistence) and that the proper reference for military pay raises should be the rate of civilian wage increases. They further agreed that the best immediately available reference for civilian pay changes is the Employment Cost Index (ECI). However, they unanimously argued that the ECI should be applied to basic pay, independent of the price-driven change in allowance rates. This is in contrast to the QRMC recommendation that allowances be adjusted based on price changes, and basic pay adjusted by the amount necessary to make the aggregate change in Regular Military Compensation (RMC) equal to the amount implied by the ECI.

The services advance essentially four arguments in support of their position:

- Basic pay, as the cornerstone of military compensation, should have its own identifiable adjustment standard for visibility and clarity.
- There are risks of reduced pay raises in periods of high inflation, and politically untenable basic pay raises in periods of low inflation.
- It would make the basic pay raise in part dependent on the rate of increase in food and housing prices.
- Cycles in food and housing prices could induce cycles in drill and especially retired pay.

SERVICE EXCEPTIONAL RESPONSES

Table B-1

RECOMMENDATIONS	SERVICES							JOINT STAFF	ASD (HA)	ASD (RA)
	USA	USN	USAF	USMC	USCG	NOAA	USPHS			
1. Vision of the Future a. Continue present system with modification b. Pursue evolutionary simplification c. Consider modifying pay-element linkages	✓		✓					✓		✓
2. Basic Pay Restructure table			✓	✓						
3. Basic Allowance for Subsistence (BAS) a. Single, cost-based rate for all members b. Standardize administration c. Eliminate surcharge except during TDY	✓	✓		✓						
4. Housing Allowances a. Combine BAQ and VHA, base unified allowance on price b. Revise rate-setting methodology c. Interim measures: 1. Price-based adequacy floor 2. Base selected rates on external price measures d. Eliminate the 50-percent offset e. Eliminate BAQ minimum f. Full allowance to Reservists on active duty										
5. CONUS COLA Establish CONUS COLA with a 5-percent threshold										
6. Other Allowances a. Periodically review and adjust fixed-rate allowances b. Phase out partial BAQ c. Revise BAQ-related rates										
7. Special and Incentive (S&I) Pays a. Classify S&I pays into three categories for management b. Develop an officer continuation bonus c. Establish cost-benefit methods for setting rates d. Review incentive pays annually e. Restore hazardous duty pay value, review quadrennially f. Repeal two unused pays; restructure another										
8. Annual Pay Adjustment a. Use ECI for adjustment; develop DECI b. Apply annual pay raise to RMC	✓	✓	✓	✓	✓	✓	✓	✓		✓
9. Integration and Transition Transition to near-term proposals in one year										

While cognizant of the service arguments, the QRMC believes the annual pay raise should be applied to RMC, for the following reasons:

- RMC is the measure of military pay that corresponds closest to the concept of civilian salary that is measured by the ECI; by adjusting RMC at the same rate as civilian wage growth, overall relative cash compensation will be maintained.
- Achieving comparability consistently in a pay and allowances system implies price-based allowances and wage-driven RMC.
- Prices and wages tend to move together; cycles to the contrary are unusual and should not form the basis of a policy decision.
- On the whole, wage increases are driven by productivity increases; generally, wage growth has outstripped inflation in the U. S. economy, and it is unlikely that service members would be disadvantaged by systematic increases in the weighted average of food and housing costs that are greater than the rate of increases in wages.

PAY ELEMENT LINKAGES

Two services, and two other Coordination Council members, objected to a review of the linkages between basic pay and the retirement system. While there was some variation in the details of their arguments, the gist of the issues was two concerns: that retirement ought to remain linked to active duty pay and that the retirement system, recently itself substantially modified, ought not to be further reviewed now.

Generally, the QRMC views on the retirement system are in agreement with those of the Coordination Council. Performance and productivity during active service ought to be reflected in the level of retired pay. Further, one should have serious reservations about revising the retirement system in the near future. First, the services are currently undergoing significant and painful personnel reductions. Experience (both of the military and of the private sector) suggests that cuts of this magnitude are very likely to engender future morale and continuation (retention) problems. Adding to that turbulence a substantive reevaluation of one of the major incentives for a military career would be unwise. Moreover, the current arrangement is the result of a carefully crafted balance between career content and cost.

There is no reason, given the balanced nature of the force reduction, to revise that work so soon after its completion. Indeed, the QRMC recommendations for changes in the pay and allowances system are predicated on force experience levels and quality mixes that would result, given the existing retirement system.

However, the QRMC does find it necessary to point out how the interdependent nature of the compensation system shapes structural alternatives.

BASIC PAY RESTRUCTURE

Two services objected to the insertion of a 28-year longevity step increase for senior officers and NCOs, on the grounds that it would reduce pay that would otherwise accrue earlier, that there are no significant retention objectives at the 28-year point, and that it would reduce incentives for the most able officers and NCOs.

The QRMC did not suggest the 28-year longevity step to address retention problems but rather to reduce the tendency of the current table to produce "clustered" retirements at the 26-year point. While the QRMC-recommended structure will tend to facilitate the current drawdown in comparison with the existing pay table, it is a part of a comprehensive revision to the pay table, to make it more robust under most circumstances; it is not intended as a short-term, force-shaping tool. Finally, increased senior officer and NCO pay at the 24-year point preserves or improves the incentives for most people advancing rapidly through the ranks.

BAS RATE REVISION

Two services objected to reducing officer basic pay to fund the increases necessary to raise officer BAS to the level of food costs. They cited two reasons: first, that it would (slightly) reduce officer retired pay, and second, that officers were now paying part of their food costs out of basic pay, so the difference should be restored. A third objected to the fashion in which the QRMC added money to enlisted basic pay to offset reductions in BAS to that corps.

The QRMC designed the cost-based subsistence allowance and the transition to it such that the increase in cash income while on active duty will more than compensate most officers for any implied "reduction" in retired pay. Second, the transition was designed to preclude anyone from experiencing an actual reduction in retired pay entitlement. Third, under current fiscal constraints, any serious proposal must be close to cost neutral; the QRMC proposal meets that objective. A net increase in officer RMC would be an unnecessary expense as would an increase to enlisted RMC.

Glossary of Acronyms and Abbreviations

GLOSSARY OF ACRONYMS AND ABBREVIATIONS

This list includes items found in this report and in the 7th QRMC Staff Analyses as well as others that may be encountered in military compensation literature.

AAFES: Army and Air Force Exchange Service

ACCP: Aviation Career Continuation Pay (traditionally, *AOCP*)

ACIP: Aviation Career Incentive Pay

ACOL: Annualized Cost of Leaving

AFB: Air Force Base

AFQT: Armed Forces Qualification Test

AHS: American Housing Survey

ANG: Air National Guard

AOCP: Aviation Officer Continuation Pay (see *ACCP*)

ARNG: Army National Guard

ASD: Assistant Secretary of Defense

BAQ: Basic Allowance for Quarters

BAS: Basic Allowance for Subsistence

BLS: Bureau of Labor Statistics

BMC: Basic Military Compensation

BP: Basic Pay

CES: Consumer Expenditure Survey

CHAMPUS: Civilian Health and Medical Program of the Uniformed Services

CRNA: Certified Registered Nurse Anesthetist

COLA: Cost-of-Living Allowance

CONUS:	Continental United States
CPI:	Consumer Price Index
CPS:	Current Population Survey
CPSI:	Current Population Survey Index
DAA:	Dependents Assistance Act of 1950
DECI:	Defense Employment Cost Index
DIC:	Dependency and Indemnity Compensation
DLA:	Dislocation Allowance
DMC:	Defense Manpower Commission
DMDC:	Defense Manpower Data Center
DOPMA:	Defense Officer Personnel Management Act
DoD:	Department of Defense
DoT:	Department of Transportation
DSMR:	Daily Sale of Meal Rate
ECI:	Employment Cost Index
FEPCA:	Federal Employees Pay Comparability Act of 1990
FFRDC:	Federally Funded Research and Development Center
FHA:	Federal Housing Administration
FICA:	Federal Insurance Contributions Act
FITA:	Federal Income Tax Advantage
FMR:	Fair Market Rent
FSA:	Family Separation Allowance
FY:	Fiscal Year
GAO:	General Accounting Office

GI:	General Issue; Government Issue
GS:	General Schedule
GSA:	General Services Administration
GSP:	Global Support Paper (a category of 7th QRMC Staff Analyses papers)
HA:	Housing Allowance
HALO:	High Altitude-Low Opening
HFP:	Hostile Fire Pay
HHG:	Household Goods
HHS:	(Department of) Health and Human Services
HUD:	(Department of) Housing and Urban Development
JSHAS:	Joint Services Housing Allowance Study
JTR:	Joint Travel Regulations
JFTR:	Joint Federal Travel Regulations
LES:	Leave and Earnings Statement
LMHC:	Local Median Housing Cost
MHA:	Military Housing Area
MHCI:	Military Housing Cost Index
MPI:	Military Pay Index
MSA:	Metropolitan Statistical Area
MTS:	Major Topical Summary (a category of 7th QRMC Staff Analyses papers)
MWR:	Morale, Welfare, and Recreation
NCO:	Noncommissioned Officer
NMHC:	National Median Housing Cost
NOAA:	National Oceanic and Atmospheric Administration (U.S. Department of Commerce)

NSLI:	National Service Life Insurance
OASD:	Office of the Assistant Secretary of Defense
(FM&P)	Force Management and Personnel
(HA)	Health Affairs
(RA)	Reserve Affairs
OASDI:	Old-Age, Survivors, Disability, and Health Insurance Program
ODASD:	Office of the Deputy Assistant Secretary of Defense
(MM&PP)	Military Manpower and Personnel Policy
OHA:	Overseas Housing Allowance (Station Housing Allowance authorized by 37 U.S.C. § 405(b)—also found as SHA (Station Housing Allowance))
OMB:	Office of Management and Budget
OSA:	Overseas Station Allowances (the per diem allowances authorized by 37 U.S.C. § 405(a))
OSD:	Office of the Secretary of Defense
PATC:	Professional, Administrative, Technical, and Clerical (survey)
PCMC:	President's Commission on Military Compensation (*Zwick* Commission)
PCS:	Permanent Change of Station
PDTATAC:	Per Diem, Travel and Transportation Allowance Committee (OASD(FM&P))
PHA:	Price-based Housing Allowance
PMA:	Personal Money Allowance
PMSA:	Primary Metropolitan Statistical Areas
PPBS:	Planning, Programming, and Budgeting System
QRMC:	Quadrennial Review of Military Compensation
REDUX:	The retirement system for members who first joined a uniformed service on or after August 1, 1986
RMC:	Regular Military Compensation
ROPA:	Reserve Officer Promotion Act

ROPMA: Reserve Officer Personnel Management Act

ROTC: Reserve Officer Training Corps

RSFPP: Retired Serviceman's Family Protection Plan

SBP: Survivor Benefit Plan

SES: Senior Executive Service

SGLI: Servicemen's Group Life Insurance

SHA: Station Housing Allowance (see OHA)

S&I: Special And Incentive (pays)

SRB: Selective Reenlistment Bonus

TAD: Tax Advantage

TDY: Temporary Duty

THA: Total Housing Allowance

TIG: Time in Grade

TIS: Time in Service

TLA: Temporary Lodging Allowance

UPH: Unaccompanied Personnel Housing

USA: United States Army

USAR: United States Army Reserve

USAF: United States Air Force

USAFR: United States Air Force Reserve

U.S.C. United States Code

USCG: United States Coast Guard

USCGR: United States Coast Guard Reserve

USDA: United States Department of Agriculture

USMC: United States Marine Corps

USMCR: United States Marine Corps Reserve

USN: United States Navy

USNR: United States Naval Reserve

USPHS: United States Public Health Service

VA: Veterans Administration

VGLI: Veterans' Group Life Insurance

VSI: Voluntary Separation Incentive

VSLI: Veterans' Special Term Life Insurance

VHA: Variable Housing Allowance

WHS: Washington Headquarters Services

WO: Warrant Officer

YOS: Years of Service

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