



INSTITUTE FOR DEFENSE ANALYSES

**2004 Defense Economics Conference:
Informing the Debate on Military Compensation**

Stanley A. Horowitz, Project Leader
Ayeh Bandeh-Ahmadi, Conference Coordinator

Speakers/Panel Members:

Richard P. Burke	Douglas Holtz-Eakin
William J. Carr	Ken Krieg
David S. C. Chu	Michael Lofgren
Vern Clark	Jerome E. Pannullo
Michael L. Dominguez	Bernard D. Rostker
Gordon R. England	Cindy Williams
Glenn A. Gotz	John D. Winkler
Henry Hinton	

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PREFACE

The Institute for Defense Analyses (IDA) prepared this document for the Office of the Director, Program Analysis and Evaluation, under a task titled “Defense Economics Symposium.” This document partially fulfills the task objective by documenting the proceedings of the Defense Economics Symposium that IDA annually organizes and conducts in cooperation with the sponsoring office. The 2004 conference was held at IDA on June 9, 2004.

This document did not undergo formal technical review. The conference proceedings were recorded, transcribed, and edited for clarity before they were reviewed by the participants for accuracy. IDA would like to thank Belinda D. Lomax, court reporter, for her careful transcription of the proceedings.

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I. INTRODUCTION

DR. RICHARD P. BURKE (Deputy Director, Office of the Secretary of Defense, Program Analysis and Evaluation/Resource Analysis): Good morning. I would like to welcome you all here today. Today's topic is military compensation, and is highly timely and relevant. Again, welcome to IDA. Let's get on with the conference. Stanley.

MR. STANLEY A. HOROWITZ (Assistant Director, Cost Analysis and Research Division/Institute for Defense Analyses): I'm Stan Horowitz. I have been the IDA coordinator for this conference. I just want to make a few administrative and perhaps expletory remarks. [Mr. Horowitz's explains the location of the rest rooms, the need to be escorted, the procedures for leaving the building's garage, and the use of the telephones.]

We have distributed question cards with the conference material. If you have got a question for any of the speakers or any of the panelists, please write it down noting which session it pertains to. We will have people watching to collect the cards and present them to the relevant speaker or panel chair. You can submit questions before a session begins and we will hold them until the relevant session.

If during the session we run out of questions, the session chair may well ask for informal questions from the floor. That's fine. That's up to them.

I'm sure you have noticed that we've distributed Cindy Williams' new book, *Filling the Ranks*, as part of the conference materials. We think its recent release is quite serendipitous, raising many of the issues that we wanted to discuss today. That's why we have given it a place of prominence.

I'd like to take this opportunity to thank Cindy both for the book and for agreeing to participate in the conference and for giving us free copies to distribute to everybody.

I'm sure you also noticed we distributed purple clipboards like this one [indicating]. In part, that was because we didn't have enough space in the room to give everyone a table to put their stuff on, but we also thought that purple was the appropriate color to emphasize the nondenominational nature of the conference.

Please remember we're having a reception at the end of the day. We will have wine and hors d'oeuvres. We hope that you will be able to avail yourselves of the opportunity

to assess still more on military compensation and perhaps just to renew old acquaintances.

If you have any questions during the day, please feel free to ask me and I will try to help. I think, now, Ken Krieg is going to kick the conference off.

II. WELCOME AND KEYNOTE ADDRESS

MR. KEN KRIEG (Director, Office of the Secretary of Defense, Program Analysis and Evaluation): Thanks. My welcome as well. I'm thrilled that 60 people would show up out in the middle of Virginia to talk about military compensation.

I thank both Cindy for the book and for adding to this debate because this is a debate that most of Washington doesn't want to have. I think we'll see, as the day goes on, the economics of it are such that we must have this debate.

Our challenge today, I think, is building on the all-volunteer conference five or six months ago that many of you attended and that framed some of these issues. I hear rumors that someone in our room may be working on a fall discussion of this.

I think momentum in this is an important issue. It will be incumbent upon us as analysts to raise this issue in a way that policy-makers can deal with it.

I'd like to thank IDA for providing a lot of the support for this. In particular, I'm really sad that Stan Szemborski can't be here because I think this room would remind him of his days on submarines. We'll send him a note by Blackberry to say we're all feeling for him today. He's out in Monterey with blue sky and beautiful surroundings.

Before I introduce today's keynote speaker, I want to first lay out why we're having this conference, and, secondly, what some of my concerns are in this, and to introduce our speaker. PA&E does this once every two years if we get the energy to do it.

As we began to look at this issue about six months ago, and we were considering topics, we ultimately settled on this topic, I think, for three reasons.

One, the fully loaded cost of manpower is growing rapidly. It is the only consistently growing part of the defense budget, yet managers throughout the Department of Defense act as though uniform manpower is free. I'm a historian, but I pretend to be an economist when I come into rooms like this. As we all know, that's not exactly how you see things. That's how historians read economics textbooks. But that reality—that the price of the good that is growing rapidly is disassociated from how people deal with things—is a huge issue.

The second is we have plenty of advocates in our political system that are all for the next unit of benefit and the next benefit idea, but there is really very little true understanding of whether that benefit is creating the outcome that we seek. I think we'll see today that we are really in that era at the first part of the twenty-first century.

The third one, the one most concerning to me when I think about costs and benefits, is that the skills and competencies necessary to fight the nation's wars in the twenty-first century are changing very rapidly, but yet our compensation system is firmly rooted in a structure that was designed—you all will argue when—but certainly in an era different than today. Whether that system will produce the thinkers, leaders, warriors of tomorrow that we need is, at best, unclear.

As we go into this, and I will come back later to give thoughts, but there are kind of four broad questions. First, as defense managers, should we be concerned about growth in personnel costs, and if so, what should be done about it? Second, how do we know if we are doing a good job of managing human capital? We have some records about retention—and David Chu, who will speak to us later, is doing a lot to work with that—but clearly we have to work in that area. Third, does the compensation system or scheme support the core structure and skills mix that we're going to need, and is it flexible enough to provide for those changes in structure over time? Fourth, are we providing those benefits in the most cost-effective way so that we really drive the kind of behavior that we want to overcome?

With that as an opening, I will exit by introducing our keynote speaker for this morning. When I go through his resume, it gives me hope that someone who has professional attention deficit disorder as I do can survive over time.

Our keynote speaker has spent more time thinking about these and related personnel issues from a variety of different angles than most of the people in this country. We're very pleased to have him.

Bernie Roster is a distinguished military graduate of New York University where he was commissioned in the Army Reserve. He also went on to achieve master's and doctorate's degrees from Syracuse University. He began his work in the Department of Defense in the Manpower Requirements Directorate of the Office of the Assistant Secretary of Defense for Systems Analysis and, therefore, he's required to come back for the PA&E Conference. In 1970, he moved over to [the] RAND [Corporation] as a Research Economist and Director of Manpower and Personnel Training Programs working on Air Force issues, among others. In 1977, he returned to Government service

as Assistant Secretary of the Navy for Manpower and Reserve Affairs. In 1979, he became the Director of the Selective Service, where he formulated the Selective Service Revitalization Plan.

In 1981, he moved to CNA [Center for Naval Analyses, now the CNA Corporation or CNAC]—now across the street—as Director of the Navy’s management program, and later went back to [the] RAND [Corporation] to establish the Army’s studies and analyses center, the Arroyo Center. In 1994, he returned to Government service again as the Assistant Secretary of the Navy for Manpower and Reserve Affairs. In this position, he was also named a Special Assistant for Gulf War Illnesses. In 1998, he became the 25th Under Secretary of the Army. Following that tour, Bernie went on to become the Under Secretary of Defense for Personnel and Readiness. Since leaving Government, he’s gone back to [the] RAND [Corporation] and continued his work on military manpower issues. Obviously, as I said, he’s looked at this from many of the different chairs and we’re looking forward to his thoughts today to really open the conference and set the energy for the challenge we have got ahead of us.

Bernie, thank you for coming. The floor is yours.

DR. BERNARD D. ROSTKER (Senior Fellow, RAND, Former Under Secretary of Defense, Personnel and Readiness): Many years ago there was a conference on the draft at the Hoover Institution. Charlie Moskos applied the words from “Casablanca” as “round up the usual suspects.” Well, I think I see all of the usual suspects in this room, so I really don’t need to say anything else. I will throw out Code Number 27 and you will know exactly what I’m talking about.

Let me say when Stanley asked me to be the keynote speaker, I was quite honored but I need to be truthful. It was not the honor I was looking for, but the opportunity to recruit you to join the revolution. I ask you today, as all potential revolutionists, hopefully by the end of the day you will go forth and carry the banner of the revolution. I want nothing less from you than your full commitment to join me in turning over the current, outmoded, inefficient, inequitable, and antiquated personnel system.

In recent years, the military has been subject to a revolution in military affairs and a revolution in business affairs. These efforts have transformed the military in the way we fight and procure equipment. This revolution has brought modern technology and organizational practices to the Department of Defense, unfortunately, to be employed by people whose careers are structured by a set of statutes, rules, regulations, and compensation structures largely put in place at the end of World War II. It is a system

designed to correct the abuses of the seniority system in place in the Army before World War II and to provide for the mass immobilization of forces to defend Western Europe in the event of an invasion by the Soviet Union.

Today, the Soviet Union is gone. Today, we no longer plan for a mass mobilization and the hordes of Soviet troops are not pouring across into the German border, but the basic post-World War II personnel system lives on. It's a system better suited for the 1940s or the 1950s than for the world in the twenty-first century.

Today, we need no less a revolution in military personnel. Times have changed and the military career has not changed very much. In 2000, the personnel task force put it this way: "Shaping and sustaining a total force of flexible capabilities will require a creatively thoughtful and dynamic approach. Unless the Department makes changes in the personnel and compensation system, the force will be unprepared for twenty-first century needs. Quality people will not stay in sufficient numbers and those who do will lack necessary skills and experience. A new system is needed, one unlike any DOD has seen before."

But why has the personnel system not reformed itself over the last number of years? Richard Danzig, the former Secretary of the Navy, often spoke about how difficult it is to change mature institutions that, in the eyes of their leaders, are not in crisis and, in the eyes of their leaders, appear to be doing well.

Such is the case in the military personnel system. The current generation of military personnel who have been charged with managing the system have worked their entire professional lives under a single system. They know the rules. They know how to manipulate the system, and they know the parameters from which they can operate. They know how complex and interactive the system is, connected as it is to compensation, tenure, promotion. They are not very certain about what changes to make or how those changes will impact people in the institutions they now are familiar with.

Service members have structured their lives around the expectations of when they will be promoted, when they will retire, how much they will earn, and what constitutes success. For them, thinking out of the pocket is impossible.

Professional personnel managers are charged with working within the box. At best, they press on the sides of the box with little effort to explore alternatives outside of the box. Hopefully this conference will give us an opportunity to consider what lies outside of the box.

Now, there is an early recruit to this revolution in personnel affairs, and that was Donald Rumsfeld. He is the first secretary sworn in the twenty-first century, but he also was the Secretary of Defense during the Ford Administration, and before that, a congressman from the 13th District in Illinois.

In an event he still remembers to this day, because we have talked about it, he described to me how, as a young congressman in 1967, he went before the Senate Armed Services Committee and its chairman, Senator Russell, and asked the Congress to “declare its intention to establish a voluntary military and conduct the necessary investigations and studies to determine the best means to establish such a force.” This is 1967.

In due regard to Congressman Rumsfeld’s request, Congress voted a full four-year extension of the Selective Service and thought the all-volunteer force a pipe dream. Well, Rumsfeld was a visionary then and I dare say he’s a visionary today.

In 2001, upon becoming Secretary of Defense for the second time, he immediately focused on three personnel issues as important for the future efficiency of the military. He expressed dismay that officers’ assignments were so short, that the amount of time an officer spends on a given job being what he was focusing on, and argued that officers did not become proficient given this kind of assignment pattern.

He complained that outstanding senior enlisted members and officers who had risen to the highest levels of command responsibility in their field were being forced out by mandatory retirement rules at an age when they would be considered, in the private sector, just entering their prime.

He explained that neither of these personnel practices embodied the law and regulations or policies that anyone in the private sector would allow. In addition, “jointness” would become the keynote of his administration. Jointness impacts the personnel system through the provision of Goldwater-Nichols. For an officer to be competitive for selection to flag a general officer’s grade, he or she must serve in various positions, joint positions, positions that are characterized as or coded as joint.

The joint requirements have added to the already demanding professional experience, career content, if you will, an officer must master throughout his career. It often has been suggested that Goldwater-Nichols adds five years of career content to an officer’s career without extending that career for a single day.

The results of Goldwater-Nichols has been that fast track officers often know more about the joint world than they know about the world that they are coming from, their individual services. We have, in the current Chief of Naval Operations, a chief who has held a senior position on the joint staff but had not worked as a staff member on the CNO staff, his own staff.

Now, at this point you might ask what all of this has to do with the purpose of this conference, which is compensation. I would submit that logic demands that we consider the kind of military force this nation needs before we consider the compensation system.

The clear goal of the compensation system is to attract, retain, and motivate people to join, to stay, and to perform. This can only be understood in terms of the desire for structure. If you look at Kenny's questions that he discussed—asked, "How do we know if we are doing a good job?" and there lies the issue of core structure. If we don't know the kind of core structure we want, then we will never be able to say whether the policies we have will attract, retain, and motivate the required people. When Congress and the DOD in the past have addressed major changes, like the Gates Commission, they did look at the personnel implications.

In 1979, the chairman of the President's Commission for Military Compensation, Charles Zwick, originally argued that the commission's work was not related to the design of the personnel system. He came to understand that changes in the compensation system would in fact impact the personnel system.

In their final report they noted "the retirement system supports the promotion system in two ways: It stimulates, through voluntary retirement, sufficient losses to ensure adequate promotion flow and it compliments the upper officers by providing for mandatory retirement for those not promoted to the next higher grade at a certain point in their career."

In effect, the first step of considering compensation is a clear understanding of the desired core structure the military needs for the future. If understanding the core structure and personnel system is the first step, the selection of a compensation mechanism that is acceptable to members is the second step.

Over the last half century, there have been nine QRMCs, Quadrennial Reviews in Military Compensation; a congressional commission, the Defense Manpower Commission; and a presidential commission, the President's Commission on Military Compensation. Each time, the results of these commissions and studies have foundered on the issue of the nature of the compensation system.

In general, the military services have supported the status quo. They have argued for traditional pay and allowance systems, saying that this strengthens the notion of the military as an institution.

The point of view promulgated by civilians who formed the commissions and who were in favor of more efficiency, as Ken argued this morning, has generally favored a salary system. The former, the military view, tends to be backed by sociologists. Economists—and I truly say many in this room—have backed the latter.

In fact, this is a false dichotomy because, in reality, we have a mixed system. Nevertheless, IO Theory has dominated the thinking of many in the military, and I believe it is responsible for the rejection of the recommendations of almost all of the studies and commissions that have gone before.

Note that since the President's Commission on Military Compensation, no major study has taken on the big issue of the nature of the compensation system. They have generally been satisfied with making small changes around the market, although many of these changes have been significant.

In the one day of this conference, I suggest you focus on the first step, trying to understand what kind of military we want for the twenty-first century. That is particularly timely given the realities of Iraq.

As it turns out, we have a personnel system largely designed for garrison, for the steady regulation of our troops, for the assignment of our troops and promotion, and we have not adequately thought through the implications of going to war on the compensation side, but more importantly on the design of our forces.

I must admit that I'm not optimistic that you can make much progress on the issue of the efficiency of the present compensation system where nine department studies and two external commissions have failed. But if you could make progress in one day, it would truly be a remarkable accomplishment.

Now, if I'm correct that we need to give some consideration to the structure for the twenty-first century, I have some ideas for you to chew on. You can find a version of these ideas in Cindy's book. Those who have been familiar with my rantings for the last 20 years will find nothing new in what I'm going to tell you.

I would like to see changes in the retirement and tenure rules and see a system that has elements of the system that was discussed by the Defense Manpower Commission and the President's Commission on Military Compensation. One of the curses of being

around as long as I have been is I can remember the Defense Manpower Commission and the President's Commission on Military Compensation. In the final throes, God willing, of a history of the all-volunteer force, I had the good fortune to be able to go back and relearn the lessons from those bodies. What I would like to see is a competitive up-or-out system in the junior grades and a transition to a career force with a very stringent selection rate, perhaps as low as 30 percent.

Once in the career force, [I would like to see] an expectation that they [recruits] would serve for a full career. Not a full career in the military sense but in the sense that anybody else in this country understands, well into their 50s. Longer tenure and higher remuneration should encourage those selected and who choose to join the career force to stay for a full career.

Competitive packages need to be structured to motivate people to stay and encourage those with a limited potential for future service to leave. Limited compensation selection may be used to re-enforce the competitive nature even in this career force. That would be the stick, but challenging jobs, higher pay would be the prime way of motivating people to stay in the career force, and that would be the carrot.

Those who are asked to leave the career force, as well as the junior officers who would not be selected, would receive severance pay and an old-age annuity based upon ERISSA standards. Both of these were recommended by the President's Commission on Military Compensation and by the Task Force of the Defense Science Board.

All of what I have said highlights the issues that Secretary Rumsfeld has raised. Smaller careers and smaller [numbers of] more selective senior officers are the salient features of my recommendations and his concerns.

As a result, the breadth of assignments would include more than joint assignments losing the expertise necessary to manage one's apparent service. The recommendations put new emphasis on experience and performance without losing the previous focus on youth and vigor, but experience and focus would be elevated to a higher level of importance, reflecting both human conditions we find in the beginning of the twenty-first century and the needs of a complex military in the post-industrial information age.

As information is substituted for troops on the ground and forces in being, and as greater situational awareness impact the design of combat formation and new equipment, the management of information becomes the new force multiplier.

Once officers are identified and selected for higher commands who can master the new world of jointness and information, it makes little sense to force them to retire in their late 40s or early 50s based on a model of human endurance, performance, and job complexity that was built in an industrial age of mass armies well before the information revolution.

Thinking in the abstract about the ideal personnel system and profiles is very difficult. However, I would submit that it is relatively easy compared to the challenge of charting a path to move from one system to another. In such a case, some people will do well and some people will do poorly. Changing expectations, some will find the changes to their liking and others will not.

I would have to tell you that the record of the military services is uneven in terms of implementing transitional policies, even transitional policies where the leadership has passed to Congress. But I would submit that reform and transformation are all about the long-term. Hard choices have to be made.

It is possible to design a series of transition policies that allow for change and treat fairly those caught up in the change even as old expectations are altered. In the final analysis, reform will not only take a deep understanding of the personnel system and how it works, but the willingness to make the hard decisions necessary to implement change.

At the end of today, after you have explored the needs of the twenty-first century, I will ask you to join the revolution. I'm thrilled to say not only has Secretary Rumsfeld been a charter member of the revolution, but so has David Chu.

I fully endorse the Administration's legislative initiative to change the way flag and general officers are managed. However, this is just the first battle in the revolution, the revolution of the military personnel system.

What I want to know is whether we can count on you to carry the banner and join the revolution. Thank you very much.

MR. HOROWITZ: Do you want to take questions?

DR. ROSTKER: Sure.

MR. HOROWITZ: I have a question. One, naturally I am ready to sign up for the revolution. It seems to be the model that you have put forward is kind of oriented toward officers. I think it's relevant for enlisted but with modifications. Do you have any thoughts about that?

DR. ROSTKER: It's relevant for enlisted with modifications. I think that's exactly right. I have spent more time thinking about officers than enlisted, but I would tell you at the senior enlisted ranks, much of the same transpires. Maybe the added problem is that for really fast burners, you can make master chief petty officer in 15 years. When we see guys doing that, they leave in 21 years because they reach the top and there is not very much more.

One of the things Eileen has worked on is an additional pay grade, but that needs to be worked out in terms of roles and responsibilities but we certainly can put additional compensation in. Ending the focus where they are and having the tenure limitations makes no sense. The logical thing for somebody hitting 20 years of service is to retire in either force and get started on that second career because the possibilities of making flag or staying more than your late 40s is so low. We need to change that. We need [you] to be in service based upon your contribution, not upon your chronological age.

But I completely agree. I think some further work certainly would have to be done in terms of the combat forces, as well as support forces particularly, Stanley.

FROM THE AUDIENCE: The enlisted force in peacetime, what do you think about overtime pay?

DR. ROSTKER: Anything that ties effort to compensation is good. The problem has been selling that to the senior enlisted advisors as spokesmen for the enlisted force who see a desire to have everyone in a given pay grade, regardless of responsibility, paid the same thing.

You have my endorsement, but is Sergeant Lee here? Are you signing up for that, Sergeant?

LEWIS LEE (Senior Marine Specialist, CNA Corporation, USMC, Retired): Got to think about it.

DR. ROSTKER: He'll keep you honest. I often say this, and don't get it wrong, but in a sense, the last great communist society is our military because throughout the ranks, we want to pay according to, not the ability, but according to the commonality of the grade thinking this builds institutions. That's a bill that has been sold by our sociologist colleagues but it has gone over well with the uniform side.

FROM THE AUDIENCE: I can think of one example. When recruiting gets tough, the recruiters work long hours, 50, 60, 70 hours a week and are paid a big salary. I think

that puts a lot of pressure on them. I think it's something to consider in situations like this.

DR. ROSTKER: I don't disagree with that.

FROM THE AUDIENCE: You have mentioned transitioning to a longer-term career force. Is there any concern that such a transition would make it more difficult to change the forces later on without the ability to bring fresh blood to the top of the chain?

DR. ROSTKER: I'm talking about a much more stringent selection into the career force. Today, the cuts for lieutenant colonel are not very high, and that gets you 27. I'm sending most of the junior officers home and maintaining, in the system I would have, a limited selection out to keep the force current.

I think a broader question is do we have enough distinguishing features in the junior years to be able to pick the winners of this career lottery because the nature of the job changes. In the junior years, you're company commanders and combat leaders.

Here we're guessing on who is going to go be the managers of the institution. Who is going to have the ability to go to the Hill and represent our programs? Who is going to be able to master technologies that will now come forward but yet have that experience? Somehow, we need to be able to really have good discrimination of the junior officers in the system that I will be concerned about.

FROM THE AUDIENCE: You mentioned that we have had nine QRMCs and no change in the compensation system. I was wondering about your thoughts of how do we create the incentive...to have change. We will just have another commission and no change. What are your thoughts on changing that mind set?

DR. ROSTKER: Well, certainly in Vern Clark we have somebody who understands and wants to change the Navy, and he has a view of the kinds of technological Navy he wants for the future.

We have in the past argued that well, you know, any money you can save in the personnel system can go back into your budget. I'm reminded of the end of the last administration when I was a speed bump in TRICARE for Life and was rolled over. I have said several times that you could put the amount of analysis that was done on that program in the margins of this paper.

Now the services are saying, "Well, if I really understood it was all going to come out of my bottom line, maybe I wouldn't have done that." Shame on them. They knew

exactly where it was coming out of. The argument that we save in personnel and the services can use the money has not been very successful.

The largest example of this is Congress set up the Defense Manpower Commission, for one thing. They were concerned about the rising cost of personnel and wanted ways to conserve money. The Defense Manpower Commission reported out. It was a big disappointment to Congress because it did not suggest any ways of saving money. It addressed some of the personnel design efficiencies but it was not a panacea on how to save money.

I think that you have to look towards the kind of force we need in the twenty-first century, and whether or not we're going to recruit and retain and train and have the experience of people in uniform that we desire. Here the war is very helpful to put the system in stress and help us focus on what those needs are for a system both in peacetime and in conflict.

MR. HOROWITZ: Bernie, could you do just one more for us?

DR. ROSTKER: Yes, sure.

FROM THE AUDIENCE: Bernie, you started all this with the observation that the compensation system really has to support and be derived from the personnel system itself and the manpower needs of the services. Yet, you also noted that the services are, shall we say, reluctant if not absolutely loathe to enunciate a need for anything other than what they already have. They would never be willing to come forth with the desired corporate structure that differs in the slightest from what they have. Maybe I overstated a little bit, but the one opportunity that I can think of in the studies that you have cited is for the services to participate in a rethinking of the desired core structure was the fifth QRMC, and they didn't. The fifth QRMC was forced to posit an objective core structure different from what the services wanted that it made up, not one the services supplied, although they begged the services to provide a description of how—what they wanted their forces to be. Given this history and this, shall we say, inertia, if not intransigence on the part of the services, where do you think the kinds of descriptors of the new core structure are going to come from?

I notice that in your summary comments, the kind of changes you were talking about basically derived from the studies done for the DMC. While I think those changes are ones that virtually everybody in this room would support and say are long overdue, they are not rooted in any desired changes in the core structure that I'm aware. I'm

curious as to how do you think the services can be brought to this table to participate at the front end.

DR. ROSTKER: Well, let me start on the negative side. I would not refight the battle of salary versus pay and allowance systems. I think you, in reality, can get enough flexibility in the pay and allowance, enough differentiation in pay and allowance because of retention and various bonuses to get some degree of differentiation. I would attack directly, as the Defense Science Board tried to do, the issue of what kind of core structure we want for the future. You're absolutely right, except you're talking about 1984, and it's 20 years later.

The reality of the information age, the aging of the baby boomers who are not quite ready to apply the old paradigm of, you know, "you're finished," I think all speaks to the possibility of having a dialogue on the structure and letting that be the driver of the compensation, rather than, as I say in this, that you can start with the compensation and somehow derive from that changes in the core structure that you want.

I think the war has a big impact. It certainly is going to force us to come to grips with the active reserve issues. It's going to force us to come to grips with the contracting out issues, the high demand, low-density issues. There are things that we observed I don't think a rational force planner is going to be particularly pleased with that we backed into unwittingly.

I hope the post-Iraq War inquiries will very much focus on the design of the force for the twenty-first century. Thank you very much.

MR. HOROWITZ: Thank you, Bernie. Very provocative.

III. ACTIVE DUTY COMPENSATION: ARE WE GETTING WHAT WE WANT FOR WHAT WE PAY?

MR. HOROWITZ: Admiral Clark is going to have to leave somewhat early. If you will bear with me, I think it would be worthwhile to start this panel as quickly as we can. So, Rick.

DR. BURKE: Thank you, Stan. We are fortunate today to have a very distinguished panel to address the topic of active duty compensation. There are three panelists that we have this morning.

The format here is that we are going to have each of the panelists give a short presentation. Then we have allotted about a half an hour to 45 minutes for questions and answers.

Given the size of this room, you are able to use the cards that were passed out for questions. We will collect them at the aisles. If you want to, provide them during the presentation or you can use the technical approach, a show of hands. I'm sure our chair and panel will be able to handle that.

I'm fortunate to be able to introduce the three panelists this morning. First, Admiral Vern Clark has had a long and distinguished career in the Navy. His complete bio is in the package handed out. I will not go through it. I will point out that he became the 27th Chief of Naval Operations in July of 2000. Since that time, he has had a very strong hand in guiding the future of the Navy. We are very happy to have him here this morning. I can just tell you personally that he and Gordon England, among all the services, have been worrying a lot about personnel and personnel shaping. No less than three times in the past few years he sent his staff down to PA&E to say, "I have a new initiative I would like to propose to get the Navy in the right position in the current system."

Second, we have Mr. Bill Carr. He is the Acting Deputy Under Secretary for Military Personnel Policy. He had a long and distinguished career in the Army and is currently working with Dave Chu, the Under Secretary for Personnel and Readiness. Again, as you have heard from Bernie Rostker this morning, David Chu is one of the revolutionaries in the Department trying to push pretty substantial changes in the military

personnel system. I can tell you personally, because it affects my paycheck, he has already pushed some substantial changes on the civilian side. Those are underway. I'm sure we will hear a little bit about who the Under Secretary for Personnel and Readiness is. Dave will be speaking to us at the end of the day.

Finally, Cindy Williams, as you have already heard and seen, has just put together a new book on this topic. Ironically, we put together the list of potential speakers for this topic. Cindy noticed that it had a high degree of correlation to the chapters in her book.

Many of the panelists today had written chapters. We felt it would be appropriate, and we are extremely grateful to her for getting the foundation, the sponsors hopefully, and the book that we were able to hand out to all participants today. I think you will find it useful on this topic in the future.

I have a long relationship professionally with Cindy Williams. We both worked during the Reagan administration at various times in PA&E, in the Department of Defense, to an apropos get-together this week, particularly in Washington. Cindy will be chairing the panel this time. Cindy Williams.

DR. CINDY WILLIAMS (Principal Research Scientist, Security Studies Program, Massachusetts Institute of Technology): Thank you so much, Rick. The subject at hand is "Active Duty Compensation: Are We getting What We Want for What We Pay?"

I am going to start with the answers. The answer is yes, in a sense. The sense is that we have the strongest military in the world, and that, by and large, we have very strong recruiting and retention. It seems to hold up, meaning in periods of economic boom when we have problems, we find ways to throw money at them to solve the problems.

But no, in the sense that there are problems buried beneath that, and that we probably have to spend too much money to solve problems that could be solved with a lot less money, and also in the sense that when we do throw money at things to get out of our immediate crises, we often make a situation that is worse from the point of view of the services, worse in a sense that it makes it more difficult for them to manage their forces.

The way you see that is in the imbalances across skills that the Air Force and the Navy have today. The Air Force needs to get rid of some 18,000 people. The tools it has been using for two years to try to do that are not working for it because the tools that it has at hand are not the appropriate tools for force shaping. This goes to the point that Bernie made about needing to be able to use the compensation tools to shape the force in a better way.

So, yes and no. And, no, it's especially not resilient in terms of force shaping and what the services need when you come to what looks either to the public or the Congress or the individuals who are serving in the military like crisis time. At that time, it's just too easy to reach for across-the-board solutions that are going to cause problems down the line.

Now I'm going to go to a more elaborate answer to the question. Before I do that, I feel like it's important to parse that question a little bit.

The question is: Are we getting what we want for what we pay? I'm going to parse it by looking, first of all, at what we pay, and second of all, who is this "we" that we're talking about.

First, what do we pay? That's a really good question, because if you ask somebody in the general public or somebody in Congress what do we pay, they would probably say, "Well, let's look at the expense appropriations for military personnel. That's the natural place to look."

That's what, \$100 billion a year right now. That sounds like a lot of money, but that appropriation includes things that aren't part of military compensation, like some recruiting expenses, and it excludes a whole lot of military compensation.

It excludes the housing that's provided in-kind to members and their families. It excludes almost all of the health care benefits provided to military personnel and their families, because those are in other Department of Defense accounts.

Also, it excludes billions of dollars that taxpayers put into this system that aren't in Department of Defense accounts. So, it excludes the tax breaks that people get because the allowances are not taxed.

It excludes all of the veteran's benefits that certainly are a part of military compensation. They are part of what goes to people who have served in the military.

CBO [Congressional Budget Office] has done some very nice work over the past couple of years, trying to get a grip on what the nation pays, what the taxpayer pays for military compensation. They are coming up with a figure of \$140 billion a year, but I have seen other figures.

That's just on the side of what we pay. Most people don't know what we pay. So, to ask are we getting what we want for what we pay, most people don't know. Now, there is also, on the receiving side, almost nobody knows what military individuals are receiving. If you look at any of the articles that have been written since the eve of the Iraq War

about what military people are paid almost every single one looks at basic pay. They cite the amount for basic pay, which, as you know, is only a fraction of what they are paid.

We in this room do virtually nothing to disabuse the press of the notion that basic pay is all there is to it. You're constantly reading articles about how a private earns \$12,000 a year, or how a major earns, what, \$60,000 a year, because people look at the table of basic pay.

Most of the point of view of what's paid out by the taxpayer and what's coming in to the individual, there is very little discussion except among us. There is very little clarity for decision makers, for people in Congress, for the public, or for the press on those issues.

So, that's the beginning of my parsing of the words. But, let me talk about who the "we" is. I think this is really important, and Bernie broached this subject. Are we getting what we want for what we pay? It gets you a little bit into a point of the multiple constituencies who are interested in the question of military compensation.

I think military compensation lies at the intersection of three crucial constituencies. The first is the taxpayer, the one who is footing the bill. In the sense of "are we getting what we want for what we pay?" the taxpayer is one-third of that "we." But there are two other constituencies. One is the military as an institution. Then the third constituency is the individual who serves, and with that I'm going to include the individual families, retirees, and veterans as well. In that category I mean to include not just currently serving members, but retirees, veterans, and families as well.

Donald Chisholm wrote a really good book about two years ago. He is a military historian and he wrote *Waiting for Dead Men's Shoes* about the Navy personnel system in the period before World War I. He points out that—and this is what I think is right—to get things right for all three constituencies is really hard.

Now, once in a while you will find a sweet spot that lies right at the intersection of those three things, and you can imagine a policy that would be really great for all three or a change in policy that would be really great for all three. I'm going to suggest one which I hope Admiral Clark is going to elaborate a little bit about. This is an assignment option.

The notion is this. It's no secret that there are a lot of assignments, a lot of duties or locations of serving that almost nobody wants to do that are a hardship on families or a hardship for individuals who have to do them.

But people vary, of course, in their tastes for doing those assignments, for going to those locations. Maybe a single person wouldn't mind as much as a married person about going to Fort Hood.

The idea of an assignment option is that you can take advantage of those differences in taste by offering a bonus to people who will volunteer for the assignment that nobody wants to do. The bonus amount can be set to be as low as possible by basically auctioning off the privilege of volunteering and getting some extra money every month to do this.

That change in policy serves the individual because it lowers the likelihood that the individuals in the military are going to have to go places they absolutely despise going to. But it also serves the taxpayer; first of all, you don't have to pay everybody across the board some extra amount to make sure that a lot of people stay in so you have enough to assign people randomly and not voluntarily.

It serves the taxpayer in the sense that it's efficient in the sense that it's a way of setting lowest price possible, the lowest price that the taxpayer can pay to get these people to go, but it also serves the individual.

It also serves the military as an institution in the sense that if you have people who actually volunteer to go on these unpleasant assignments, it stands to raise their morale but it also stands to raise the morale of all the individuals who really didn't want to go and who now don't have to. That seems like a sweet spot, although you can take it too far.

Imagine this. Here's the Army battalion commander to his troops: "Ladies and Gentlemen, who will be the first volunteer to take this hill? The bidding will start at \$250." You don't want to go that far. So, obviously, there are ways that can do backfire for the institution. But, my point is there are things that you can do that work for all three.

I think as economists, we need to look at things from the point of view of the taxpayer and leave it at that. When you do that, you get to the point that Bernie made, that it makes it very difficult either to design policies that are really going to work for the institution and the individual, or to sell those policies. It's important that every time you think about policy changes, to think about all three.

Now, it's much easier to find ways that you could satisfy two of those interests at a time. Piling on the money, especially if you do it through bonuses that give the services some leverage on who stays and who enters the military. Piling on the money can be a

win/win for individuals and for the military as an institution, even though it can be a hardship on the taxpayer.

If you remember [General Carl] Mundy's idea, then the Commandant of the Marine Corps, that the Marine Corps would no longer welcome people as recruits who already had families, and that over a period of time, people would be discouraged from forming families in their first term, and, over a period of time, the Marine Corps would end up with people who, in their first four years of service, had no families.

He was trying to put into action the notion if the Marine Corps wanted you to have a family, it would have issued you one. A policy like that would be great for the taxpayer because it would cut down on the level of family benefits. It could be great for the military as an institution in that it would cut down on problems of people going through divorce. Mundy thought it would increase the readiness of members, but it was going to be a hardship on the individuals who saw it as a real encroachment on their personal rights.

As I say, it's not too hard to find things that would be good for two constituencies. It's really hard to find things that would be good for three. But it seems to me that our current policies are falling short across the board in serving any of the constituencies well, and it's very difficult to find policies or recent policy changes that were good for even two of the three constituencies. I am just going to give a couple examples and then I will be done.

The taxpayer's bill for cash pay rose substantially in recent years, as you well know. That's good for the individuals who serve, and it helped the military as an institution in recruiting and retention, but it probably backfired for the military as an institution in terms of being able to shape the force, because the people it would like to leave are so well paid now that they are not going anywhere.

The nation spends a lot more than private sector firms do on in-kind benefits, benefits that are provided directly to the military members, families, and retirees, not in cash, but by direct goods and services provided by the Government.

You would say, "Well, at least they are good for the individuals." Well, they are not necessarily good for all the individuals. A lot of that money is spent on services that are available to people if they happen to live on a military installation, but a lot of people don't live on a military installation.

Some of the goods and services are good for the military retirees, but they don't help veterans who are not military retirees, and it's not even clear that these in-kind goods and services are giving the military what it wants as an institution. Often they are held up as institution builders, these in-kind goods and services.

As Bernie pointed out, if you have a force that is increasingly expeditionary, it's not clear that having these garrison-style goods and services is the best thing for it. It's also not clear from the point of view of the military as an institution surviving in the key role that it has in the nation today.

For the health of the institution, for the military to be perceived, it might be a lot better for the military to be perceived as being out and about, integrated with the rest of the population. There are some big questions about whether the policies that we have in place today are serving any of the three constituencies well, which brings me back to my short answer.

Yes. We're getting a very strong force, but the force is brittle in the sense that we don't have the policies in place that would allow us to manage the force in the way that the services need to. The policies are serving a segment of the military individuals, but not all of the individuals, well. From the taxpayer's point of view, it's vastly inefficient. Thank you.

ADM VERN CLARK (Chief of Naval Operations, U.S. Navy): Well, it's a privilege to be with you all here today. I would just say that I'm already glad that I came. I don't know what's going to happen from this point on and what will happen in the Q&A but I'm grateful for the opportunity to be here.

If I accomplish nothing other than getting to transmit this next sentence, I will consider this to be successful. I'm glad that I'm here because I want to introduce you to the Service Chief who believes that the current personnel system is not serving our needs well and I am trying to do everything that I can to change it as fast as I can. Maybe I should just sit down now.

I really was surprised by the fervor with which the questions were asked to Bernie about the services being viewed as stuck in the 19th century. But then I thought about it and thought, "Well, I'm the only guy that's trying to cut manpower in my program. I am standing alone in trying to create some changes that I believe are absolutely essential for the future." I guess I do understand where you're coming from.

I have been in this job almost four years next month. Rumor has it I'm going to stay a while. Congress has to act before that occurs.

I came to this position concerned about where we were with manpower. By the way, I'm not a seasoned expert in this. I'm totally self-taught. I'm reading everything I can get my hands on to understand it better, and I know what I believe.

What I believe is that we have a cold war system or a pre-cold war system that absolutely will not meet the needs of the services in building a twenty-first century force that is as capable as it needs to be at a cost that the taxpayer can afford.

Do I believe that we're paying too much? I absolutely believe that we are. But then the question becomes: [Too much] in units or in the macro sense? I don't happen to believe that we are necessarily paying too much in units.

I view it like this. My task and responsibility isn't just to form and create and nurture the human resource structure of the Navy. I sized it up pretty well when I laid out my priorities when I took this job four years ago. I have to provide for the current readiness of the force and I have to provide for the future readiness of the force, that is, what is the force going to be like 10, 15, 20 years from now?

These are number two and three on my top five priority list. But manpower was on the top of my list when I started this job because if we don't win the battle for people, the readiness of our Navy is will suffer. That's what Vern Clark believes.

Let me just spend my few minutes here with you sharing some things about what I believe. I believe we have to have tools and techniques to effectively lead the organization. In my mind, these tools and techniques will allow us to face our challenges and attack our list of priorities. And at the top of that list is winning the battle for people.

My to-do list has 400 to 500 things on it. Most of the things I can delegate. But there were some that I thought were important enough that they ought to be Vern's job. So, each year I have had a personal project that I have named as my own. Year one was Alignment.

Year two was the Revolution in Training and Task Force EXCEL, because I believed if we didn't revolutionize the way we trained and developed people that we couldn't win the battle for people.

Year three was the Revolution of the Personnel Distribution System. Cindy alluded to it. I believe that we have to incorporate the power of choice into the system or we will not be able to compete in the twenty-first century.

Vern Clark believes that we need to apply marketplace principles to our human resource strategies or we won't win. Simply, that's what I believe. In my research, I found that everybody didn't like his or her detailer. All the surveys show that people don't like their detailer. Why would that be? Tell me.

FROM THE AUDIENCE: We're dictators.

ADM CLARK: What else?

FROM THE AUDIENCE: They get sent places they don't want to go.

ADM CLARK: Who has the power of choice?

FROM THE AUDIENCE: Is he happy?

ADM CLARK: I think most days, probably not, because he deals with a lot of unhappy people. Our "slam rate," which is when we "slam" somebody into a job that they don't want to go to, was pretty high. Our past data is poor, but we believe our slam rate over the years was about 30 to 35 percent. Our slam rate for the last year was 1.5 percent.

The year four project was our relationship with our number one Joint partner, the United States Marine Corps. The year five project, if the Senate confirms me, is to create a twenty-first century Human Resource Strategy. I believe that there are things that we could do today with this strategy that will create the biggest advantages for the United States Navy in the future battle for people.

Let me talk about it very briefly. I have listed everything I believe about this outlined on one piece of paper. It starts with what we believe about people. I believe that they are at the heart of everything good that is happening in the Navy.

Retention rates—in my 35 plus years of service, we made our retention goal one time. Once. In the last three years, we have achieved the highest retention rates in our history, because of the principles that we put into place and the way we decided we were going to deal with people.

We live in a world where we talk about an enemy that has asymmetric advantages. We need to understand that our ability to win on the battlefield is based upon exploiting the utility of our primary asymmetric advantage.

We happen to have two principal advantages. One is our ability to field unsurpassed technology at unbelievable rates. That is crucial to our success and one of our advantages. But the most important advantage is to exploit the genius of our people.

I'm a believer in something called covenant leadership. I learned this from Max DePree some 15 to 20 years ago. It fundamentally says this, "Our people raise their right hand and promise to support and defend the Constitution and obey the orders of the President of the United States." What we have done in the Navy is answer the question, "What do we, as leaders, promise in return?"

We have modified our fitness reports and all the performance evaluations for every leader in the Navy; they are going to be evaluated on two things. We put into place a structure that says we are going to evaluate leaders based first upon their personal commitment to mission accomplishment, and secondly, their personal commitment and dedication to the growth and development of the people who have been entrusted to their leadership. It is the leader's responsibility to see to it that these young people prosper.

I am convinced that job content is more important than we have ever understood. Enhancing job content is one of the reasons why I'm trying to streamline the Navy. The degree of job content is related to attrition rates. By the way, our attrition rates were totally and completely buried in our retention statistics and our leaders didn't even know what our attrition rates were. We hid the rates from them. We now have made them available and unavoidable—they are on billboards in their offices, and we have cut attrition by almost 40 percent.

You know, it's foundational, but what we found out is this. When I got here, we were recruiting 57,000 people a year. This year the number is 40,000. The next year it will be 38,000 and the next year it will be 35,000. When you do that to an organization, you fundamentally change the culture of the organization.

We ought to be able to understand something about what it takes to put together a human resource strategy that will work in the future. My studies of Gen X and Y and the millenials—which leaders ought to be doing—tell me that today's generation wants a chance to make a difference. If we provide an opportunity for them to do that, they will astound us with their achievements. It's an eye-watering experience to watch them. They are incredible.

So, building the Navy of the future, what kind of people do I need? The Congress, if they do the right thing, will approve the construction of the first DD(X) this year. DD(X) will be a 14,000-ton ship. A ship that size in World War II would have had over 1,000 people in its crew. When we got rid of boilers and put gas turbines in more recent ships, we moved toward today's standard, closer to 600 people. Tomorrow's standard, with new technology, will be different. DD(X) will have about 125 people in it.

Now, here's my question to my leaders: As you build the human resource strategies for your organizations, how are you going to acquire your people? How are you going to either acquire the skilled people that you need, or develop skills for people after you acquire them? And then how are you going to retain your people? How are we going to come to grips with what it is we believe about the way human beings are going to compete in the marketplace and react to the marketplace in the twenty-first century?

We have this mindset that service members must come in young and stay with us for life, and anything else is not going to fit the model that we have for them. Everything that I understand in reading what's going on in the marketplace is that's not what the twenty-first century human capital marketplace is going to be like at all.

The technical advances that are coming are challenging us to figure out how we are going to do those key things that are required in a human capital strategy. I don't think that we have done it well. I don't believe our policy structure is set up to do what needs to be done and to compete effectively in the twenty-first century.

What kind of things must a new human capital strategy address? First, how are we going to assess our people? So, we asked ourselves, how do we fundamentally change the factors which lead to our current slam rate? How can we get a one and a half percent slam rate? From this question came the pilot project called geographic incentive pay. It started as a pilot. The rest is history; now we have one and a half percent.

We must also understand what we believe about the accession process. The issues include whether we will we buy into on-ramps and off-ramps, and how can we acquire, for instance, necessary female human capital skills if you don't have some better way to deal with the things that both women and men want out of a balanced life? Because when we examine why women leave our institution, it is principally because they are challenging the question of whether or not a career in our institution is compatible with the rest of their life's objectives. We have to address this, and we have to have policies, and promotion and assignment rules in place that allow women to be successful and to compete in our institutions.

The assignment process itself. I don't see why in the world we can't have a system that allows the freedom of choice for individuals, and why we should think that such choice changes the key part of our culture where people take orders in our institution. I don't see those things as mutually exclusive at all. I think they are two totally different kinds of functions.

Someday, in the future, I believe the entire placement process is going to be done on the Web and the only thing the detailer is going to do is facilitate placing data on the web; all the decisions are going to be made by the Executive Officer and the Command Master Chief on the unit acquiring the asset and the individual.

We're going to be honest with people. They live in a competitive world. If they don't compete well, they are going to have a hard time getting the kind of assignments they want. What is wrong with an approach that is straight up with them? Because Vern happens to believe that being direct is a good way to do things in life.

Let me tell you what turned me on to this in the beginning. It was because I cannot make the twenty-first century Navy that we collectively dream about with the current system and processes.

Why? I'll tell you. At the height of OIF, I had 54 percent of my Navy deployed. I get a little piece of paper everyday that tells me how many ships I've got in the Navy that day. I never read all the way down to the bottom. There is one last piece of data that I just never paid any attention to. Frankly, I haven't spread this around too much because I'm not tremendously proud of it but it is endemic in the whole military.

On that particular day, 54 percent of my Navy was deployed, I had almost 400,000 people on active duty, and 12,000 of those were reserves, but I was pushing 386,000 people in the active force. With 54 percent of my Navy deployed, I had 78,000 sailors deployed. I went, "My goodness. Where are the other 300,000 people?" I have come to understand that 10,000 people means \$1.2 billion per year, and that we must be successful in redirecting amounts of capital to do the other part of my job—this is part of the balance sheet—to create a future Navy.

We are determined to figure out what jobs don't have real content in them anyway. To streamline the organization, we will pack every job with content because, fundamentally, people's satisfaction index registers when they have real meaning and real work and purpose in their lives.

How are we going to grow and develop them? How are we going to get the job content right? I happen to believe that we have got to look at the differentiation between officer and enlisted structure. I am openly saying now that we must actively pursue the blurring of the lines between officers and enlisted personnel. We will not get where we need to be if we don't do this. The Master Chief Petty Officer of the Navy who retired almost two years ago had two master's degrees.

When I got commissioned, Master Chief Leedy put his arm around me and said, “Ensign Clark, I like you. I’m going to teach you how to be a good officer.” Back 35 years ago, the Master Chief probably had a high school diploma. I’m convinced with the kind of high-tech Navy we are, there will be a day when you can’t be a chief petty officer in the Navy if you don’t have a college degree. I believe that opportunities for educational advancement are a big reason why people are coming to us. One of their principal objectives is that they want the chance to grow and develop.

Our philosophical approach to retention will change when we understand that “on ramps” and “off ramps” are necessary. One of the most important things we can do is get the right skill sets and the right assignments so that people can do the right thing for this institution. Experience really does count. Donald Rumsfeld has been telling us that, and he is absolutely correct.

We need policies that will allow us to incentivize the behavior that we are looking for. Pay and allowances are just one of the very important tools that we have to work with as we try to develop the twenty-first century work force.

With that as a backdrop, I hope you leave here convinced that there are people in the active military that are very concerned about the policies and the structure that we have in place today, and that you’re talking to a service chief who believes that we have accomplished some change but not nearly as much as we need to accomplish in the future to have the kind of Navy our nation needs. Thank you very much.

MR. HOROWITZ: While I am trying to get Bill’s slides set up, perhaps we can take a question or two. Is that okay?

ADM CLARK: That’s fine.

FROM THE AUDIENCE: We have a long history of commissions that never go anywhere because we have the same old compensation system that never seems to change despite the commission’s recommendations. My last question was about how we get the services to change. My new question is: How do you get Congress to change?

ADM CLARK: Here’s the problem that I have. I’m vehemently opposed to any notion that all E-5’s over 6 years of service should be paid the same amount of money. That is nonsensical in today’s world. We should pay for skill sets.

This is why I said I believe in the marketplace. Let the marketplace dictate. It’s not just the pay and allowance piece of it, but the whole package. The first thing you have to

do is you have to get the whole system, all the Services, to agree that we're going to have different systems.

I could be bolder if I had the force-shaping tools, but there is a reticence about giving tools for the Navy only. If you were big DOD, you would take that approach, and if you were the Congress you would take that approach, I think, with where we are today.

But I believe we have to develop an understanding that one size doesn't fit all. Hopefully conferences like this will help. You all are people of influence and your voice will be heard on key issues.

FROM THE AUDIENCE: Admiral, this isn't so much a question as it is a sales pitch. A few years ago I had the privilege of working on something called the Naval Personnel Task Force. I don't know if you're familiar with it.

We addressed a lot of the issues that you have just been speaking of. I just wanted to call to your attention that report and some of the recommendations that came out of it in the event that you haven't had the chance to become familiar with it.

ADM CLARK: I told you I don't come to this with a great background in this. I also believe that if you're not learning, you're dying. That, by the way, is what I tell all the Admirals and SES's. I'm studying this stuff. Early on, I went to CNA[C] and spent a day with them and said, "Okay. Show me what you got." We're getting ready to do that again with the latest version of where we are in the HR business.

I just bought a couple hundred books for all my Flag officers. There is a new book out called *Play to Your Strengths*. This is very, very informative. You can't learn unless you're investing your time in reading such books.

One of the things we have to do is to create a core executive leadership structure that is informed. I don't think we have had that before. I will tell you that we're working at building that in our Navy. Yes, ma'am.

FROM THE AUDIENCE: I'd like to hear a little bit more about women that you mentioned and careers for women.

ADM CLARK: You know, there are about 400 possible answers there. I don't know which one to choose.

FROM THE AUDIENCE: Your choice.

ADM CLARK: We absolutely have to have the talent that women bring to our Navy. So, how do we put together a human resource structure that allows them to meet all of their needs?

Look how far we have come. I don't even keep track of how many women are doing things anymore. I have all kinds of stories to tell.

There are two airplanes on a tanker in Afghanistan. The Special Forces guy on the ground says, "Get down here quick." The guy in one of the F-18s says, "I can't. I'm on the tanker. I'll be there in five minutes." The guy on the ground says, "I can't wait five minutes," and the F-18's wing person, a woman, says, "I will be right there." The F-18 goes down there and saves those guys on the ground. This stuff happens out there all the time. So, let's deal with the realities we face.

What are their challenges? A lot of women want to have families. Do our policies align in a way that makes that achievable for them and to also have their career? Well, not as long as you don't have effective on and off ramps. So let's get on with it.

By the way, what does the literature and what do the data say about today's work force? Young people today aren't wedded to this idea of coming in when they are 18 and staying until they're 50. It's a neat concept. It just happens to be N/A.

By the way, the civilian personnel reform that was passed last year had segments in there to deal with people who had skill sets that we could hire for five years. Let the record show that Old Vern was up there speaking to get that significant reform passed. I made a dozen trips up there. That's what it means to me.

FROM THE AUDIENCE: I would like to hear from the panel on your opinions on the cafeteria plan approach to its military compensation, as you see in corporate America. I know on and off over the years we have seen that appear and disappear. Is that a good idea or is that a bad idea?

DR. WILLIAMS: For the panel, once we come back, after we have the cards being sent. Would you like to address that, Admiral?

ADM CLARK: Why don't I be quiet? Let's have Bill talk and I will stay as long as I can.

MR. WILLIAM J. CARR (Acting Deputy Under Secretary of Defense, Military Personnel Policy): One of the great parts about when you're going to speak is to try and do it after lunch or after a passionate speaker. I have the benefit of the second one.

I'm going to talk about eight pictures. The reason I'm doing this is to set some context for the discussion we are going to have.

Now, it's true that we have had a whole series of QRMCs [Quadrennial Reviews of Military Compensation]. It's true, also, that there have been a number of studies that, as all the speakers have pointed out, there are some changes we have to make. How can we have a basis for optimism?

I think the reason is because we're the people. We're the tail that wags the dog. You give us an owner's manual for a Chevy and we'll figure out how to turn it into a compensation program that works. I'll give you an example.

Operation Iraqi Freedom, it's all new stuff. We're making it up as we go, but we're making it work. The laws don't suit us. The policies don't fit.

How do we get past it? Well, let's look at how we did do. "Twelve months, boots on the ground," says the secretary. The chairman in the meeting says, "I think that calls for about a \$1,000 a month for an incentive for that." The secretary placed his hand down on the table and says, "That sounds about right," and the P&R community sounds like a motorboat.

In that context the decision is made, and it's a good one. Then you have to make some other decisions that suit it. So, how do we make it work? You give us a set of laws. You give us a set of policies. You give us the people in this room, and we will find a way to make it work.

When we're making it work we're trying to get certain alternatives, and I'd like to point out at least a few of those for our discussion. Later on, as I talk about this, we know we have structure. We know we have personnel policy and we know that we've got some judicious compensation.

I think a great example of that is the one Admiral Clark used about chasing the structure with sea warrior, an option, if you will, by which people choose their assignments.

True that we have taken a personnel policy, slam rates, and optimized it and then used a very judicious use of money, market rate, and personal choice. Through those powerful factors you achieve the objective you're trying to get at with the most favorable personnel policies that reduce the demand on compensation.

Then you couple it with a really clever compensation scheme; in this case, assignment and incentive pay. You sign up, you want it, I can get the money, you've got

a deal, and it's a bid. Those are the kind of things that leveraged compensation and those are the kind of things that no matter how many QRMCs we have, that's the reason that we make these things work.

We took that same pay because nothing else would work. When the secretary said \$1,000 for those who stay on, you cannot find an authority under the law to do that. We had to throw those things all in assignment and incentive pay.

Thank God the Navy was leading on that a few years ago and that it was there because we used it. We said, for example, "You have got to stay. You can stay and receive no money or you can stay and sign this and get money."

Now, that's a pretty perverse application. But, hey, if that's what it takes to get \$1,000 in the hands of a warrior, then that's what it's going to be, and that's the reason that we're probably all optimistic about the system, because we know how to make it work no matter the constraint. Give us a structure. Give us that. We'll work the personnel policies and the judicious use of compensation.

We'll target, but who are we targeting? A couple points on that in the discussion as we go on. We know what kind of quality we're looking for, and you hear a lot about math, verbal, aptitude, AFQT. Why do we care? Because that signals productivity.

That picture lower left is millions of dollars with the National Academy of Sciences to answer the question: Why are you going after so much quality? The answer is because they are more productive. They are more cost effective.

If you take the increased cost of recruiting a high-aptitude person and shake it up with the economics factors, you're going to come up with an optimum solution that says, "You ought to be clustered in the high 60's for the services." You ought to be in the high 60's as far as top half math, verbal aptitude. So, that's an optimal solution. Then you say, "I don't know how many I need but I know when I get them the quality I want is over 60 percent."

With high school graduates, the only reason we care about that credential is the same reason we have always cared about it, only for its power in predicting stick-to-it-tiveness and retention. High school graduates stay for three years. Eighty percent non-grads don't. That's who we're going after.

We quantitatively have to throw that into the mix, too. These are the two qualitative factors I talked about that. That's what's going into the force. Then you've got that old force profile that we're trying to shake; varies by occupation, varies by service, varies by

the shocks that occur to it. Throw in a regular pay raise, throw in a draw-down, then you have certainly got some ripples.

Those numbers at the bottom are just reference points. It doesn't necessarily represent any service. It would represent no service if you're trying to change your grade structure, and we are. We inexorably have been on a march towards putting more money into systems that are as lethal but demand fewer people.

When you do that, then you are going to demand more noncommissioned and petty officers. When you do that, you better adjust your profile if you want to keep the same kind of people. That's how it all kind of works together and that's how we struggle with this with all of our creativity over time.

Now, we have to do some things. We have talked about what Neil brought up, the structure in the services and so forth. Here's an example of the core structure guys let us down. And if took the Army as an example, they let us down because who could have foreseen the world we face now ten years ago.

So unforgiving of our brothers and sisters in force development; not that we will never love them, because they make our job tough.

But for the force developers, there's what the Army faced and they had to bring down structure. Field artillery is not what they needed. Cops are what they needed for reasons you understand. So, the Army is going through one of its largest core structure changes—and look at the magnitude of that—in a long time. We're going to have to chase that. So, fine with us. We're creative, smart people. You give us a structure and we'll intercept it. We'll twist statutes within law and within the advice of our colleagues from OMB [Office of Management and Budget], but we'll do those things in order to intercept it.

Now, to kind of pull this stuff together, top left is a weapons system. That's with a lot of people. You have people humping ammo over to the system, feeding the artillery and putting it within range.

We replaced it with the system on the right years ago. There are smart ships. There are tons of examples of this stuff, but I will just stay with this one to make the point.

We decided instead—I will tell you what. I will get a multiple launch rocket system. It will be more lethal and it will put more steel on target, and it will demand fewer people. Put technology out there and we don't need the ammo humpers because we just pull out the module, put it on and fire.

But, you know that we're going to have a different grade structure. The laborers are gone, that pyramid with the wide bottom with the laborers. Now we have a more grade-rich structure. That ripples through and tells us what we've got to do.

Now, let's look at a 1968 conscription, probably a really lousy period in terms of its experience profile. That's the way we looked, but we were balanced. We had a whole lot of people who were churning through their first two years because we know that conscripts stay on about 10 to 20 percent of the time. Volunteers stay on about half the time, but that matched that grade structure, as you see.

Well, when we go to those new systems, we have different grade structures and, therefore, we have a different experience profile. I would say that if you take that profile on the left and slam it against that system on the right, it ain't going to work. That's the reason that I am recommending that we resist conscription the way that we do.

Now, there are some things that we have been given that we weren't seeking. Bernie Rostker talked about, for example, TRICARE for Life, and the financial consequences. Well, the red bar is the consequence. When you say, "I'd like to provide TRICARE for Life," then you are buying into a big bill. That's what we bought into.

Congress more recently has taken actions to say, "I want to really take particularly good care of the annuitants. Within the defense dollar, I'd like to take care of certain persons that retired and have disabilities and do more."

When you do that, you are creating an entitlement program that is going to limit our flexibility long range. If the top line of defense were to stay the same, a greater proportion of it is going to entitlements, and in this case, annuities.

What does that do for combat effectiveness? Well, you can make the argument that it makes those that are in the force more likely to stay because of the future. If you slap discount values on that, it is a pretty weak argument, as we know.

Now, we have moved toward targeting, just as I mentioned in the example of the Navy using the smart, judicious use of target incentives in just the right amount. The more we do that, the more bang for the buck we're getting. This is the gospel according to Devine, "Targeting is a good thing. Generally, pay raises are a bad thing," and we subscribe to that.

We're limited a little bit because the force out there, the commander is dealing with homogenous pay patterns. We do know about that. So we're tempered in our targeting. We're certainly mindful of it.

If we looked at the past few years from 2000 to 2004, if you looked at the chart on the left, the red line is the civilian wage structure. In other words, for people that were similarly educated and experienced.

That's the kind of bucks they are making on the economy. If you look at the military, we weren't doing as well. We were that bottom line and we wanted to get up toward that top line.

Who was doing particularly well and always has? New recruits. Relative to their peers, they are doing okay and have been for years. Non-commissioned petty officers, not so much. We didn't have a retention problem.

We figured we would if we let this continue. So, we went after it as a consequence of the 10th QRMC, and we have made a lot of progress in closing the gap.

What does that do? It gives us some stability in those non-commissioned petty officers. No matter how angry they get about the circumstances that they now face, at least we put some durable compensation in place to keep them and their families stable while we react to events that come our way with more targeted approaches.

Now, talking of targeting, this is not any kind of gospel yet but it's one we're selling. How do we pull things together? Well, we've got a lot of laws on the books. One of them is this thing called purse tempo pay. That is Congress's years ago effort to lay a speeding ticket on us if we put too many people deployed too long.

So, if you do it enough, you have to pay them \$100 a day operations and maintenance dollars. Holy Toledo—scared us to death. We frankly never faced it. Navy was about to face it in a very big way. Coincidentally, 9/11, with its occurrence and the implementation of the national emergency, under the law, the meter stops, and it's been stopped for years.

Now, when we bring it back, how do we want to bring it back? Under this theory, you would bring it back in a very modest way. For example, you would say, "I tell you what. This thing where I pay people to go to be away from home really pays somebody in Iraq the same as we will pay somebody to go to the National Training Center in California. That doesn't sound right to me. I tell you what. Let's just consider that a general ointment so that whenever you accrue a lot of days, you are going to get general ointment."

By the way, these three steps are about retention. It's the way to make everything turn into the wind and work together with these disparate pays toward retention. So, we

say tempo pay is a relatively small amount. Maybe it's \$50 a month. I don't know, but it's low.

Now, we also have people, though, that are in some pretty crummy places; Iraq, Guantanamo, and Korea. So, what are we going to do about them?

The answer is while they are in that theater, you shower dollars upon them when they enter. Then the shower stops when they leave. That offsets some discontent, hopefully in the amount not enough to make them want to stay, but at least not get them to the point where they are determined to leave.

So, you would pay most in Iraq. You would be in the middle if you were paying Korea. I'm sorry. Korea, I have to check my colors here. Korea bad. Guantanamo is worse, and Iraq is the worst of all. So, you would normalize your payments to do that. That way you get a little bit of the ointment—everything does—for being away from home.

You get showered with a certain amount of money while you were in a particularly defined area. Then at the end of the day, the highest leverage dollars we've got, the old SRB [Selective Reenlistment Bonus] program or career status reenlisted programs.

May I point out that that last one is quite a discussion by the Congress because we know that when we have a compensation program, it's hard to use it. There are rules. There are laws. There is a labyrinth of stuff.

Well, the Congress signaled a willingness to say, "I tell you what. I will give you a checkbook and some broad parameters. You spend it. Don't screw it up." That really happened with the enlistment bonus. Pay up to \$200,000 over a career. You figure out who gets it and when.

My point there is that we have got plenty of latitude to handle that curve. If we miss there, we're dead. Whatever we choose as our experience profile to meet the great structure to match the weapons system, we have got to make sure that the people are there with the requisite experience and we, therefore, would probably deploy our money from the least targeted on the left to the most targeted on the right.

The left is pretty much everybody. The middle is people in certain places. The right is a person who is making a decision that is, at a discrete point in time, highly targeted. So, that would be our theory on how to integrate these pays and adapt them to today's situation.

So, in quick conclusion, we have to set cost effective quality goals. We work at that. We have done it. There is science behind it. Bring it on if you want to challenge us because we have got certainly good reason for the quality goals that we have chosen.

Secondly, we have got to get structural balance, the mix of skills. I offered the example of the Army migrating from artillery to cops.

Grade and experience, retention is about an experience pyramid. That's what you're left with after you're through with retention. You know about grade pyramids. If you line the two up, then you've got seasoned NCOs and petty officers.

Some policies are working now. We want to try and make that more explicit so we don't say, "I'd like to get X percent first termers," because at that percent, the output depends on what your base was. I mean, gee whiz. If you have ten people versus 1,000, ten percent produces a different result.

But if you say, "I tell you what. I prize non-commissioned officers who are Grade 6, who have eight and a half years of experience plus or minus," then you're talking about something that is a more legit reference point when you're going to lay your money down.

Finally, the manpower source. [There is] enormous work going on in that. Should it be a civilian? Should it be military? Should it be a contractor? I have learned lessons I have not even, despite a career in this business, known about; points at which you can have, for example, civilians such a UCMJ are contracted to carry weapons.

That is not by any means a resolved rhythm, but the manpower mixes were stretching the boundaries, and in doing so, stretching a number of tenets about UCMJ and discipline. And what if you misbehave? You go to a federal court or whatever. Complicated factors but it's not slowing anything down in terms of manpower.

Finally, the point I make is target where possible. That's where you leverage your dollars. Then that will lead us to get what we pay for.

One final comment: The Defense Commission on Military Compensation, as the admiral pointed out, the Secretary is determined to make productive change. When you want to make change in a big system, one way to do it is a powerful commission.

The Zwick Commission had credentials, portfolio, and most of all, smart ideas, so they moved forward. If you can assemble smart people and they come up with simple, smart, marketable ideas, and they have a leader who has rock-solid credibility like a

captain of industry, that person could sit across the table from Congress and say, “If we ran our business concentrating all those resources on annuitants, we would go broke,” and they could say it with credibility. That’s an important message to have.

They could talk about simplifying our pay system. I could go into that and it may come out in the course of the discussion. But that commission, they are going to produce some output that we hope will simplify, empower, and make us more effective in the internal core structure. Thanks very much.

DR. WILLIAMS: Thank you. We want to open it up for questions, but we want to take the question first that is already on the table about the cafeteria benefits.

For those of you who, having had the book in your hands for more than an hour now, have not read that chapter, Carla Tighe Murray wrote a wonderful chapter in the book about the in-kind benefits that are offered to military people, to military families, and to retirees. As one suggestion, she says we need a way of getting exactly what the Admiral talked about, more choice into the hands of the individuals who serve.

Among the ways of getting choice into their hands, she says we need more choice in the kinds of benefits that people get because, from the point of view of the single person comparing him or herself to the person with a family in the military, the single person would see himself as getting ripped off where benefits are concerned.

The people who live off base would see themselves as getting ripped off. Certainly reservists who don’t live near a base and are eligible for some benefits that are provided on base are getting ripped off relative to reservists who happen to live closer to a military base.

What Carla proposes is a cafeteria scheme that looks more like the type increasingly modern private firms are going to that would offer people a package with which they could choose. So, the question is what do we think of offering that kind of choice? Let’s start with Admiral Clark because I know that you have some time constraints.

ADM CLARK: I’m going to stay until 11. DR. WILLIAMS: Wonderful for us. Thank you. I was just reminded about the question cards. If you have a question card and would like to submit a question via card, you need to hold it up.

ADM CLARK: I think fundamentally that you have to start with the foundations of what it is you believe. If you believe in choice, then you have to believe in that approach. So, I do.

Now, I don't dismiss the degree of difficulty. This is hard to do, especially in a very large organization, and you have to get robust and very flexible authorities from the Congress. I understand that's hard, but that's the way I come at this: "What is it I believe in?" I believe that one size will never fit all. I certainly understand why an approach that works for me in the Navy won't necessarily work for one of the other services. I don't want to be bound by things that [other services] have to have that don't fit me.

The idea that everybody in the Navy has the same sort of a life situation that would cause them to all be of one mind is also, I think, looking at the world as being way too simple.

Cost effectiveness. I keep going back to that. See what our choices are and give the winner the lowest cost deal. The same is true in compensation. For an extension in Iraq, we can offer cash or we can offer stability in a follow-on assignment. We can offer either of those and people will respond differently. Let people take what appeals to them until you get the requisite number. That is a more efficient solution.

We must understand the market. But the market is hard to predict. We talked about the auction several times. Let the record show that the lowest cost that I had to pay on the winner of an auction was zero. The person wanted to go so badly he did it for no extra pay. That would never have been predicted in the market.

DR. WILLIAMS: Other questions?

FROM THE AUDIENCE: I guess I'd like to push a little bit on blurring the lines between officers and enlisted personnel. The model is an old model, sort of the lords and the peasants in the military. Now we have people who have two master's degrees and—

ADM CLARK: And Ph.D.'s.

FROM THE AUDIENCE: ...and PhD's, and have junior officers who have a long way to go, not just a little way to go to catch up with the knowledge these guys have. Where does the blurring come in?

ADM CLARK: Well, see, this is why next week I will have all three- and four-star admirals in. I'm assigning a task of a human resource strategy to all of them. Just created it. First question, external or internal? What's the answer? What do we think the market is about?

I was at a ROTC commissioning three weeks ago in Norfolk. Of the 47 people that I commissioned, five marines and the rest Navy, 37 of them were from the fleet with previous experience. I walked out of there going, "Wow. What does this tell me?"

To go back to this promise I talked about and the covenant, when they call home and talk to mom, they talk about what they got to do and what they are learning and what courses they are taking. They don't talk to me about that. That's what they talk about back home.

They want to go home and talk to their friends about how successful they are, how they are growing, and what opportunities are going to come as a result. So, I'm convinced that we have to have a system that allows this growth to continue.

I interviewed a guy the other day that made chief in seven years. I was looking at hiring an aide. He was prior-enlisted and decided he wanted a commission. He just left his XO job and has been in 18 years now. It's a different path.

What does a person look like in terms of this chart right here [indicating]? This is a really important chart. We're talking about skill sets and round pegs and round holes.

What is the comparison between a fresh ensign straight out of the university, and another person that has eight and a half years of service that is also an ensign out of a university? We have to have a system that allows both of these individuals to be successful.

When my retention started skyrocketing, my quality numbers went through the roof. Now I'm worried about whether I'm providing enough opportunities for people who are disadvantaged earlier on. My high school numbers are at 95 or 96 percent. I think the internal accession route is going to increase. I also have to make opportunities for growth in job content opportunities for a master chief who has a master's degree.

DR. WILLIAMS: Bill Carr, do you want to say something on this subject?

MR. CARR: The only thing I want to say is what we talked about in this case was extending the highway straight ahead, and Admiral Clark talked earlier about on ramps and off ramps. We do have the manpower mix issue, contractors coming in, civilians coming in.

I guess the point would be that not only are we faced with a two-dimensional officer/enlisted issue, but also multidimensional because we can start throwing in migrations back and forth from the reserves or from the military and the civil service. It boggles the mind.

I think the admiral's point is exactly right, that we know the kind of quality we have got. We know they are out there and we know they can do it. So, open up the widening highway up ahead.

DR. WILLIAMS: Before I take other questions, I want to put something on the table that broadens a question that Beth Asch has been asking. I'd like to ask both of the other panelists.

Admiral Clark, you have a reputation for really being on the vanguard here. *Government Executives Magazine*, for those of you who don't know, has highlighted his work twice this year and pointed out that he really was in the forefront of the services. He made it clear in his talk that he's really pushing the envelope of what an individual service chief can do.

I also think that the Rumsfeld Pentagon has a very strong reputation in that regard, pushing as far as it can go internally to make change happen. Bill Carr I know is a part of that.

I want to ask each of the panelists: If you had one thing you could get from Congress in the next couple of years, something that you can't do on your own, that you can't do internally through the service, and can't be done by the Secretary of Defense by himself, what is that one thing you would want to try to get from Congress?

MR. CARR: The one thing I would look for is pilot authority because then we could do as we believe we should do in order to achieve a given outcome and to prove it's a smart idea. If there was one thing, that would be it.

That would open assistance for problems the services face now, problems with bulges in their core structure. The law won't let us solve them. We keep bumping into it.

With pilot authority, as it was written and submitted to this Congress, we would have to work with OMB, the director of OMB, control the scale, report back to the Hill.

But, when we saw something we wanted to do to the force, we could do it, notwithstanding any other provision of Title 10 or Title 37. If we had that, we could all use our collective energy and make progress faster than when we have to wait for the Hill to permit and to approve them.

DR. WILLIAMS: Admiral.

ADM CLARK: I would take Bill's approach, but I would ask for the authority to run a massive pilot that gave me the ability to search out the Fortune 100 companies that have the most progressive human capital tools and approaches that exist and let me try them in a segment of my market. That's what I would ask to do.

My chart out here (indicating) with 15 to 20 years is totally out of whack, completely out of whack. There should be tools available to me to do something about it.

That's what I would do. Give me a chance to show what can be done. Define the pilot set. Make it broad and give me a lot of flexibility, and I believe we can show the Congress that we can produce the human resource core structure for a lot less money than we're paying today. I'm absolutely convinced that we can do that.

DR. WILLIAMS: Thank you. Other questions? Carl.

FROM THE AUDIENCE: I have a question about the internal organization that you have in order to support your vision of a dynamic human resource management. I think you have the same problem here.

As you put force development up on the stand, what manpower requirements [inaudible phrase] oversight. Then we have the management of people, which is assignments and promotions. It's all done in a personnel system separate from the other. Then we deal with the pan allowances, which is program based.

How can you get a dynamic, integrated management structure to realize this vision when you have these completely separate accountings [inaudible phrase] that are really closely related?

ADM CLARK: Me?

FROM THE AUDIENCE: Yes.

ADM CLARK: It requires an enlightened management approach. I looked at even integrating more of these things under one person. You have to run a matrix approach that has everybody involved. What I found is that if the senior executive is involved, that the other executive vice-presidents are involved. That doesn't mean it's without difficulty. It is a challenge. Just taking the training piece alone, some of the services run the training organization and personnel organization together. I've got my training guy. He's got a full-time job. There is no way he could do what we expect of him and also do all this innovation in the personnel side.

It's a matrix. That's the way I think you have to do it. That's the way I'm trying to do it.

FROM THE AUDIENCE: I have one thing to say about pilot programs. They may be all right provided that you set forth at the outset what will be the criteria by which this pilot will be judged as a success or a nonsuccess.

Far too often when we have pilot programs, “We’re going to do this for three years.” We do it for three years. The world doesn’t come to an end. “Great. We’ll make it permanent.” There are no criteria whatsoever.

A good example of this is the Army College First, which the Army ran back door through the Congress. Not completely through yet. But they had no criteria. They showed that it attracted a few more people. So what? Big deal. What does that mean? Nothing.

The other two questions I have, they are not really questions but I could reformulate them as questions. There are two serious objections that I have to Bill Carr’s presentation. The first is that whole slide on pay gap, which I think is totally bogus. The second is on the perversion of assignment incentive pay in Iraq, which I think is a bad precedent. I’d like to comment on those two things. I would make them a question by saying, “Bill, how in the hell could you say this?” We are at war and you find yourself with some odd circumstances, and Gene and I just talked about this. You have no idea how we struggle with this stuff with our leaders and trying to get done.

I think what I would say to it is we didn’t have anything in law that says what to do once you promise 12 months boots on ground. Promises, we break them all the time. We have been doing it for years. But, “Not now,” says the Secretary, and for good reason. We probably all applaud that.

So, when he says that and the chairman suggests a reasonable amount, I have nothing more reasonable to offer. There is no research base. So we say, “I’ve got to deal with this circumstance of a seriously broken promise.”

It creates dynamics in my organization. It creates political dynamics and I’ve got to deal with it, and the only rotten tool, because I don’t have the pilot authority, is to semi-bastardize within the law something that I can use to achieve the desired outcome. That’s the tail wagging the dog, and we shall do it together.

ADM CLARK: This all came about from some analysis that was done by CNA[C] that showed, for the Navy, we’re committed to six-month deployments based on 2:1 turnaround ratio and all that. Beyond that, we must negate the negative effect of a deployment extension with some sort of a stipend.

As much as anything, it’s about a recognition. Who knew what the exact amount should be? But recognition in the psychic sense is very important to the individual, communicating that we understand that their sacrifice was great.

FROM THE AUDIENCE: That's what this is. It's a recognition, but why pervert a beautiful pay, assignment and incentive pay as voluntary to do this?

ADM CLARK: Well, we're in the practical matter of need. Let me make one more observation. ITEMPO [Individual Personal Tempo] pay was enacted by the Congress to slap our wrists if we kept people gone too long. I would ask you in your work to consider what our profession is about. It is about being gone. The concept behind this law was absolutely the opposite of what it needed to be. I need incentives to encourage people to believe that operating at sea is a good thing. It's difficult. It's challenging. I make no apologies.

The rest of my promise is your life is going to be hard, but if you're gone too long, something happens and you get a little bit more money. The idea behind ITEMPO is the opposite, that you're going to punish the Services and there is going to be a penalty tax.

The psychology of ITEMPO pay works against building a force that wants to be part of this organization. So, I ask you, then, in your work to consider that the psychology of this really must be understood by totality of our force.

The \$1,000 stipend was a move that I understood to say, "What we do is hard. You're doing especially hard things. We're about to try to remunerate you for it." I think the concept is right. I don't argue with the manner in which we had to go about it.

FROM THE AUDIENCE: I wasn't making a case for the other congressional thing.

MR. CARR: By the way, so I'm clear on Gene's thing, the short answer is it was the only game in town, according to the lawyers, so we went that way. Secondly, we immediately followed up with an increase in the ceiling for the pay that would serve that purpose. We have it if we do these things, we recognize and follow a duty to quickly follow-up and correct the legislative deficiency.

FROM THE AUDIENCE: I was an early supporter of assignment incentive pay. I worked to get that through. One of the things I wanted from the Navy but I didn't get, and I let it go because it was a good idea, I wanted an assignment and incentive pay to replace all of these pays that are based on location. Prime among them is hardship duty pay. Who is to say what a hardship is? A hardship for one guy is a piece of cake for another guy. Assignment incentive pay takes care of that. You don't have somebody in the Pentagon making an arbitrary decision, "Well, there is a hardship over here. Here's a \$300 check."

DR. WILLIAMS: Let me talk about that because I would like to pull together Gene's comment about the pay gap and his comment about the pilot authority. I think both of those get to something the admiral mentioned, but something you in this room have taught me. I never discovered this by myself.

That is that we never know enough about how people behave when you provide a new set of incentives to them. We wrote a chapter all about this, all about pilot studies, simulations, experiments, and the unfinished level of most military pilot studies where personnel issues are concerned.

We don't know enough about how people will behave. Before we make any changes, we really should find out more about how people will behave, which is why it's good to have pilot studies that are real studies where you really select and you really understand. If you design it well from the beginning, you get new understanding.

This goes to the heart of this question about the pay gap that Mr. Carr mentioned in his briefing. The last QRMC took up the question of whether there was a pay gap. They said, "Well, there must be a pay gap because increasingly enlisted people are going to college."

If you compare their pay to pay of people in the private sector who have been to college and have the same number of years of experience, it's not as close to the 75th percentile level. It's not as much higher than paying in the private sector as pay for people in the other bands of the military.

So, they said, "We need a pay increase, a targeted pay increase to boost the pay of mid-level enlisted people." Now, were mid-level enlisted people walking out in great hordes? The answer is no, they weren't.

CBO recently took a look at this issue again and said, "You know, before you make changes, you ought to ask whether there is a real problem or is this one that the economist sees that could become a problem."

See how people are really behaving because the truth might be that overall, the total military compensation package is so good that it keeps people in who have college education. They are not wandering away. So, to the extent that you want to target pay, maybe it should be targeted so that you have the specific skills that you need.

So, I think we can leave the story that takes up both of those. I would highly commend this piece of work.

IV. RESERVE AND NATIONAL GUARD COMPENSATION: SHOULD IT CHANGE?

DR. JEROME E. PANNULLO (Director, Economic and Manpower Division, Office of the Secretary of Defense, Program Analysis and Evaluation): The next panel we have is Reserve and National Guard Compensation: Should it Change? Each of our panelists has a great wealth of experience and knowledge and expertise in this area.

First, I will introduce John Winkler, who is the Deputy Assistant Secretary of Defense for Reserve Affairs, Manpower and Personnel. In this capacity he serves as the principal staff assistant and advisor to the Assistant Secretary of Defense for Reserve Affairs, for all National Guard and Reserve manpower personnel compensation policies, and this includes Reserve component manpower requirements, personnel programs and management. He also looks after medical readiness and develops legislation affecting Guard and Reserve manpower, personnel, and compensation. Dr. Winkler, prior to this, was a Senior Behavioral Scientist at [the] RAND [Corporation] and Associate Director of Manpower and Training Programs at Arroyo Training Center. In that capacity, he managed and directed studies addressing personnel management, readiness and resources, and individual unit training, and Army Reserve Components. Dr. Winkler, has an undergraduate degree from the University of Pennsylvania in psychology and anthropology. His doctorate in social psychology is from Harvard University.

The second panelist is the Honorable Michael Dominguez. He is the Assistant Secretary of the Air Force for Manpower and Reserve Affairs. He is responsible for force management and personnel, equal opportunity and diversity, Reserve Affairs, and Air Force review boards. Mr. Dominguez has a lifelong association with the military. He grew up as an Air Force dependent living on bases around the world. He attended the United States Military Academy at West Point. He graduated from there and served on active duty for five years. When he separated from the military, he went to Stanford University for an M.B.A. From there he went to the Office of the Secretary of Defense, Program Analysis and Evaluation [PA&E], where he rose to Senior Executive Service, heading up the Planning and Analytical Support Division of PA&E. Then he went to the Office of Chief of Naval Operations Staff in their programs and budget shop. He left

Federal service in 1997, went to the private sector and worked there for a couple of years. Then he came to the Center for Naval Analyses [now the CNA Corporation or CNAC], and after that, back again to the Chief of Naval Operations. Subsequent to that, he was appointed to and confirmed in his current position.

The chair of this panel is Dr. Glenn Gotz. He is currently a research staff member here at IDA. His research is on defense manpower, personnel, and training issues, and on roles and missions of reserve forces [and] employer support for the National Guard and Reserves. Prior to being here at IDA, he spent a couple of years in Cambridge, Massachusetts, at the Workers' Compensation Research Institute. Before that, for more than 25 years, he was a RAND [Corporation] researcher in Santa Monica. While at RAND, his research included studies of reserve force staffing and organizational issues, and the effects of compensation, retirement, personnel policy changes on the structure, turnover rates, and cost of military work forces. He was Director of RAND's Defense Manpower Research Center. His Ph.D. is in economics from UCLA.

DR. GLENN A. GOTZ (Research Staff Member, Institute for Defense Analyses): I'm also the oldest panel member. We're going to do this in descending order of age. Befitting the oldest panel member, I am the only one who is going to stand up. [The others] are going to work from notes from their chairs.



Restructuring Reserve Compensation

Glenn A. Gotz
Institute for Defense Analyses

This talk summarizes the chapter I contributed to *Filling the Ranks: Transforming the U.S. Military Personnel System*, edited by Cindy Williams. Who would have guessed how many things have changed even since I wrote the first draft? The number of reserve units called up has increased tremendously. The importance of having ready units not requiring too much training, ready to go, is increased. It's pretty amazing.

My ideas haven't changed since I wrote the chapter, but the emphasis on reserve compensation is certainly even more important than when I wrote it.

I'm going to start off and say one of the themes in my paper is that there really isn't adequate flexibility to deal with problems. I'm going to discuss three kinds of challenges facing DOD.



Challenges Facing the Reserve Components

- Offsetting potential retention problems
- Accommodating a wider range of participation levels by reservists
- Meeting occupational qualification goals in the Army reserve components

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One of them is offsetting potential problems associated with how long reservists are being required to serve on active duty and the numbers of people deployed, something we haven't seen in such great numbers since, I think, Korea.

Secondly, I will make some recommendations for allowing the compensation system to accommodate a wider range of participation levels by reservists, something that

OSD [the Office of the Secretary of Defense] has recommended. I think John Winkler will talk about this wider range of participation.

Finally, [we turn to] resolving a perennial problem in the Army Reserve and the Army National Guard, inadequate military occupational specialty qualification levels.



Offsetting Potentially Negative Effects of Involuntary Call-Ups

- We still lack strong evidence on the effects of recent mobilizations on retention
 - 1990s experiences are not good guides
 - Desert Shield/Storm active duty periods were shorter
 - Few reservists involuntarily called up in the period between Desert Storm and 9/11
 - Recent aggregate RC attrition rates have been stable
- DoD should be prepared for attrition increases attributable to sustained high level use of RC personnel in operations

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Just to sort of recap the issue, we really don't know yet if reserve retention will decline as a result of the recent mobilizations. There is just not enough information out there to determine the extent of the problem. After all, people signed up for the military. These are people who knew the possibility existed that they would be deployed. Certainly their deployments are longer. Some people have said we have broken a covenant with them. But we really don't know. We don't have any historical evidence one way or the other. The experiences of the 1990s are not good guides. Desert Storm was pretty short.

Even [with] Reserves, the number of duty days in support of the active forces was much greater in the 1990s than in earlier periods, it was pretty much voluntary. People who didn't want to go commonly didn't have to. Recently, at least, Reserve Component attrition rates haven't really declined. So, maybe there is not a problem. On the other hand, if there is a problem, it may come pretty fast with personnel coming back from Iraq

and demobilizing. DOD should be prepared to go out and use compensation to help offset those retention problems.



Accommodating a Wide Range of Participation Levels

- DoD considering new concept of reserve service—“continuum of service”
 - Some reservists may participate significantly fewer days than the norm; no need for 48 IDT periods per year
 - Others will regularly serve much more than the norm
- Structure of compensation is particularly problematic for attracting those who are needed only a few days a year
- End strength counting rules and rules for paying benefits may hinder use of reservists at the high end of participation

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The next challenge is one that Dr. Winkler actually took the lead on, defining a new concept called continuum of service. Some individuals you might find participating much less than typical, e.g., IT [information technology] professionals. You only need them to come in and wear a uniform two, three, or four days a year. Then, if you need them during a war, you have them available to call up. The current compensation system certainly is inadequate to attract and retain those kinds of people.

Other reservists might serve significantly more than the norm. If you want to have a system in which people are going on active duty for extended periods of time, then there are some accounting rules and ways of paying the benefits that ought to change in order to facilitate this movement on and off active duty.

Finally, the perennial MOS [Military Occupational Specialty] qualification problem. Many of you are probably aware of it. The goal for the Army Reserve Components is to have 85 percent of personnel qualified in their Military Occupational Specialty. They hardly ever make it.



ARNG & USAR Duty MOS Qualification Problems

- Goal is 85 percent; actuals commonly fall below 70 percent
- Unit personnel turbulence is a significant cause
 - Reservists change units and often need retraining due to enhanced promotion opportunities or geographic location preferences
 - Reservists spend long times in training pipeline
 - Untrained recruits counted against unit strength
- Reservists need retraining when units are reorganized or given new missions

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There are a lot of reasons why it happens. Personnel turbulence is a big cause. There are two principal causes of turbulence: high rates of personnel attrition from the reserves and high rates of transferring among units. But the upshot is that as new people are brought into a unit, especially raw recruits, the percentage of MOS-qualified personnel goes down.

Another source of low MOS-qualification levels, re-missioning units, is a different sort of problem and not as susceptible to amelioration using compensation, so I'm not going to deal with that.

Now, let me get to the recommendations because this is the heart of things. What I'm trying to do is build a system in which things are very flexible. So I'm saying, "Let's pay people in a different way than today."

A more flexible system is a two-part pay system." One part is just for participating. The amount that one person in a given grade and year of service might get could be different than the amount that a similar person in another unit might get based on how difficult it is to attract people into the different units.

The second part is pay per duty pay. Pay per duty pay in my scheme would be roughly the same as any active duty person gets. You get a day's basic pay and any

special pays. You get one-thirtieth of monthly basic allowance for subsistence and basic allowance for housing.



Recommendations: Facilitate the movement of RC members on and off active duty

Establish a two-part payment structure

- **Pay per duty day**
 - Basic pay and any special pay (like a current active duty day)
 - 1/30th of monthly BAS and BAH
- **Participation pay**
 - Initial structure: just enough to keep pay constant for the member with typical IDT and AT patterns
 - Over time: adjust according to where the problems are, e.g., by occupational specialty and/or unit to achieve recruiting and retention goals
 - Should be the principal compensation of reservists with limited peacetime participation. Reduces the significance of not having “good years” for retirement

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Participation pay is where the flexibility comes in. Initially you structure participation pay so that most people would come out even. The first day you put this plan into effect, if you're in inactive duty training 24 days a year and you are participating in annual training of 14 days a year, you get the same amount of money at the end of the year as you would under the current scheme.

That's only initially. Over time, one would expect that hard-to-fill units or hard-to-fill occupations would tend to get more participation pay. Easy to fill ones or perhaps less critical ones would get less. One of the deals is that unless you have a lot of money, you have to pay some people less in order to pay other people more.

So, as I say, over time you adjust participation pay according to where the problems are. For those IT specialists I mentioned earlier, this might be their principal compensation, so fairly high participation pay might be needed to induce them to become reservists.



Two-Part Pay Examples

- O3 with over 6 years of service, 48 inactive duty training (IDT) periods and 15 days annual training (AT)—39 duty days
 - Current compensation (2003 pay table): \$136 per IDT drill period and active duty day
 - Proposed: \$185 per duty day plus \$1744 participation pay
- E5
 - Current compensation: \$68 per IDT drill period and active duty day
 - Proposed: \$109 per duty day plus \$440 participation pay

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What would this two-part pay system look like? This is an example I did with the 2003 pay table looking at an O-3 with over six years of service who participates in 48 IDT [Individual Duty Training] drill periods and 15 days of annual training.

Currently, that person gets \$136 in basic per IDT drill period and active duty pay plus Basic Allowance for Housing II during annual training. What I'm proposing is to pay that person \$185 per duty day plus \$1,744 annual participation pay. The situation is analogous for the E-5 listed on the slide.

Now, if we were talking about Air Force Reserve pilots, then the participation pay would have to be much higher to make them come out even. You start off by setting their participation pay high enough so that everybody is basically coming out even.

But over time, if the pilots are hard to keep, then you might increase their participation pay. If they are easy to keep, you might not let it go up by as much as the annual military pay raise. This is a more flexible way to establish pay levels sufficient to achieve retention and recruiting goals in different units and/or military occupations.

This two-part pay system would also eliminate any unbalanced financial incentives that push reservists to prefer an inactive duty training day to an active duty training day or to a day in support of operations. Doing so would facilitate the movement of RC

[Reserve Component] members on and off active duty as well as any other change in duty status. Reserve compensation should be the same for each duty day, whether the days are performed in multiple short periods, a small number of lengthy periods, on reserve status, or active.



Recommendations: Facilitate the movement of RC members on and off active duty (2)

- Provide families of RC members on active duty with choice of subsidized care with current providers in lieu of TRICARE
 - Reservists currently choosing to keep their families with their civilian health care providers must pay the full premium themselves
 - DoD now pays employee's share of Federal Employees Health Benefit Plan premium for employee called up in support of contingency operation
- DoD should seek separate personnel end strength limits for RC personnel on active duty
 - Incentive is to write orders for 179 days or fewer consecutive days
 - Leads to accounting tricks and problematic planning

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Another thing that would make things easier to go in and off active duty is to change the medical benefits. Right now if you have orders for active duty for longer than 30 days, your family is covered under TRICARE. That means they may have to change the health care providers they are accustomed to dealing with.

TRICARE is not cheap. Right now TRICARE is not any less costly, I believe, than most HMOs [Health Maintenance Organizations] that people belong to through their employers. I'm recommending that reservists called to active duty should be given a choice between TRICARE and subsidized health care with their existing providers for their families instead of TRICARE. As it currently stands, reservists who want their families to stay with their existing health care providers must pay more out of pocket except in those cases in which employers will subsidize them.

The DOD now does it for its own employees. If you are a DOD employee and you go on active duty, your family can stay covered under the Federal employees' health

benefit plan rather than going on TRICARE. Do the same thing for the reserves. It should be a choice. It's like a cafeteria plan. It's not a requirement.

My second point on this slide is that there is an incentive to write orders for 179 days or fewer. Part of the deal here is compensation. Part of the deal is end strength accounting rules. If you are on active duty at the end of the year, then you count against active components and constraints.

To facilitate the movement of reserve personnel on and off duty, and especially to reduce the incentive to get those back off active duty before September 30th, some changes need to be made in the accounting rules. This, again, is part of the increased flexibility.



Recommendations: Bonuses and Other Special Pays

- Establish contingency bonus fund for intervening when retention declines in high perstempo units
- Provide payments to increase rewards for longevity/proficiency within same skill
 - Critical skills retention bonuses or proficiency pay for hard-to-fill skills with payments linked to remaining in the same skill
 - Rewards for job tenure would have to increase to offset lower promotion rates
- Increase funding for special pay differentials or bonuses for hard-to-fill units

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The amount of pay that goes to the reservist that's flexible, that isn't mandated by law, is very small. I believe the amount of bonuses is maybe equivalent to five percent of the basic pay budget, certainly less than ten percent.

But what we have seen is that basic pay is too blunt a tool to deal with the turbulence causing MOS-qualification problems and other sources of personnel

shortages. It doesn't necessarily put money into the units where you have retention problems.

I'm recommending that there ought to be a much larger reenlistment bonus fund. Especially, I'm suggesting a contingency bonus fund for when all these people come home from active duty from Iraq because we don't know what is going to happen to their retention.

Maybe it won't be needed. Congress doesn't like to give funding for money you don't know for sure you're going to need. But if people come home from active duty and leave in droves and DOD has to wait a year before it gets the budget authority to alter retention incentives, that's waiting too long.

If you wait until the retention and recruiting goes down, you have waited too long. That's a line from the QDR of a couple years ago and it's the right line.

I also suggest that rewards for longevity and proficiency within skills be increased. In particular, to help deal with the MOS-qualification problem, there should be payments that are tied to remaining in the same skills rather than changing skills to advance in grade. The payments would have to be large enough to offset any negative effects due to reducing promotion prospects.



Recommendation: Revisions to USERRA for High End of Continuum

- Existing protections in USERRA not appropriate for the reservist who is at the high end of the continuum of service
 - Employer required by law to maintain the reservist's job and, in general, treat the reservist returning from active duty as if no break in employment
 - USERRA will impose undue burdens on the reservist's employer at the high end of the continuum of service
- DoD should establish new category of protection for reserve service
 - Applies at high end of voluntary service continuum, e.g., missing more than 125 civilian work days per year for more than one year in a row
 - Lacks some or all protections enjoyed by those whose absence from their employers is not as frequent except in time of national emergency

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Finally, something that I have been working on is employer support for the Guard and Reserve. If we want to talk about a continuum of service system in which people can consistently go on active duty for maybe a half to two-thirds of the year, come back off active duty, and then do it again the next year, that's very unfair to employers. It could cause, I think, a major negative impact.

As you may know, the law currently requires that if you leave your job to go on active duty for a period up to five years—if you are on active duty voluntarily for up to five years—the employer has to provide you with the same or equivalent job when you return and there are certain retirement benefits the employer has to provide you as well.

What I am recommending here is that DOD should establish a new category of protection for this type of reserve service. Those individuals who know and plan to go on active duty for, let's say, over half time for several years in a row shouldn't receive the same amount of protections as those individuals who are called up involuntarily to active duty in time of national emergency.

That's it.

MR. MICHAEL L. DOMINGUEZ (Assistant Secretary of the Air Force, Manpower and Reserve Affairs): First, I want to say thank you for inviting me to be here. With your permission, and my apologies, I'm going to take you off on a little tangent that is connected to Reserve Component compensation but it's, as I said, a tangent.

The first point I'd like to make to you is that it may be premature to talk about compensation for the reserve units because compensation is a quid pro quo. The problem that we have now is redefining the "for what" the Reserve Components are to be compensated for, because the implicit contract that has been around since World War II, I think most people now are beginning to recognize is gone.

The origins of the Reserve Component or our concept about using Reserve Components is based in this major struggle for national survival, a once in a generation kind of event. You see it coming, the nation would mobilize, and everyone would go off to war, kick the bad guy's butt, come home, celebrate, and return to peacetime pursuits.

That's the philosophical underpinnings of the system that we have here and, you know, it's not now the experience that we have. Certainly it's not the expectation many people in American communities hold for their potential future.

We, in the Department of Defense, just had a huge discussion about whether we should go to 24 consecutive months of mobilization instead of 24 cumulative months.

That is a big debate. It is a signal that our business model has changed and that we have not yet adapted to the reality of what we're experiencing out there.

So problem number one is that we really have to define a new expectation. It's clearly not a once in a generation mobilization, go to war, come back again. It's something different.

The next thing is that we have to recognize that there are other very significant stakeholders in this discussion. This is not something that we solve inside the Pentagon in a little discussion among a bunch of policy and operations people who are drinking their own bath water. This is something that we have to work out with the Chiefs of Staff and the Chiefs of the Reserve Components. But beyond that, our state governors have a significant stake in the outcome of this discussion.

This week in the *Washington Post*, there was an article about the heavy use of the National Guard. The Adjutant General from New Hampshire was basically saying, "We're out of gas. I'm tapped out. Everybody is gone. We have used up the governor's militia." Now, there hasn't been an invasion from Canada in a long time, but there are other reasons the governor needs the National Guard. We're putting a serious tax on it.

The leaders in New Hampshire are saying, "We have concerns about our responsibility to our state." Other Adjutant Generals are in similar positions. Governors care about this "demand model"—the "for what" will we use our Reserve Components that we now have to develop and understand.

The Congress is keenly interested and vastly concerned. The spending binge they are on now is evidence they know there's something wrong and they are throwing every dollar they can get at the problem partly because it's an election year, but partly because they know that the way we are now using the Guard and Reserve is inconsistent with the expectation created and sustained for a generation. It is not the business model they grew up with.

Go back to the 24-month consecutive or cumulative debate. The law says consecutive. As you get into the dialogue with Congressmen, it's perfectly clear their understanding when they wrote that law was, "You go for 24 months, then you're back and it's over. If you want more than that, you better see us because we're going to declare war and go to national mobilization." Again, it's an issue of expectation defined by our business model. The Congress cares very deeply about how this debate comes out. Their unguided, well-intentioned spending binge is evidence of their level of concern about the outcome of this discussion.

Employers need to be involved. You think about it. These are your employees, and service in the Guard and Reserves pushes onto the employers an enormous amount of risk. In the old days, it was a risk they could deal with; it was a once in a generation event. Every patriotic U.S. company or any company doing business in the U.S. would step up to the plate and support their Guardsmen and Reservists going off to fight and win the war for national survival. Many of these employers guaranteed their citizen-soldiers protection of income, health care, and the like. They did wonderful things.

These employers are looking now at an open-ended commitment extending on as far as the eye can see. The amount of risk that's been shifted to employers is enormous. They can't deal with that. They are with us one time, two times, three times, but six, seven, eight? I think we will start seeing some drop-offs in employer support. Employers are critical stakeholders in this discussion.

The discussion about tax incentives for employers and about shifting the medical care burden from employers to the Government is all premature because right now, we don't know what to demand of them and they don't know what to expect. With that kind of uncertainty, you can't find a price that's going to clear the market.

I think the first order of business is to recognize that the contract that shapes the use of our part-time warriors is shot. Once we reach that realization, our next challenge is to redefine the parameters of a new relationship among the stakeholders. Only at that time can we have an intelligent conversation about compensation and benefits, and about splitting the workload burden among the different components of the force and the burden of compensation and benefits between the private sector and public sector.

Now I want to say a few things about some factors or characteristics that I think will shape this debate, or ought to shape this debate about what it is we're facing. The first is this will be a long, long, long conflict. Again, this week the *Washington Post* reported Secretary Rumsfeld musing, "I wonder if they are producing terrorists faster than we can kill them." What does that question tell you about the center of gravity for the conflict?

The center of gravity is what Art Cebrowski calls the non-integrating gap. It's the political environment in these countries. It's the economic hopelessness. It's the aversion to globalization and the threat globalization poses to traditional values and culture. It's a clash of cultures. It's a war about integrating the non-integrating gap. That's how you win the thing. Well, those things take a long, long time. This conflict is going to go on for a long, long time.

This conflict will be characterized by a higher level of deployed engagement than was our pre 9/11 experience. Even after Iraq and Afghanistan are restored to stability, U.S. forces will undoubtedly deploy to other trouble spots to support struggling regimes and to pursue the terrorist threat. In addition to this high level of sustained engagement around the globe, we will experience unanticipated surges or spikes in the demand for military capabilities. These spikes result from opportunities to reach out and kill the terrorist or because they brought the fight to us. Those are the characteristics of the demand function that we need to be thinking about. Our challenge is to spread that work across the different components of our work force.

Now, as we think about the components of your work force, we have to realize that our part-time force is a shared asset. We have to borrow that force from somebody else using it and who has other uses for it. Now, if we can't arrange a predictable schedule for our use of that shared resource, we are going to pay a risk premium. That's logical. That's just business. We either pay the risk premium or figure out how to mitigate the risk.

As we work through this problem, we will realize one size does not fit all. For some skills, for example IT [Information Technology] and civil affairs, we will find that it is not economical [to] keep those skills sharp in the active force. In these cases, we will want to rely on the civil sector to provide those skills and we will tap them as needed. Part-timers will be involved in the force and in this fight. But it won't be all skills. It won't be all demands. In this situation, the rigid pay table based approach may not be our best compensation strategy.

We may have to look at each individual skill or competency and negotiate the deal that's needed for that component of the force. In this negotiation over shared assets, all the stakeholders must participate.

In summary, we must recognize that our demand function has changed, so our business model for use of our part-time force must also change. That process must begin with a definition of the anticipated demand function. Subsequently, we must map the individual characteristics of the different components of our force to the unique characteristics of the new demand function. That allows us to apportion workload rationally. Only then can we begin an informed discussion of compensation and benefit strategies that will induce the part timers (and the other stakeholders) to perform the work we need them to do. In my view, the reality of the new business model will involve more use of part-timers over a very long duration of conflict. For those aspects of the part-time

forces that are going to be involved, expect to pay a higher price. We'll be renegotiating a contract that is 50 years old, and the price of the new contract will go up.

That's my take on compensation for the Guard and Reserves. I hope it was helpful. I will pass the microphone now to the youngster in our group.

DR. JOHN D. WINKLER (Deputy Assistant Secretary of Defense, Reserve Affairs): Only younger by a couple months, I believe. [It's a] real pleasure being here today. Thank you for the opportunity.

In preparing my remarks, I responded directly to the question [of] Reserve and National Guard compensation: Should it change? You will see that I am in total sympathy with the point Mike Dominguez has made about how the contractual foundation for reserve service is changing, and we can't anticipate all of the implications for compensation.

I will argue, however, that in response to the narrow question of whether reserve compensation is adequate and will continue to be sufficient, I'm of the belief that the structure of reserve compensation has worked pretty well and should provide us with the ability to respond to emerging challenges, provided that we have additional flexibility in the use of legislative authorities that we have today. In addition, we probably need some new legislative authorities regarding how we apply reserve compensation.

Let me begin with a classic formulation of the problem and then I will move on to talk about how compensation may change in the future.

As a general matter, many of us believe that compensation is at its essence a tool in support of larger force management objectives. In the personnel business, first and foremost among them are recruiting and retention.

If you want to ask the question, "should compensation change," first you want to know, "are we having a problem with recruiting and retention that implies there is something deficient about compensation?"

Are we attracting the high-quality people we need or are we not? Are we keeping the talented and best performing people that we have or are we not? This is a particularly interesting question, because in recent years, demands on the reserves have grown.

Despite growing usage, when we look at recruiting and retention or *attrition*—what we prefer to look at in the Reserve Components—in the recent past, what we see is that generally we have done all right. Have we experienced difficulties in those areas? That answer largely appears to be no.

The Reserve Components have been successful in the past few years in achieving recruiting objectives—during the two years plus since 9/11 and also encompassing the period of the 1990s during which we experienced increasing use of the reserve forces. Attrition has also stayed within acceptable limits during this time. Up to this point, I'd say that our compensation tool kit has been sufficient to manage the force to this point.

Having said that, I certainly don't want to be overly sanguine about the future. We are 32 months into the global war on terrorism, and we certainly do see some warning signs. We are starting to see some shortfalls in the achievement of recruiting goals. As of April 2004, looking at all Reserve Components together, they are reaching 94 percent of their recruiting goals. Attrition is still at acceptable levels, but as we survey reservists periodically, we are starting to see some alarming signs with respect to stated retention intentions.

Now, we all know that intentions and behavior are different matters, but there is definitely growth in the number of people saying they don't plan to stay. That certainly causes you to want to monitor this very carefully. Moreover, as Mike indicated, we have a high future demand. We anticipate using Reserve Component forces at a level of, say, 100,000 to 150,000 on active duty each year over the next three to five years. There is cause for concern about whether that level of utilization will have deleterious effects in the future. It certainly may reduce the intake of prior service personnel, which is a desired recruiting marketplace, as well as non-prior service personnel if people feel they are likely to face extended periods of activation. Similarly, attrition could go up.

Let's assume now for the moment we have our current compensation tools and ask if they are sufficient or inadequate for responding to emerging problems in recruitment or to higher attrition rates. I want to offer you a few general hypotheses about how compensation could work and whether it needs to change in any way.

First, I want to begin with an important observation, which is that compensation clearly does play a role and will play a role in determining how well we will do in recruiting and attrition. But it's important to remember that the reasons that people join or leave the military are heavily influenced by factors other than compensation. For reserves, we feel that providing predictability about the frequency and duration of activation and ensuring that when they are called up they are given meaningful and important work are important factors. The lack of those things is going to probably have a far greater effect on whether people join or stay than whether we make some changes in the nature of the compensation we offer them.

That goes to Mike's comments because clearly we will be changing expectations about the nature of the reserve service in the future. We may well be telling people now that, "When you join the reserves or if you stay in the reserves, you will have to look forward to, perhaps, being on duty as much as, roughly speaking, one year out of every six." Whether that expectation is met or violated will be a very important determinant of how we do with respect to recruiting and attrition. Now, having said that and assuming we do face difficulties, clearly compensation is where we're going to look in terms of where we might want to consider change.

Now I want to offer you some simple-minded observations in that regard. First and foremost, and I think it is no surprise to anybody in this room that if you want to improve recruitment and retention (or reduce attrition), current compensation is going to be far more important and powerful than deferred compensation.

As I say, it may be obvious to us, but there are people who feel that it's important to do things with deferred compensation like lower the age of eligibility at which reserves can collect their retirement check, which, incidentally, has its greatest impact on the people who have already retired as opposed to people who are in the force today who you want to induce to stay or those who you want to join.

Why is current compensation more powerful? As Bill Carr mentioned earlier, it's a discount rate issue. As Saul Pleeter and John Warner have shown, officers discount future benefits at an average rate of 10 to 19 percent a year and enlisted discount future benefits at 35 to 54 percent. A soldier with a 35 percent discount rate values a dollar that he receives in 21 years, like a retirement dollar, at a fifth of a cent. It's easy to see that one dollar is more effective than one-fifth of a cent in shaping a near-term decision to join or leave the force.

My next observation is that among elements of current compensation applied to recruitment and attrition problems, pay is, generally speaking, more effective than benefits. Cash in hand as opposed to in-kind benefits has a powerful effect. This is arguable, because certain benefits can be very powerful. For reserves, educational benefits appear to be important. Nonetheless, on a relative scale, cash benefits are probably where you want to look to first.

Next, we want to give particular consideration to targeting cash benefits such as enlistment and retention bonuses to skills facing the greatest recruitment and retention challenges. This is the area where we get into the issue of authority.

In the reserve world, we have the ability to target benefits in selected instances, but we're very restricted in many respects. We really could use more flexibility to respond to emerging challenges.

I give you two examples. We are not allowed at present to give accession bonuses to officers in the Reserve Components. As demand for skills increase, we cannot respond by offering such bonuses. Having that kind of authority would be very helpful, for example, with C-130 pilots, where we face increasing demand and personnel shortfalls.

We also have restrictions with reenlistment bonus authorities. Basically, the reserve reenlistment bonus is much smaller and it is more restrictive in terms of eligibility requirements. If we are going to have reserves spending more time on active duty, we need more flexibility to recognize this shift in reserve utilization and the effect it may have on retention.

These reenlistment bonus authorities could be an important means to accomplish what we need. But we have the tools. It is the authorities that we would like to get.

I focused on this point on recruitment and retention as force management objectives. I want to comment on what Glenn talked about with respect to the "continuum of service" as a new personnel management paradigm, and additional considerations that are introduced in thinking about compensation. This will also tie, I think, to Mike Dominguez's comments.

There are a number of ways to characterize the "continuum of service," but one key facet is that it seeks to capitalize on volunteerism and adapt to individual circumstances to a more extensive degree than we do today.

That is to say, if members of the reserves wish to spend more time on active duty, the system should encourage transitions between more limited and more extended service. Additionally, as Admiral Clark talked about, think of it in terms of [that] active, full-time people should be allowed to "get off the freeway" and then get back on again.

We need a system with mechanisms that allow people who are able and willing to give more time to do so, consistent with service requirements. We need a more flexible personnel system that can respond more quickly to changing demands. Sometimes we call this the "Wal-Mart model." You size your work force not at its highest peak of demand, but at a level that is able to surge and meet periodic increases in demands and then fall back again.

Another metaphor I like to use is the FFRDC [Federally Funded Research and Development Center] model. By that I mean that you have in an organization [with] an integrated workforce composed of folks who participate at different levels. Some are full-time employees. Some are part-time employees working steadily at different levels of part-time, 25 percent, 50 percent, and so forth. Some are “project consultants” who sign on to do a particular task full-time for some period and then return to a lower level of participation.

If we had a military built around the ability to capitalize on different and changing levels of voluntary contribution, I think it would be flexible enough to meet changing and uncertain future requirements.

In our thinking, there are certain kinds of capabilities that can lend themselves well to this type of organization, but not everything does. You can’t necessarily build a combat brigade out of these kinds of volunteers, but you can certainly build certain specialized units. Commando Solo is one of our favorite examples in the Air National Guard.

If you seek to create these types of organizations, the issue is: Do we need to change reserve compensation? Now, we don’t know entirely. We have sponsored a study, which Michael Hansen at CNA[C] is leading, to examine whether we need compensation changes or not. It is at the moment focusing particularly on special pays such as assignment incentive pay and enlistment and reenlistment bonuses for critical skills as important tools. Some we have already in our tool kit, but we need more authority and flexibility in their application.

However, they are also looking at some new forms of compensation like availability bonuses similar to what Admiral Clark talked about to expand the pool of people willing to serve in the kinds of units that might be on a short string and used extremely often.

CNA[C] is also examining the idea of cafeteria style benefits, which could be very intriguing in this context, depending on what the individual values, whether it is special pay, matching in a thrift savings program, or extra retirement points and so forth. The service can structure these compensation packages in order to incentivize the kind of extended service it needs.

Now, as a continuum of service may rest on enhanced volunteerism, some think this needs more compensation. We do believe that there are numerous reservists who would volunteer to participate more extensively under the current system of compensation if the

personnel management system allowed it. In that case, they would receive more compensation because, the more they serve, they receive more days of compensation, more retirement points, more allowances and so forth. On the other hand, we think it's time we at least begin to prepare the foundation that we may need more tools or authority to use assignment incentive pay, availability bonuses, or "cafeteria-style" options.

To conclude, even imagining a different world, we think the general structure of the compensation system for the reserves can allow us to accomplish a lot of what we need now and may need in the future, assuming we get more flexibility in how we are able to use certain authorities, and assuming we get new authorities to use tools that exist today, including ones that the active forces have that the reserve forces do not have. Thank you very much.

DR. GOTZ: Any questions for the members of the panel?

FROM THE AUDIENCE: I will pick up since you're challenging us. Bernie was talking earlier about how he wanted the core structure [inaudible phrase] and compensation. I think Mike picked up on that. We were talking about a business model and see what the compensation should be and [inaudible phrase] in compensation right now. I think Mike is right. I think what we have in the Department is a kind of an overarching broad concept and a total force policy, which is clearly just kind of a basic credo that says [inaudible phrase], and that is implemented very differently in the services.

In the Navy there are a lot of individual organizations. People are going [inaudible phrase] compensation [inaudible phrase]. The Marines use small unit augmentation, the Army uses big unit augmentation, and the Army has particular problems of where to put the tooth and where to put the tail [inaudible phrase]. The Air Force has some mixture of all those models.

Not only [inaudible phrase], but I would also submit to you that the Air Force model, which I am familiar with, has really changed in the last ten years to the point where the Air Force[s] original idea was that we can use reserve units as augmentation to the [inaudible phrase] in a big way. But due to draw-downs on the active side and increased deployment requirements, they found themselves in a situation where they did not even do day-to-day peacetime continuous deployments. Now they are relying on reserve forces. Now, later on, due to mismanagement on [inaudible word] in the active side, in the pilot forces in particular, they can't even do day-to-day training of fighter pilots without relying on reserves.

That business model has changed in fundamental ways because we have been unable to make the [inaudible word] outside of the active forces [inaudible phrase] deployment requirements and we have had no real thought about how the personnel [inaudible word] on the active side to support and sustain the requirements of the reserve force over time.

There have been major changes certainly in the Air Force business model in response to the requirements. Now we see the same problems in the Army. They are dealing with enormous issues on how to use the reserves in the future.

Picking up on Mike's theme and Bernie's theme, what I think the Department really needs for the future is to begin with thinking through a business model as to how do you size this, actives and then the reserves, or pick up an [inaudible phrase] the other way around. [Inaudible quote.] I don't think we have any coherent concept of how to determine what's an active or what's a reserve function. We have no coherent policy for assigning functions, operations, and missions, and how to sustain them over time between actives and reserves. We are dealing with a compensation which is lacking in coherence to [inaudible word] business model. It is just too early.

MR. DOMINGUEZ: Let me offer a couple comments. The first is, as I would approach this, I would look at the demand and then the characteristics of the force; neither going in and saying, "How do I size the active force," nor going in with Steve Duncan's, "All missions are reserves unless otherwise." Just look at the demand function. Just look at the kind of capabilities of the different part-timers and full-timers. That is a sort of a business decision, I think, about where to put those as opposed to starting out with a bias one way or the other.

But I think you're right. This I see is the fundamental problem. I also think, and I have been telling people, "Look at this world today. It's a part-time force." They are not any longer in the Air Force. They are no longer a force in the reserves. They are in everyday. There are full-time forces manned by part-time people. That is what's happening in the United States Air Force today. You are right. We have some of all of this stuff.

One of the discoveries that we made in the 1990s in the Air Force is that you can buy a lot of recruiting and retention with predictability. You don't have to throw money at somebody. You just tell them, "Look. You got it from June of '05 until December of '05. I'm not going to bother you outside of that window." You can buy a lot with predictability.

One of the things I have also been telling people is it's probably a bad business model to apportion the surge requirement, the instantaneous, immediate, unanticipated, unscheduled surge on a part-time force that is also a shared asset with somebody else because that kind of disrupts somebody else's life. Not just the reserves. I'm talking about the employer, the Government. I wouldn't go there for the surge. I think our force in reserves increasingly ought to be active because they are the most flexible, the most immediately responsive, and the ones, if you look at the best characteristics of the force, best suited to that mission.

DR. WINKLER: To respond to Carl, we would love to have perfect vision and know exactly what we're going to face in the future and then back up and assign missions and structure forces with perfect clarity, but we don't. We can't. We never will. We can't sit on our hands and wait and hope that someone figures it out so we can design a force sufficient to meet parameters with which we all agree.

There is another method that can work. It's a form of boot-strapping that uses current demand to estimate near-term demands, say, over the next three to five years, and then examines force structure utilization with respect to inventory.

Doing so, you discover you have force structure imbalances. Certain people in certain skills are being used at too high a rate to sustain their use for three to five years.

Now you go one step further and decide on a goal, a force-sizing goal. Let's say you only wanted to use your reserves one year roughly out of every six. If you apply this in conjunction with the utilization rates, you can immediately see that you need more of certain capabilities and less of other capabilities, or you can examine the business rules you currently use to change how you use some of your assets.

I don't think there is anything wrong with operating this way. It responds to the stress on the force you face and reacts and shapes, as opposed to waiting for the perfect answer about the future.

DR. WILLIAMS: I want to see if I can get a fight started between Glenn and John and maybe Mike. John, you painted a picture that made me think we're pretty good. Recruiting is holding up and retention is holding up. [Inaudible phrase] the Reserve Component has people mismatched to their jobs. I think the figure was 70 percent of people are in the wrong MOS.

DR. WINKLER: They are lacking in duty MOS qualifications.

DR. WILLIAMS: This sounds like a recipe for a disaster to me, especially when a country goes to war, to have people not qualified for their jobs in those jobs. Maybe some of it has to do with the fact that people are moving or people just arrived, but some of it has to do, I'm sure, with the fact that we're paying people, you know, a one-size-fits-all way, and that people with critical skills in some MOSs are harder to get in. Some units are traditionally hard to fill.

These sound like real problems to me, problems that are buried under the surface of your big look at just recruiting and retention. I'd like to hear the two of you talk about: Are these problems or not, and are these problems that are amenable to compensation solutions.?

DR. GOTZ: Well, I'll start. The problem that I was specifically referring to is really endemic of the Army Reserve Components, not within the Air Reserve Components. The Air Reserve Components are smaller proportionately to the total Air Force. They have a lot more prior service people there.

In the Army Reserve Components, what has to happen when you have let's say 30 percent of the unit not MOS qualified and it's time to mobilize and go to war, you need to bring in other people from other units. One way of resolving that, of helping to resolve that is this new model of training, mobilize, and deploy, not mobilize, train, and deploy.

That is the idea there. You call up the unit staff to do this, to train, and you send people off. It just seems to me better if you want to train these people as a unit and minimize the time that they have to train collectively—you want to have people who are already qualified in the unit. It's very difficult to have a unit where 100 percent of the people are MOS qualified. My argument is basically that compensation could help reduce turbulence in the unit by increasing compensation for people who want to stay in the unit in lieu of getting promoted into other jobs. In terms of increasing retention, you don't have to bring in as many new people.

DR. WINKLER: In my comments, I was really just trying to stick with the issue of compensation and retention. That's not to say there aren't other issues or problems in Reserve Components.

The issue of duty MOS qualification rates is a chronic problem. Problems have been present for a long, long time. In one RAND study, as I recall it, historically in the Army Reserve Components, about 15 to 20 percent of assigned personnel are non-duty MOS qualified at any point in time, caused by a combination of force structure changes and personnel turbulence attributable to attrition and job movements.

To minimize job movements that result in MOS mismatches, the researchers proposed to use “stay in place incentives,” which is a compensation tool. However, a lot of people are non-duty MOS qualified for other reasons that ultimately tie to lack of resources for training and readiness

I think in the end, the real issue there is not so much compensation as it is resources. It’s more a matter of changing structure, as the Army Guard and Reserve are doing, reducing overstructure and populating the remaining units to a higher level, and then finding resources that ensure a higher state of training and readiness. Being able to train prior to mobilization or well before scheduled deployments would also improve qualification levels.

MR. DOMINGUEZ: You had a question?

FROM THE AUDIENCE: Yes. I just want to make a general observation that I thought was interesting. When Glenn was sort of saying, you know, we kind of don’t know the supply, and then he was immediately saying we really don’t know the demand, a lot of us were at the all-volunteer force conference in September. One of the things I remember from that conference is that leading up to the all-volunteer force was a lot of research on learning about supply and demand, and it anticipates the end of the draft. That was more of an observation. I think there is a lot we don’t know right now. We are kind of in a new environment and we don’t know what the supply is for the reserves. Maybe you could speak to that. I wonder what’s going to happen to retention. Retention looks good but things could look bad soon.

On the demand side, I think Glenn was involved with research on demand and what is the productivity of people in the military, what is the volume of experience. We don’t really know what the value of experience is in the reserves. On the active side either. We don’t know what the demand function is.

DR. GOTZ: We certainly don’t know the supply. We don’t know what the supply function is right now in light of this new environment. One of the reasons why I was arguing for a lot more money to put into bonuses is exactly that reason. If we could know, if we could predict what the effect would be, we could have compensation authorities to offset them.

FROM THE AUDIENCE: And be ready.

DR. GOTZ: And be ready. We don't really know. I guess that I would say that my look was the shortest look. I'm worried about the next couple of years as opposed to thinking more broadly. We may be going after different things.

FROM THE AUDIENCE: I think what Gene was saying about the pay—maybe he's thinking there is no pay gap. In some ways, the pay increases the last couple years have been a buffer and, frankly, the recession that we have been in, or maybe we are not in, has been a buffer and has really served us well in light of what is going on.

That's one way to look at it. Had there not been those pay increases, things could be really bad right now in terms of retention and recruitment.

MR. DOMINGUEZ: I want to speak, I guess, generally. We don't need perfect certainty on this supply function or the demand. The first order of business is the demand function. We don't need perfect certainty. We can make some assumptions like I offered one. What you got out there today, that's what you keep there forever and forever. It doesn't matter what country. It's just that it's going to be like that. Okay. Now I can plan.

My own personal prognosis of how I would approach this, and I'm thinking about the part-timers are the wrong guys to use for a source [inaudible words]. We're out of the national mobilization or the national survival crisis stuff. We can set that aside. We can't discount it completely, but set it aside for purposes of the discussion.

What I would do is lay in the part-timers in a scheduled way around the globe until you use them all up in a way that they can be sustained in terms of training and preparation and that kind of stuff. You don't send them on deployments every year; maybe every six years, five years, four years, but lay them in the schedule.

Then you fill in the blanks with the active force. Then what's left, is your [inaudible phrase] active because they are responsible. I think you could do that. You could get a huge bang for the buck without throwing any more money at them.

Let me put one other thing out there for you. We talked about two components of the total force. There is a third component of the force, and that's the civilians. There are lots and lots of jobs that can be either military or civilian. We need to be thinking about it. We definitely need to be thinking through the contractor business, too.

But one of the things is integrating these things, particularly the Government employees, into a package, a single work force that I would use and develop and grow, you know, equally, use them where their characteristics are most beneficial.

In particular, on the civilian side there are forward-deployed requirements for civilians. We need civilians out there rebuilding countries. There are jobs out there that are best done by civilians and contractors.

Thinking through that thing that we start with, just nail down to some planning assumptions so we can start building around it and the certainty that the planning functions—everybody understands adjusting the plan. You have to have a plan to start with. Nail down something, build a plan around it that will deal with the supply problem. Certainty is a word for buckets of money.

MR. HOROWITZ: Will you join me in thanking the panel? We have actually had a real estate addition. We managed to get our hands on the IDA boardroom, which is just through there [indicating]. I believe what we're planning to do is we will have lunch in there. Secretary England will speak.

This is a somewhat more commodious environment and I think we will be able to fit. We then will come back here for the afternoon panels.

[At 12:30 p.m., the luncheon recess began.]

V. LUNCHEON SPEAKER

MR. KRIEG: It is my pleasure at this point to introduce our luncheon speaker, Gordon England. Gordon is a native of Baltimore and a citizen of Texas. He graduated from the University of Maryland with a bachelor's degree in electrical engineering, went on later to earn a master's degree in business administration from Texas Christian. Prior to joining the administration of President Bush, Mr. England served as the Executive Vice President of General Dynamics Corporation in a position in which he had responsibility for two major sectors of the corporation, information systems and the international division. Previously he had served as an Executive Vice President with the combat system group of General Dynamics in Fort Worth, and President of the General Dynamics Land Systems Company. He has seen much of our business from the industrial side serving almost all of our components.

At the onset of this administration, he became the nation's 72nd Secretary of the Navy, a position he served in until January of 2003, when he became the first Deputy Secretary of Homeland Security. We are very fortunate that Gordon chose to return last year to become the 73rd Secretary of the Navy, becoming only the second person—and my notes don't tell me who the first was, so I'm hoping he will know the answer to that—in history to twice serve as the leader of the Navy and Marine Corps team. It is with great pleasure that I introduce Gordon who, in addition to being the Secretary of the Navy, is the senior executive in the Lead of the National Security Personnel System implementation within the Department working very closely with David Chu in that responsibility.

I think he will provide some pretty interesting input both on the military and the civilian side personnel. Gordon, thanks for coming.

MR. GORDON R. ENGLAND (Secretary of the Navy): Ken, many thanks for the opportunity to be here today. This is a unique occasion for me. After 40 years as an engineer and a businessman, this is my first time to speak before a “dismal science” forum. All of you are certainly far more knowledgeable than I—after all, economists rightly predicted 9 of the last 5 recessions—but perhaps I can make a few observations that may assist you in your deliberations and discussions.

Earlier this week, I saw an interview with the former catcher of the New York Yankees, Yogi Berra. I always have to tell people who Yogi Berra is. I find when I go out in the street and I talk to people and I mention his name, everybody looks at me like who is that? I forget not everybody is my age.

It turns out that Yogi was a seaman in WWII [World War II] and, of course, he is famous for his profound advice on a myriad of subjects. After all, he was a student of Casey Stengel's. As I was watching and thinking of my comments today, I recalled Yogi's famous statement, "If you come to a fork in the road, take it." That ranks with the pronouncements of such economic sages as Keynes and Friedman—I'll try to be equally profound!

First of all, I thank you for what you're doing. This is a very important topic. What you do can be very important in terms of reviving us and reaching conclusions and recommendations. So I thank you.

Let's first, however, put this topic of compensation in perspective, or at least my perspective. The nation's reliance on compensation to recruit and train military forces began when we ended conscription in 1973. The Gates Commission, which recommended ending the draft and establishing an all-volunteer force, recognized that it would take substantial increases in pay to recruit and retain the quality and quantity of volunteers that the Nation required. That has remained a continuing mantra to this day; that is, ever more money is required to maintain quantity and quality.

Frankly, I believe we should test the premise; that is, does adding money alone to a conscription force make for a volunteer force? This premise seems to promote the approach that almost all military personnel issues can be solved with money. Even in time of war, if we want people to serve longer in Iraq, we provide extension bonuses. It seems to me that most personnel issues have devolved into some form of monetary incentives. So while this group is studying compensation issues, I suggest that you put this subject into a broader context.

We ask young men and women to make commitments and sacrifices that go far beyond the demands most employers make of their workforces. It's not just that we ask them to risk their lives and expose themselves to unusual dangers. We ask even more. It is that we ask these wonderful people who wear the cloth of our nation to also subscribe to higher and stricter standards.

My view is that that we may be placing too much emphasis on the bottom of Maslow's pyramid and not enough on the higher, motivation and satisfaction of accomplishment.

Some examples to make this point: Pat Tillman obviously didn't serve for money. Southwest Airline pilots make about one-half of their major competitors and fly more hours. Nurses, teachers, policemen and firemen all serve for some higher motive. For many, a life of consequence trumps compensation.

Another factor to consider as you study individual compensation is the total number of people in uniform. In most economic enterprises, executives address the total cost of the enterprise, one factor of which is compensation. But successful executives also increase effectiveness and efficiency by constantly retraining, adjusting, and modifying the workforce so they achieve maximum output at minimum cost.

My observation is that there is great reluctance to reduce the size of any part of a military organization except through attrition, and even that is difficult. In short, it is very difficult within the service to adjust the work force.

We also need to better understand the kinds of military organizations needed as new generations of technology are developed. For example, today someone on the battlefield in Iraq can communicate with words and pictures directly to a research facility in the United States. We can move information horizontally from almost anywhere in the world on almost any subject, but we still retain the military Napoleonic organizations of the past 200 years—organizations where information flows up and down.

That said, having been in Washington for going on four years, I clearly understand that not all problems and issues have answers. These are complex and profound issues and do require thoughtful study, discussion and dialog, and I again thank you each for your contribution.

Regarding individual compensation, the system is as much a disincentive as an incentive—although the total dollars appear adequate. The CBO [Congressional Budget Office] recently estimated that the average cost of a man-year of uniformed labor was \$99,000 in FY 2002 dollars—that's \$107,000 per year now, and even that figure excludes some elements of compensation. It also excludes the VA [Department of Veterans Affairs], one of the tail costs of DOD.

That realization was startling to many people who had imagined that our soldiers, sailors, airmen, and marines were just barely getting by. We have, far and away, the best

compensated military force in the world, especially when you consider that the average age is probably in the mid-twenties. But the other, and more overlooked, finding from that study was that only about 40 percent of the compensation package for our military personnel was in cash, compared to close to 80 percent in the private sector. And substantial portions of the total compensation are deferred—much higher than for private sector workers at similar ages.

I don't need to remind a roomful of economists about the costs of a high proportion of in-kind and deferred compensation. It produces a compensation system that is much less efficient at motivating most of its members than a system in which more compensation is up front and in cash. Unless we begin to reduce that inefficiency, we may not have the resources we need to use compensation as an effective force-shaping tool.

Although the Defense budget will remain adequate, it is probably evident to most economists that large Federal deficits cannot be endlessly increasing. We will soon come to hard choices and, if our personnel costs continue to increase, we will need to further reduce our investment accounts.

Unlike the most effective civilian compensation systems, the military system (and the retirement system, in particular) does not perform well in terms of efficiency, flexibility, or equity. The military's twenty-year vesting causes some members to be "carried along" to twenty years, even if the jobs they perform could be accomplished by less-experienced personnel, outsourced, or eliminated. It causes service members who might otherwise want to leave to stay until twenty or else forfeit a large fraction of their total compensation.

At the same time, the immediate annuity and mandatory retirement at thirty years of service results in some members with important technical and management skills leaving soon after reaching twenty years. They are about to collect their annuity, continue their health coverage, and start a second career while still in their early forties.

The fact that so few junior members serve long enough to qualify for retirement, coupled with the very high discount rates that younger members apply to future income, mean that retirement has little impact on initial entry or early continuation choices— young people overwhelmingly prefer immediate to deferred compensation.

I can speak to this personally. In the early 1960s, after graduating from college, newly married and then new babies, still paying off school loans, etc., etc., I elected not to invest in the company's retirement account. It was too far in the future, and I needed

the money then. Fortunately, later in my career, the company provided a one-time opportunity to buy back those years in which I had elected not to participate. But the point is still clear to me—that young people have immediate demands that are not satisfied by deferred compensation.

Direct active-duty military personnel-related costs consume about one third of the Navy budget, making it hard to afford the operational pace and recapitalization programs we require. Here are a few facts from the Department of the Navy: Active duty military personnel spending increased by 40 percent (from \$24 billion to \$34 billion) from fiscal years 2000 to 2004 while [the] number of personnel remained flat.

Included in the \$34 billion is \$1.1 billion to move military personnel, families and household goods in Fiscal Year 2004.

We will spend another \$5.4 billion for housing costs (construction, maintenance and housing allowances) in Fiscal Year 2004. That equates to approximately \$9,700 for every sailor and marine on active duty. That amount does not include costs associated with barracks facilities or shipboard berthing, but includes the personnel living in barracks and on board ship.

My point is that these costs are large and growing and are crowding out other needs. Even that would be okay if we were convinced that we were getting the maximum return for dollars spent.

In my judgment, the management issue we need to confront is that the demands of the twenty-first century military are not being well served by the current human resources system. If you believe, as I do, that the global war on terrorism will be with us for a long time, much like communism was with us for forty years, then it behooves us to design a system that fits the times and the needs.

The civilian environment that serves as both a source of—and competition for military personnel—is changing in some dramatic ways.

Increasingly, the private sector is going to cafeteria-style benefits and 401(k) plans to augment and sometimes replace retirement plans. The military compensation system is still too rigid. We are working at the edges, but not fundamentally with what the system should be.

I would like to encourage this group to challenge some of the fundamental assumptions of the current compensation system.

First, does our compensation system need to be so confusing and complex, much like an airline fare structure? We all like to get the lowest fare and no matter how low our fare, it is still a personal inequity if the person sitting next to us has an even lower fare. Does our military compensation system have similar disincentives? Frankly, only an economist could possibly understand the myriad of classifications, incentives, and bonuses that exist today.

Second, are we viewing compensation as part of a total package of reward, including satisfaction and accomplishment for serving our nation, or are we trying to displace higher needs with lower needs? If you concentrate only on the compensation, then I believe we're doing a disservice to the nation. Even when we had a conscription system, we had a lot of volunteers and they served at very low incomes. They did it for the nation—again, much as police, firemen, and nurses and other people do today.

Additionally, should military compensation be paid to pay grade and years of service or individual value to the organization? Our system is a pretty rigid one. At a certain rank you get a certain pay. And within those ranks you get an increase over time. It's not based on value. It's based on time and grade.

Fourth and last, can we turn the deferred compensation system upside down? How do we change it and what's the time line?

I'll leave you with these questions and I want to tell you about a story I recently heard. A man is walking along a road in the countryside when he comes across a shepherd and a huge flock of sheep. He tells the shepherd, "I will bet you \$100 against one of your sheep that I can tell you the exact number in this flock."

The shepherd thinks it over—it's a big flock of sheep—and so he takes the bet. "Nine hundred and seventy three," says the man.

The shepherd is astonished, because that is exactly right. He says "OK, I'm a man of my word, take a sheep." The man picks one up and begins to walk away.

"Wait," cries the shepherd. "Let me have a chance to get even. Double or nothing that I can guess your exact occupation." The man says sure. "You are an economist for a Government think tank," says the shepherd. "

Amazing!" responds the man, "You are exactly right! But tell me, how did you deduce that?"

"Well," says the shepherd, "put down my dog and I will tell you."

Finally, I do want to leave you this one last thought. Right after 9/11, a reporter interviewed a little nine-year old girl. The reporter said to this little girl, “What is patriotism?” And this nine-year old girl, said, “Patriotism is taking care of America.” Taking care of America. The pleasure I have as Secretary of the Navy is meeting with people across America who are patriots taking care of America.

I thank you for the opportunity to be here today and I hope I gave you a few good thoughts. I am happy to answer any questions or make any additional comments. Thank you.

FROM THE AUDIENCE: You’re not going to tell us who the other secretary was?

SECRETARY ENGLAND: This is a true story: the USS Princeton was on the Potomac River; it was a Navy ship and it had a new gun. This was about 1844. The new gun was 2,800 pounds, I believe, and it fired a 300-pound cannonball. It was an experimental gun. President Tyler was on-board. The senator from New York was on board. The Navy secretary was on board. For entertainment for the guests, they would depress the gun and skip cannonballs down the Potomac. This would not pass the *Washington Post* test today. That was the entertainment on-board ship. They decided to do it one more time. The gun blew up, and the gun killed the senator from New York and also killed the secretary of the Navy, and he had only been in office for eight days.

It turned out, by the way, the senator’s daughter was on-board, and Tyler, whose wife had died, had asked this young lady to marry him, but she had refused because her father felt that was not prestigious enough. I mean, he was a senator, a lot of money. Being married to the President wasn’t held in the same way in 1844 as it is today.

When the senator was killed, it turned out that this young lady, Julia Gardner, passed out. Julia passed out, and the President carried her across the gangplank to another ship to safety. Eventually Julia Gardner did marry the President. By the way, as I carry you on through the story, Julia had parties and all in the White House. She liked that. She was sort of the one that started these big, festive affairs.

It always bothered her that Tyler, who was a relatively small man, would come into the room during cocktails where everybody would ignore the President. She didn’t like that. She instructed the Marine band to play “Hail to the Chief” whenever Tyler came into the room.

Also, she was the proponent to bring Texas into the nation. She worked hard with her husband and with the Congress. She lobbied the Congress. Indeed Texas was brought into the nation.

The reason I tell this whole story is because if all this hadn't happened, I would have probably been the Secretary of the Navy for Texas rather than the United States Navy. So, it does all come around.

[The only other person to serve two terms as the Secretary of the Navy was] John [Y.] Mason. It was Mason who replaced Thomas Gilmer. Gilmer was the one who was only in for eight days. [His first term was from March 1844 to March 1845 and the second term was from September 1846 to March 1849.]

That probably killed all the questions, I was that long. I hope you enjoyed it.

FROM THE AUDIENCE: Mr. Secretary, I have a question regarding your experience with NSPS [National Security Personnel System]. One of our speakers said as tough as it is to think about how you design military compensation systems in the abstract to make it do all the things we want to do, transition would be even tougher.

Given your experience in looking at how that transition would work with NSPS, what kind of lessons might there be to apply to a reformed military compensation package if, against all odds, we should be able to fashion one?

SECRETARY ENGLAND: For NSPS, we will put out broad regulations probably late this year, but I can tell you an approach, which I believe is very important. I personally spent a lot of time on [Capitol] Hill, with senators and congressman, talking with staffers, talking about NSPS in terms of the process. In this town, the process is perhaps more important than the end result, or you can't get to the end result. You can't ever implement it. You have to spend a lot of time designing the process and involving all the right people in this process.

For example, Monday, we had thirty-one of our union leaders—thirty-one out of forty-one unions. That probably accounts for 98 percent of all of the people unionized in the Department of Defense. At our very first meeting with our team, Mike was there and maybe David Chu was there, but it was the first meeting with union leadership.

We had to get this body and get people involved for them to be part of it. Otherwise, you won't get by them later on. We still have a long way to go, but I do know the process is at least as important as the recommendations you come up with. How you get there is at least as important as what you end up with.

FROM THE AUDIENCE: You spoke to a potentially different compensation system. One of the principles, as you know, we follow now is we have the same system for all four military services. What are your comments on why it might be useful to abandon that principle going forward?

SECRETARY ENGLAND: You know, I had that as my fifth recommendation at the end. I actually question that. It's not evident to me why we have a uniform system across all the services and across pay grades regardless of what you do. I find it hard to believe that just because you are a certain rank doing this job versus that job that you should be paid the same. Now we compensate by closing incentives, and maybe distort the whole thing and nobody quite understands who gets paid what.

I think that's a valid question. Should they be the same? I think some people in the Marine Corps are very proud to be associated with the marines. I tell you what. They are not going to go to another service if you paid them more or less.

I think that's true with all the services. There are people who have an association, an empathy for that service. I believe that is a valid point. I frankly believe we need to start appealing more to those kinds of interests than just reducing everything to dollars.

It does bother me that every subject that comes into my office becomes a dollars discussion. I do not believe that that's why people serve America. I think there is a minimum. You have to have a certain level, but beyond that—that's not why most of you are here today. It's not what you make everyday. That's not the issue.

Most people working in Washington work for a different reason. Everybody believes you are making ten times as much money. That's not why we're here. We're here to serve the nation. We're here to serve men and women in uniform.

I think we have to start appealing more to serving this nation while providing the right package of benefits, but not constantly asking people to serve on the basis of money.

"Spend another month overseas and you make this much more money. Spend another week in Iraq and you get paid this much." I don't believe that, in my time in Iraq, one single marine even thinks about what he's making. Nobody is checking to see how much is deposited in their accounts at home. That's not why they are there.

FROM THE AUDIENCE: But they know what they are getting, Mr. Secretary.

SECRETARY ENGLAND: They know what they are getting. I'm sure you're right.

FROM THE AUDIENCE: Mr. Secretary, I have a question about you're essentially a civilian and seen on the Hill as a civilian. To what degree, to change this system, is it really going to have to have a military [inaudible word]?

SECRETARY ENGLAND: It has to. It has to have a military leader. You can't do this. The civilian sector cannot do this. We don't go out and fight the nation's wars. We don't go out and do that. It's the military. This is military leadership. You have to get the military leadership convinced to buy in. It's their military. It isn't ours. It's theirs.

Military leadership works for me by way of Admiral Clark and Commandant Mike Hagee. They are the military leadership. They set the tenor for the military, not me. I can move in a direction, but at the end of the day, they are the military leadership.

By the way, somebody said, "Guys like me, we're just summer help." We come and go. The military is here. It's a military issue. You do have to get the military. I think that's important, by the way. That's why I bring it into this compensation. What is the structure of the military? How do you be effective as a military? Why do we have all these same systems in place and these convoluted organizations?

Jim Jones, when he was commandant, we were sitting in a meeting one day and we were talking deploying forces. He said, "You know, we have this whole structure in the United States Marine Corps, but when we deploy, we don't take that structure with us. We don't take this structure, this whole structure of everybody. That isn't what's deployed."

We send out a whole different command structure and, bang, "it's this way." It's very flattened. It's very precise. "We don't take that with us." If we talk about we're going to train the way we're going to fight, that's not exactly what we do.

I mean, I believe at the end of the day, they are important issues because that's a cost to how we do it. It's also effectiveness. This is not an issue of efficiency. I tell the Department of the Navy, "We are not trying to be more efficient. We are trying to be more effective."

When you are more effective, you will be more efficient. Everyday do better. Do things shorter. Get rid of overhead. Find new ways to do it and you will invariably save money. That's what we do. Everyday we try to do it better.

Thanks, everybody. I enjoyed it. Good to be with you.

MR. HOROWITZ: Any other questions? Gordon, on behalf of all of us, thank you very much for setting the tone for the afternoon. Thank you.

SECRETARY ENGLAND: My pleasure.

[At 1:00 p.m., lunch recess ended and the proceedings resumed.]

VI. MILITARY COMPENSATION: VIEWS FROM THE HILL

MR. HOROWITZ: Not all of you gentlemen were here this morning. Let me give you just sort of a broad overview of some of the philosophies. These weren't the only main threads, but I think there were sort of two threads that are of issue.

One was in the realm of military compensation; we don't quite know exactly what we want to do. There are many things we could do to improve the situation and get more efficient, but we haven't quite worked out the details. The second point was even if we did, Congress won't let us do it. I think it would be very worthwhile to hear the point of view from outside the building, and in particular, from people who work with Congress and see it from a congressional perspective.

I'd like to introduce the panel. I think we have a very distinguished group. The chair of the panel is Douglas Holtz-Eakin. He is the sixth Director of the Congressional Budget Office where he was appointed for a four-year term starting in February of 2003. He previously served for 18 months as Chief Economist for the President's Council of Economic Advisers. Before that he was a Senior Staff Economist there. Dr. Holtz-Eakin is Trustee Professor of Economics at the Maxwell School, Syracuse University. He serves as Chairman of the Department of Economics and Associate Director of the Center for Policy Research. He also served as editor or an editorial function for many journals, including *National Tax Journal* and *Journal of Human Resources*. He's been on the editorial board for *Public Budgeting & Finance*, *Economics & Politics*, *Journal of Sports Economics*—and maybe you can capture him later and inquire about that—*Regional Science and Urban Economics*, and *Public Works Management & Policy*. In the past, he held academic appointments at Columbia and Princeton, from which he received his Ph.D.

Next to him is Mr. Henry Hinton. He is the Managing Director for Defense Capabilities and Management of the U.S. General Accounting Office [GAO]. He's held this position since October of 2000. He assists the Comptroller General in directing the overall operations of GAO, and he is responsible for the full range of program audits and evaluations that GAO undertakes to improve the management of funds spent by the Department of Defense in a wide range of areas, including military and civilian

personnel. The portfolio of GAO's work under his leadership in helping Congress evaluate DOD's efforts to recruit a highly skilled military and civilian work force and create a quality of life that will help to retain the force, subjects of interest to us all here. Since he joined GAO in 1970, he has held many key positions involving defense and foreign affairs. Mr. Hinton has received several awards, including GAO's Comptroller General's Award. He received a bachelor of science in management from the University of Richmond and has completed the MIT Seminar XXI for Foreign Politics, International Relations and National Interest and Harvard University's National and International Security Program.

To his left is Michael Lofgren. Since 1995, Mr. Lofgren has been a budget analyst for national defense for the majority staff of the House Budget Committee. In 1994, he was a professional staff member of the House Armed Services Committee's Readiness Subcommittee. He began his legislative branch career as a military legislative assistant to Congressman John R. Kasich of Ohio. He has both a B.A. and an M.A. in history from the University of Akron, and he was awarded a Fulbright to study European history at the University of Basel. He has also completed the strategy and policy curriculum at the Naval War College.

We have a very distinguished group. If I can figure out how to get the mic[rophone] off, you all may have it.

DR. DOUGLAS HOLTZ-EAKIN (Director, Congressional Budget Office): Thank you for the very generous introduction. It's a pleasure to be here today. I want to correct the record in just one tiny way, which is that I am no longer on the editorial board of the *Journal of Sports Economics*. It was one of the casualties of my time at the White House, where the legal counsel somehow concluded that it would be an ethics violation for me to retain that honor. I miss it.

FROM THE AUDIENCE: I can believe that.

DR. HOLTZ-EAKIN: Other than that, I enjoyed my time immensely and I'm going to enjoy today even more because this is really a very timely conference, and it's something that certainly fits into some very important budgetary trends.

I thought what I would do, in my fifteen minutes or so before passing the mic[rophone] down, would be to really set the landscape for this discussion. One reason to do that is that it allows me to really try to explain what Congress will do, but I cannot explain Congress.

The second is, I think that given the kind of budgetary pressures they are under presently, Congress will do something as a matter of constraint given [inaudible word]. That's a useful thing to recognize, that it's coming.

The issues that are discussed today can be viewed from a purely defense-policy point of view, but also they echo in many ways the larger budgetary problems, both in the near-term and the long-term sense.

In the near-term sense, I think they are important in the larger budget picture because there will be a temptation among some to try to focus the issues on the larger Federal budget deficits and address them in exactly the same way that they were addressed in the mid-1990s.

As I recall, the basic pieces of that strategy involved very tight caps in discretionary spending, and looking back historically, what really went down was defense discretionary spending. As a result, the kinds of topics that are being discussed there would be at the center of any attempt of that type. There are clear pressures to the contrary, given the needs in Iraq and broader defense area.

In the longer term, the central message of the Federal budget is that as the baby boom generation retires and in the face of rising health care costs in our nation, we will see sustained and really substantial increases in the demand for budgetary resources from the entitlement programs.

Those programs are really quite remarkable if one steps back and looks at the potential for growth, in particular, in the health programs, Medicare and Medicaid.

To give you a flavor of that without getting into the details, in December, CBO put out a report on the long-term budget outlook. In that report, we documented that if the United States competes in the next fifty years for Medicare and Medicaid, lack of experience in terms of health care cost growth in the past 30, those two programs will rise from 4 percent of what our national income is now to over 20 percent of our national income, or larger than the current size of our Federal Government. I believe that would put us in budgetary stress.

This echoes some of the things that are going on in military pay and compensation in which the analysis we put out, for example, for the [inaudible word] program shows an increase in demand for budgetary resources over of the next two decades, but certainly a core part of it was rising costs of compensation for the military without expanding in

size, compensation for persons rising, and at the heart of that, the same kinds of pressures on health and retirement benefits that are seen in the larger Federal budget.

I think this is a conference that is on the mark both from the largest issues, from the near-term issues, and certainly from the point of view of the military pay issues.

CBO's work in this area has focused not only on how much will be the demand for budgetary resources, but also on issues in the mix of compensation between cash and noncash. I want to touch briefly on the military version of health care cost pressures that affect the mix between cash and noncash that will be driving up the noncash compensation at a fairly strong rate.

Finally, a bit on what you buy with this compensation and work in the area of the education qualifications in the military and whether that generates a need to affect compensation. I will walk briefly through the study and we can talk about some of the details.

In the paper we put out on cash versus noncash, the starting point is that the average active duty service member received a total compensation package that was about \$99,000. This is for 2002.

In contrast to the private sector, where cash is 65 to 80 percent of compensation, only 40 percent of that package is in cash and the remaining 60 percent is in noncash compensation. About half of noncash compensation goes to those veterans when they leave before retirement and only half goes to those who reach retirement in the military.

As in the private sector, the big sort of noncash compensation is health care costs. It's about 30 percent in this case, about \$29,000 per active duty member in the military. A big chunk of that is the accrued cost of veteran's benefits, but the remainder is split across the DOD health care for active duty members and their families, about \$6,000 for the cost of Medicare eligible military retirees, and about 5,000 for those retirees who are not yet eligible for Medicare. [That is] a lot of the health care costs.

The next big piece is installation-based noncash compensation. That's about 12 percent in this case, \$16,000. The final is retirement pay, about \$8,000 per active duty member.

One of the things that we can have a discussion about, I hope, is the debate between those who support this particular mix and those who would argue that it's sensible to change it.

Among the supporters, there is an argument that it is necessary to promote military readiness, that having health care, healthy troops, having on-site fitness centers and a variety of other things ensures a quality of life that attracts members to become ready, and that it's cheaper to do this than to actually do it in the form of cash compensation.

Those who argue in support of shifting for greater reliance on cash point out that cash is universal. People understand the value of cash. In trying to attract members to the military, it's easy to see. Cash makes members better off by giving them more choices. The economists are prone to say that—I would fall into that group—and also to say that changes in forces in doctrine dictate that you have to rethink the compensation package as well. It was a fine compensation package in the past but perhaps not for the future.

There are a variety of options that CBO is examining in that they are looking at cafeteria plans and offering cash allowances. At the congressional level, rethinking the way it's presented in the budget so that the noncash compensation is in some sense aggregated up and presented to Congress as a budgetary presentation, not in some sense hidden away in many different accounts, so that there is a clear presentation of the balance between cash and noncash within budgetary [inaudible word].

These are things that could be done at the individual level and at the policy-making level to address this issue.

In terms of the drivers in health care costs, the ones in the military are very similar to those in the economy as a whole. To give you a flavor of how big this is, between 1988 and 2003, DOD medical spending nearly doubled from \$14.6 billion to \$27.2 billion while at the same time the active duty core went down by 40 percent.

Doubling in spending, the active duty is down by 40 percent, not terribly surprising. Spending per active duty member rose from \$6,600 to \$19,600. Well over half of that is [due to] rising health care costs, about 66 percent. The other parts come in looking at the different mix as a result of the beneficiaries. There are far more folks who are not active duty, but they are retirees and their families. As a result, you're really dividing by a smaller denominator.

You raised the question of whether that's the right method, but that's the standard, about 23 percent of it. About 18 percent, a fifth, is just due to accounting changes, going from accrual accounting and moving into the present recognition of the fact that we are on the hook for these costs.

Finally, buried in a little 3 percent are the offsetting impacts of two very important shifts, one early in the 1990s of actually cutting some costs due to restricted access to the facilities for military medical treatment, and then in October of 2001, the TRICARE division that went in the other direction, about three percent.

Here we have the same kind of options that one could imagine, addressing how you could allow a trade of noncash for cash. Allow military retirees to cash out their TRICARE, to buy them out at the point of retirement. Even if 10 percent, for example, took this option we could save about \$1 to \$2 billion per year, we estimated in one of our options.

Or you could just allow a greater menu in a cafeteria plan that allows better matching and efficient utilization of these dollars.

In terms of the mix between cash and noncash, I think there is an important issue on the table. The noncash compensation is on track to continue rising just due to the pressure from the health care sector. That's important to recognize. You will have to address it one way or another.

The final point I guess I would like to [make] is, this is all shameless promotion of CBO products. I want to be clear about that. You want to have a picture of what are you buying when you come up with a level of compensation in this mix.

One issue that has arisen has been the fact that the educational attainment area in the enlisted force has gone up quite dramatically. They have gone up 30 percent of those who had some post-secondary education.

Some college, completed college, maybe gaining an advanced degree from 30 percent back in 1985, to nearly 75 percent in 1999. It's a dramatic increase in educational attainment as a result of the quality of force. It mirrors a rise in the population as a whole, but compared to historic rates, it's pretty striking for the enlisted personnel.

DOD responded to this essentially by looking at that and saying, "Okay. We have these highly educated individuals. If you look out there in the private sector and see how these highly educated individuals get paid, we could lose these folks. Let's take some targeted pay increases beginning in 2000, target them at sort of mid-career active enlisted folks and make sure that we hold onto them with a goal of raising the pay to something in the 70th percentile of the distribution of the private sector workers who had some college education."

That's the response, and it's a fairly pricey response. It cost \$1.6 billion in 2004 alone. It would be mirrored as well with the cost of retirement benefits that would accrue as you raise their base pay. It's a fairly expensive endeavor and raises the question [of whether] this [is] worth it in some sense.

Well, in looking at this, you sort of could make two observations. Number one, if you went back to the first thing that we discussed, cash plus noncash, it turns out that the overall compensation package is really quite comparable to the median of the civilian worker who has some college education. It really wasn't obvious that the pay was badly out of line.

Secondly, you could actually run this the other direction and say, "Well, the reason we have all these highly educated folks in the enlisted forces is that the cash and noncash compensation was a factor that was enough to get people that really have high educational attainment."

We went and looked and tried to discern if there was not any statistical basis of problems with departures of highly educated enlisted individuals. There does not appear to be a compelling statistic case to make as to the educated folks leaving at any kind of disproportionate rate.

That does raise the question of whether it's sensible to have a broad based targeting on the basis of education alone. Instead, you might choose a different targeting for top performers who are performing, presumably also highly educated. That would require you to fiddle with the basic system a little bit and allow people to more quickly graduate up into the E-8 and E-9 grades where there is a fairly small number.

If you allow that to be relaxed somewhat, you could target high performers, probably save some money overall, retain the people of high quality who you are interested in who would not, by the way, be retained by just the retirement pay. There are retention incentives to begin with. If you incorporate the mix in that way, save a little money in compensation costs and achieve the some policy objectives.

Those three studies I think are the tip of the iceberg in a myriad of things which will come, not just from the CBO but from the folks in this room, in the years to come as it becomes apparent that budgetary resources are going to be tight, that compensation costs, cash and noncash, are a really important and rising part of the defense budget, and we have to make sure that we get the most bang for each buck going forward.

Adjusting the totals and adjusting the mix and targeting to the right individuals are all of the three policy levers that individuals are likely to pull as they think about structuring things for the years to come.

MR. HENRY HINTON (Managing Director for Defense Capabilities and Management of the U.S. General Accounting Office): Thank you for inviting me here today. I also want to applaud the efforts of everyone. Collectively, I think the timing of this conference is very important to begin discussing the future implications of military compensation.

I'm here on behalf of the Comptroller General, Dave Walker, who had a prior commitment. I do want to let you know that he is thinking about us and has a keen interest in these issues. He is a human capital expert in terms of managing and is a strong proponent of modernizing the Federal human capital policy. Since he has been at GAO, he has spoken often about the growing fiscal imbalance our nation is facing.

Before I begin my remarks today, let me say this: people are our most important asset. We can't lose sight of that, especially with the many people serving in our military around the world. However, our massive and growing deficit means that difficult choices loom ahead for our nation.

I want to cover three points. One, the tough choices we will face in allocating our Federal resources; two, how some of GAO's recent work illustrates the need for change; and three, the emerging issues that GAO is examining in support of Congress.

Before I jump into these, let me make just an observation that I think we can all agree upon and appreciate. On the military personnel front, the good news is that morale and retention seem to be holding overall despite the tremendous demands being placed on our active and Reserve Components. We all hope this continues. Over the past few years, however, personnel costs have increased substantially. Today, we are paying our service members more than ever before and at the same time offering them more benefits, including significant retirement benefits.

Although the costs have risen, the personnel outlays relative to total national defense outlays have remained constant at about a quarter of the rapidly increasing and frequently supplemented defense budget of the past few years. However, we believe that this trend cannot be sustained.

Let me turn to the growing fiscal imbalance. Looking forward, the reality is this: a budget crunch is approaching for DOD and the rest of the Federal Government.

Currently, DOD is being allocated more money to support ongoing military operations. However, this increased funding is not likely to last indefinitely because the nation faces large and growing structural deficits.

The coming crunch is principally due to known demographic trends and rising health care costs—specifically, projected cost flows from social security and health care programs like Medicare. As Doug mentioned, defense health analysts are saying that health care costs will increase sharply.

GAO simulations show that balancing the Federal budget in 2040 could require either cutting total Federal spending in half or doubling Federal taxes. And, while faster economic growth can help, it cannot solve the problem. Closing the current long-term fiscal gap based on responsible assumptions would require average annual economic growth to be in the double-digit range every year for the next 75 years. Considering that, in the 1990s, the economy grew an average 3.2 percent per year, we simply cannot grow our way out of this problem.

In the near-term, the Department of Defense must continue to support many ongoing operations around the world. In the longer term, the Department faces large costs in recapitalizing the force to replace aging and worn out equipment and infrastructure.

Thus, difficult choices lie ahead. In our view, tougher choices will be required across all Federal programs.

As part of GAO's approach to addressing the growing fiscal imbalance, we have advocated a top-to-bottom review of DOD's discretionary and other spending. We believe that DOD and Congress need to reexamine programs and ask some fundamental questions: Are these programs well targeted? Are they achieving measurable and cost effective results? What are the long-term implications of changes? And, would we create programs in the same way if we were starting over today?

Let me take some of our recent work and apply it to these questions. The first question is: Are DOD's programs well targeted? Our work would suggest that, in some cases, they are not. For example, the Selective Reenlistment Bonus Program is intended to help the services retain enlisted personnel in critical occupational specialties, such as linguists and information technology specialists. However, our recent work has shown that, at one point, the Air Force was giving selective reenlistment bonuses to about 80 percent of all specialties. Overall, the cost of the program has more than doubled since the late 1990s and is showing little sign of receding.

The second question: Are programs achieving measurable and cost-effective results based on desired outcomes? Again, [the answer is] not always.

For example, the recruitment advertising program is designed to assist DOD in convincing about 200,000 people to join the military each year. The primary goal of the program is to raise awareness of the military and to help recruiters meet their goals for new recruits. Advertising alone, however, does not get potential recruits to sign on the dotted line, as we all know. Our recent work has shown that DOD does not have clear program objectives or adequate outcome measures to evaluate the effectiveness of its advertising as part of its overall recruiting efforts. The cost of the advertising program has also doubled since the late 1990s. Moreover, overall accession costs, which include advertising, bonuses, and recruiter costs, have grown from about \$8,000 to \$13,000 per enlisted recruit.

The third question: Do we fully understand the long-term cost implications and liabilities associated with program changes? Often [we do] not, in our opinion.

In the case of expanding TRICARE to reservists and their families when a member is not on active duty, we raised a number of concerns about the proposed program expansion in a letter to Congress. Among other concerns, we have warned that expanding the program would significantly contribute to DOD's rising health care costs and strain the already large TRICARE program.

Finally, would we create these programs in the same way if we were starting over today? [We] clearly [would] not, in many cases. The compensation system today is a complicated mixture of cash and benefits. How did this happen? I think we have heard a lot of discussion about this. Since the advent of the all-volunteer force, the Department has increased pay and added other benefits to enable it to meet the needs of its personnel and remain competitive in the job marketplace. Today, DOD pays a competitive wage and, on top of that, offers an array of benefits that, in some cases, exceed benefits offered in the private sector.

In our view, analyses of total compensation must include not only the cash that members take home in their paychecks but also the cost to the Government to provide the many benefits offered to service members and their families. Gaining visibility over the total cost of personnel is critical.

Where do we go from here? Our number one priority has been and will continue to be responding to our client, Congress. We have ongoing work looking at the reserve personnel retirement system; the financial condition of military personnel and their

families; death benefits and supplemental life insurance, a draft of which is in the Department for comment now; special pay and allowances for personnel that are frequently deployed, also with a draft at the Department for comment now; issues associated with obtaining security clearances; and the defense integrated military human resources recruitment, development and management process, among others.

On the civilian side, Congress remains intensely interested in DOD's implementation of its national security personnel system. We have been proactively engaged with Gordon England and David Chu as they have begun this critical effort. We believe that DOD must get this right because future civil service reforms may hinge on how well this system is implemented.

[Let me make] two final points about military compensation. First, we have repeatedly raised concerns about the rush to give across-the-board increases, such as increases in retirement pay and medical benefits. We have said that such macro measures do little to address what have been some of the narrow problems pertaining to specialties.

Second, in my view, military compensation has become so complicated—we heard this earlier—with a myriad of pays, allowances, substantial deferred in-kind benefits that we're not convinced that the average service member really understands and fully appreciates their compensation package. Moreover, we are not convinced that we understand the full costs of personnel to the Government and how these costs are changing over time.

The Department could do a better job marketing to its own soldiers, sailors, airmen, and marines. We spend thousands of dollars to recruit each one of them but do little to explain the investment we make in them.

One of GAO's goals is to help decision makers sort out needs from wants and ensure that taxpayers get the most for their investment. In the future, I believe that the Department must make a better business case on the Hill by explaining total costs, implications, and expected results of program changes.

I offer three suggestions to think about based on my many years of working closely with the Hill—the members and the staff.

First, engage Congress and listen to their concerns. DOD would benefit from listening to Congress's perspective and counseling Congress on the Department's needs and priorities. You heard Secretary England talk about how process is very important.

DOD and Congress both want to take care of the troops and their families, and you can expect the Hill to continue to exercise its oversight authority in personnel matters.

Second, be deliberate. DOD must carefully consider the implementation of its programs before asking Congress for broader authority. Repeatedly, our engagements show that the information used to justify changes and manage programs is out-of-date or otherwise insufficient. We have talked for many years about the absence of good systems to put good information together and to make the case to Congress. When we hear discussions that the most available information we have is from 2000 and 2001, that's not current. That's not what we need to be the first class organization that we strive to be. Moreover, in many cases, the information that DOD provides to Congress is unsatisfying to them. One of the best examples of this is DOD's proposal for the national security personnel system. The future of the civil service reform may very well rest, as I said earlier, on the success of DOD's landmark proposal. However, Congress had a number of complaints when the sweeping proposal was dropped on the Hill at the last minute.

Lastly, I leave you with this: tell the whole story. DOD needs to articulate the full cost of the new initiative and what the Department and taxpayers will be getting for their investment in terms of recruiting, retention, and readiness. Better planning, both at a composite level as well as a tactical implementation level, combined with a better communication strategy to market its proposals to Congress, in my opinion will serve the Department well in the future.

Let me end where I started: the most important asset that the military or any other organization has is its people. Together we must collectively find ways to balance the human capital investment with a full range of organizational needs.

I thank you for allowing me to participate. I look forward to the exchange that we will have here.

MR. MICHAEL LOFGREN (Budget Analyst, Majority Staff, House Budget Committee): My remarks will be brief. My presentation will first briefly focus on specific and near-term issues that we have already touched on and hopefully avoid repeating what many of the panelists here have already stated.

Then I will discuss an emerging issue connected with military compensation I believe has not been brought up today in the context in which I'm going to discuss it. Some may consider it a bit tangential to the topic of paying our service personnel, but I think it's worth bringing up so we can see today's topic in a broader perspective.

You have already probably read CBO's excellent issue brief that the CBO director alluded to. I won't go into that anymore than saying how striking it is that only 42 percent of the compensation will go to the average service member as cash. Another striking thing about this when you peel back the onion is that many portions of this don't even show up in the defense budget.

While the CBO document looks at the issue on the micro level, I think it's instructive to look at matters on a macro basis. If you were to look at the President's request for the fiscal year that is coming up October 1—that's fewer than four months—you will see the following: a national expense request of \$423 billion of which \$106 billion is for military personnel costs. This doesn't include, however, what we all know is coming, the inevitable supplemental of at least \$50 billion. If the same proportion of that notional \$50 billion that was in previous supplemental [budgets] for personnel costs, that would yield an additional \$13 billion in military costs for 2005.

Then you've got military retirement. It's not in Function 050. That's \$39 billion. Then you've got TRICARE for Life, which the CBO director also alluded to [and] which we enacted in our wisdom in the year 2000. That appears elsewhere in the Federal budget at \$6 billion.

Then you've got the veteran's budget. Some would say that's unfair, but that's a legacy cost of our personnel in past wars. That's \$60 billion.

Now, if you were to add up all these items and call that our national defense budget, it would add up to \$578 billion. That's 25 percent of the total Federal budget. Military personnel costs, present, future and legacy, would come to \$224 billion, or more than double the nominal military personnel budget.

Also, those totals do not include some recent additions to the budget, which are minuscule at the moment but programmed to grow, for instance, concurrent receipt of military retirement pay and veteran's disability. That's going to cost about \$22 billion over the next ten years.

Also note, on sort of a rundown of items, the 2005 defense authorization bill that just passed the House, one section of that is expansion of benefits under the Military Survivor Benefit Program. This comes out of the Military Retirement Trust Fund. Another is a statutory increase in military end strength by 39,000 people.

If you apply the CBO director's compensation per troop now, that gives us a recurring personnel cost close to \$4 billion a year. Recently, General Hagenbeck, who is

Army Deputy Chief of Staff, said that such an increase may be very difficult to pay for without significantly hurting other accounts or, of course, raising the top line.

There is a pilot program in the House-passed bill that would extend TRICARE coverage to members of the ready reserves who are not on active duty and ineligible for employer sponsored health benefits. As we know, pilot programs have a way of becoming permanent.

Also, there is a little noticed provision section, 1541, in the bill which shifts the annual accrual payment for TRICARE for Life from DOD to the Treasury. This has no net budgetary effect to the Federal Government as a whole, but it's noteworthy because it breaks the link between the beneficiary and the agency in which he or she serves; a precedent that makes determining the net cost of compensation even less transparent.

It's natural in a time of war and sacrifice that the Congress, which is charged to raise and support the armed forces, is going to try to ease the burden of duty and keep up recruitment and retention. The only lever Congress [has] is pay and benefits.

I'm not going to wade into the mind field of controversy and express an opinion about whether military personnel are over- or under-compensated, as some of the literature suggests. The argument about pay and parity with the civilian sector or how much one should pay for retention of skilled personnel and other issues, we can argue for decades and there is no definitive right or wrong answer.

These matters are, I would say in the purest and most fundamental sense, political. It is fitting, therefore, that they be settled as a matter of national policy by your elected representatives regardless of whether we think this is some scientific or objective way to determine the right level of military compensation.

From a budget committee perspective, I would argue that whatever the level of compensation, it's a good idea, to the extent possible, to monetize it rather than have it as an in-kind benefit, which can often be difficult to cost out. We should make the presentation as comprehensive and as transparent as possible so that we're not deceiving ourselves about what it costs to recruit and retain our military.

Now, both panelists have already talked somewhat about the broader context, the inexorable increase in outlays for military compensation taking place against the background of other structural increases in the Federal budget.

A lot of people—proponents at the DOD—point out that military spending is a much smaller percentage of the Federal budget than it was during most of the cold war.

That's true, but it's also true that for most of the cold war period, national defense did not compete with other mandatory spending categories.

For instance, while defense is a share of GDP, it's only half what it was in the '50s. Social Security and Medicare now is three times what they were then as a percentage of GDP. GAO and CBO stated very eloquently what the budget trades-offs are if these trends continue.

Demographics being the closest thing to destiny there is, the choices will become very stark by the end of the decade when the baby boomer generation retires and Social Security and Medicare expenditures accelerate. DOD has long understood that personnel costs are the closest thing there is to being an entitlement in its budget and the most likely to rise over time.

I would say the American way of warfare since World War II has been a lot of things. Among other things, it's an attempt to control the costs by substituting technology for people. The strategy has been on the whole very successful.

We can see the effort in new ship designs like the CVN-21 and the future surface combatants, which projected dramatic reduction in crew size. Yet, the global war on terrorism, at least in its Iraq phase, has demonstrated the limits of the doctrine of technological substitution.

There are some scenarios in which there seems to be no substitute for infantry. The call for more troops is evident in defense bills and in political speeches. If the war against terrorism is, as some have said, a war that will not end in our lifetime, how will DOD solve this dilemma against a background of finite resources?

What I'm going to touch on now is controversial. You read it in the headlines. In my judgment, it would be irresponsible to avoid mentioning it.

During its entire historical existence, the United States Government has regarded its military personnel as a special kind of uniformed civil service, a service of the state with its special career track, its own legal and educational system, a very well-ordered way of life.

The soldier and civilian are distinct and separate categories. In this way, the United States is very similar to most other modern nation states, but in the absence of conscription, it's very difficult to quickly expand a traditional military force when large numbers are needed.

As we can see from the headlines, the Government is now engaged in an experiment with profound implications for the future, the privatization of many military functions in a war zone. In the last decade, we have seen the gradual erosion of the separation of roles. Many repair, logistics, and housekeeping functions have been supplied by private contractors. This trend has seen its culmination in Iraq.

Whereas, to take a historical example, in 1944 the Red Ball Express on the continent of Europe consisted of uniformed military driving military trunks. The same function in Iraq, driving truck convoys under fire, is privatized. Now functions that have generally been recognized as core military functions have also been contracted out. By that, I mean “trigger pullers.”

We have truly entered unknown territory not only in terms of cost, which is what mainly concerns us here today, but also in terms of international and domestic law. DOD’s reluctance to confront this issue openly means it is difficult even to know what we’re dealing with, let alone to make a sound policy analysis.

Most published accounts I have seen say there are about 16,000 to 20,000 of these contractors in Iraq. Others say that is a gross undercount that ignores a lot of third world nationals, that the real number could be up to 40,000. If that’s true, that’s 30 percent of the U.S. military force in that country.

On an unofficial list, I have seen tallied 88 contractors killed or missing in Iraq. They are certainly sharing the hazards of military life in a combat zone. What I’m describing may be a new reality of counter-insurgency warfare that could profoundly change what our military is like and how we use it over the next decade.

Much of the press coverage of this issue is focused on allegedly lavish salaries. But we must ask the question: Is it nevertheless cheaper for DOD to have an at-will employee perform many traditional military functions rather than a career soldier, or does it create a perverse marketing incentive whereby DOD bids against itself for manpower?

The employment of large numbers of special-forces veterans and security specialists seems to suggest that that’s a possibility. We must also ask ourselves about what issues involved with contractors have to do with personnel quality, loyalty to the mission, and applicability of military and international law. All of these are valid questions, of course, but we have no reliable data to make a good analysis.

Since they are here today, I would strongly encourage my colleagues at the GAO and CBO to take a good, hard look at the trade-offs between military and contracted

personnel. It's an issue that we're going to have to come to grips with as a matter of our national interest.

With that, I close. Thank you.

DR. HOLTZ-EAKIN: Okay. Why don't we open the floor up for questions, and why don't I take the liberty of beginning by saying we do have some work underway on the contractors. I'm hoping to do that in a broader analysis.

MR. HINTON: We do, too, looking particularly—right out of the box—at the use of the armed forces that are there.

DR. WILLIAMS: I have a question for all three of you but it's drawn from something that Bush said, which is that the Department of Defense needs to do a better job explaining things on the Hill, making the business case on the Hill when they come up with new initiatives. My sense, looking at it from the outside, is that over the past few years, all of the big initiatives that have piled new money and benefits on the military have come from the Hill. Maybe the service chief said it would be a good idea, maybe somebody in uniform said it would be a good idea, but these were not Secretary of Defense initiatives. These really were initiatives that came from the Hill. All the initiatives that are on the table now are coming from the Hill, all these ideas about adding the TRICARE, opening up TRICARE for the reserves, expanding benefits. These are things coming from the Hill.

In the interest of phrasing this as a question, let me ask: Is there anybody on the Hill who is interested in putting the brakes on these things?

For those of us in this community who are interested in seeing change and don't want the benefits piling on, are there people on the Hill that we should be hooking in with who would help us lead the charge on the Hill to put the brakes on and to make the business case before you start up with the new initiatives?

MR. HINTON: Let me start out first. We heard a little bit from Secretary England about this today.

One thing that strikes me is that change is hard to achieve, but we have to begin a campaign. I think this seminar today is part of the campaign to start talking about this issue. My remark about making the business case is very difficult when the Hill is making a lot of proposals that they want to increase pay and DOD is saying no. We haven't been able to articulate well, I think, our full pay and compensation system to

clearly articulate for them how much our servicemen are making and how much it's costing the Government.

It's in that vein that I was making the pitch about having a good business case because I do think that a lot of building a consensus for change has got to come, in large part, from the uniform[ed] side of things.

I am sympathetic to what you are saying, but at the same time, there is an absence of information a lot of times when proposals are made about the implications of the proposals. What are the real problems that we are trying to solve? It doesn't look like we are having that discussion—that identification of the need—and the implications of adding money or covering it in another way. I think there is an opportunity here.

Then I think about the environment we're now in, because it is [a] key [part of] deciding the next steps. We're in an environment right now where all 535 members of Congress have constituents who are heavily engaged. Yes, that's the same way in peacetime, but the constituents are mobilized now and the members are thinking about them.

We're in an election year. The environmental question becomes central: When is the right time is to begin a debate? Change is difficult. That's why I applaud this.

I am very pleased to be here to talk about this because I do think that there needs to be a lot of discussion. There's got to be recognition that we need to change, and how we change is a real tough question.

I also think there are a lot of stakeholders here. I heard that both this morning and at lunch, and I happen to believe it, having dealt with the defense committee members and staff and then the members and staff who are not on the committee, when they talk about these issues with us. That would be my comment.

MR. LOFGREN: To very briefly answer your question, those [members you are asking about] are a very tiny sliver of members who are no longer interested in holding elective office.

MR. HOROWITZ: Cindy's question I think was an excellent one. Maybe there is blame to be shared on both sides. I'm not sure if the two institutions need to psychoanalyze each other, but take REDUX reduction as an example.

Bernie, I believe, earlier today referred to himself as a speed bump. Was that in TRICARE for Life? I don't remember.

FROM THE AUDIENCE: TRICARE for Life.

MR. HOROWITZ: In fighting that, it seems like Bernie might have been the sacrificial lamb, but by and large, it appeared to me that the Department got out of the way because it didn't want to take on its own constituencies, and Congress responded to its worst instinct, which was to cave to loud, politically important groups. This is a real problem.

MR. LOFGREN: We were responsive to our constituents.

MR. HOROWITZ: Is this inevitable? Is this a cost of doing business, or is there actually promise that we can break this tradition?

FROM THE AUDIENCE: They are not going to answer that.

DR. HOLTZ-EAKIN: Call me a fool, [but] I shall. I think we [already] tried to answer that. I think the answer honestly is going forward—it's not unique to the people in this room and [inaudible phrase] but it shows up here as well. You cannot simply say, "Well, we have the luxury of accepting this [inaudible phrase] the constituencies."

It will be the case that if you accept this, you're going to give up something else because this is a very tight period. It's inevitable. That is the closest thing to destiny next to demographics.

It will be in the interest of the military, the Pentagon, any agency to go up and say, "You have offered us this. You should be aware that if we do this, we're taking X, Y, and Z off the table." That's the sense in which the business case is in fact something essential and in which the information could be more complete.

I think Mike picked up on this a little further. Right now all these compensation costs are in fact all over the budget. It reminds me of trying to piece together what we are spending on homeland security. We have the Department of Homeland Security, which does not cover all the functions called homeland security, and when we actually try to go together and try to piece together the budget and homeland security functions show up, you can then put together what you are really spending on homeland security. You can establish that.

On an ongoing basis, that would be useful in all these policy discussions so that it's real clear what people are giving up when they do something that might be business as usual, but it leaves a lot of questions. That's what we're faced with.

FROM THE AUDIENCE: There has been a statement the Department needs to make a better business case. While I agree that that's the case, the secretary then could be accused of not supporting his troops because the business case will be debatable.

I almost wonder if we are at the point now with military compensation that we were back in 1991 with installations, and we had a base closure commission where we had a group of folks that did some very detailed analysis that was then presented to the Congress for an up or down vote.

We danced around the issue of politics, but I wonder if ultimately the military compensation issue will only be solved with something like a base closure commission.

MR. HINTON: That might be a mechanism worth considering. I mean, that way they have an up or down vote, as you know, when they get to the Congress. They had debates on it. Then the actions were implemented. That might be a mechanism.

Whether it's the only one out there, I don't know. But it's clear to me that, given the growing fiscal imbalance, and as I think about DOD and this subject, this is—the push is coming. We have to begin work on this right now. I think it's got to be recognition to all the stakeholders that we need to change.

MR. LOFGREN: I would just concur in that.

FROM THE AUDIENCE: Let me make an observation. Several years ago, I think it was three years ago, I presented a paper at a CNA[C] manpower conference that basically argued that we needed to change our military personnel management systems, our HR systems, because they were just going to be expensive for us to sustain in the years to come.

My designated critic, Debbie Fernandez, who was then at CBO, my successor in fact in that job, said something that I should not have overlooked in the first place, which is I should not understate the Congress' ability and DOD's ability to muddle through.

I think what she was referring to is something that comes up in this context as well and it's something that you alluded to, Doug, in your comments when you talked about how much the defense budget was going to increase, in particularly military personnel costs.

They are going to increase. We have known that for years, but it is increasing faster now because of all the things that happened since 2001 and 2002, like TRICARE for Life. But they are not going to increase all at once. They are going to increase a couple billion dollars at a time forever, but a couple billion dollars at a time. That, it seems to

me, is within the demonstrated ability of the Congress to muddle through, to add a couple billion dollars here and there to move out of the EO-50 budget account into some other account where it's not as visible just to...continue to patch the way it has always patched and, thus, to put off what those of us who have a longer range of vision might think of as the inevitable day of judgment.

If you keep putting off the day of judgment, then eventually the day of judgment gets put off forever. I just wonder what is going to be the final straw. At what point is the Congress likely to come across an inevitable constraint?

DR. HOLTZ-EAKIN: I want to offer this. I'm not a defense expert nor do I pretend to be, but muddling through I think should be rephrased. It should be: What are we muddling to?

In other policy areas, tax reform for example, there is often an argument that says, "We have to really change our tax system." "We need to change our compensation system. We need a big tax commission. The income tax is just broken," and I could make a speech on that. But, it could be the case that we each year just sort of fix things a little bit at the margins and muddle through in a sense.

However, in a world where the muddling is going to really run out of budgetary resources, you want to make sure at the beginning [inaudible phrase]. I think that's the sense in which even if you can muddle through, you still want to think about where you want to end up right now.

It is a question of where you won't always get the big fix. You want to make sure, as you take each incremental step, that you make it toward something that is desirable in the end. I think [that process] is as much a budgetary issue.

I think Mike's comments at the end about the contractors sounds like, from a pure human resource point of view: What is the nature of the contract that you as a nation want to have with the people who do this?

The traditional contract says, "We pay you in advance for the lottery," and you buy the lottery, which it could be nothing happens on your watch. It could be that you have very simple duties, or you could have a very arduous time in whatever you do.

If you're hiring contractors, you're hiring after the lottery has been revealed and it's, "We're in Iraq. These are the terms." It's not obvious that's going to be cheaper. If you have to hire someone for the worst outcome in the lottery, that seems to be an expensive proposition.

I think before you start muddling, think about what it is you want to have in [the] way of the contract, the traditional contract or something different. Figure out where you want to end up from a policy point of view.

MR. HINTON: I would add, too, that in terms of looking for the core structure of the twenty-first century, what is it that we really want and what knowledge, skills, and abilities do we want, and how do we want to get there and how do we want to pay?

I think we have to have that plan to begin that date. That becomes your true needs, not your wants. What do we really need for the twenty-first century? I don't know that we are at a point that we have defined all of those needs yet, but I think it's a very important part of the debate that has to occur.

MR. LOFGREN: I'm tempted to agree about muddling through because—[for] how many years?—maybe a decade and half we have heard about defense train wrecks. Maybe that's not the analogy. It's the creeping paralysis perhaps. Defense spending itself tends to be like a sine wave, or it has been ever since World War II.

I would say the only sort of risk factor in that or the major risk factor is I don't know that we have ever seen anything quite like the fiscal push that's going to come when the baby boomers retire and Social Security and Medicare spending really accelerate. Yes, we probably should think about it.

MR. HOROWITZ: Just a brief technical point: I think Mr. Lofgren did a nice job of pointing out that military compensation costs more than we think it does. I would just like to add that there is a difference between personnel costs and compensation, and that there are indirect costs associated with personnel that drive the numbers even higher.

I would suggest you do that, that you could add in a substantial portion of training costs that are marginal due to additional personnel, at least in the long run, and personnel management costs. There might be maybe even some DOS costs. You might think about making the story even more extensive.

MR. LOFGREN: Agreed.

FROM THE AUDIENCE: I have a question that relates, again, to this morning and the Chief of Naval Operations. Is the Congress willing essentially to let the services split in terms of compensation and go their own ways in term of providing latitude and experimenting with different compensation packages? Right now it seems to be viewed as all in one concerning the military; the Air Force has the same problem as the Army has the same problem as the Navy.

We have heard this morning we have a Navy Chief of Staff who is very interested in overhauling the system. I'm not sure the Air Force and the Army are on the same page. Would Congress be willing to consider alternative compensation based on the [inaudible word] services?

DR. HOLTZ-EAKIN: I have seen no evidence of that. The times this has [inaudible word], it was taken off the table very quickly. I don't know the answer to that.

MR. HINTON: I have no basis to comment on the answer.

MR. LOFGREN: I don't know the answer either, but if it would appear to advantage or disadvantage the service members of one service versus another, everybody has a military base in their district and I think you would hear from them.

FROM THE AUDIENCE: I think I have the answer. When the Public Health Service, the Commission Corps of the Public Health Service and the Commission Corps of [inaudible word] get the same pay scale as officers in the service do, there is no chance whatsoever of ever establishing something different, none whatsoever.

FROM THE AUDIENCE: This is kind of a relative question. When I think about welfare reform, we somehow got Congress to agree to let the states experiment with all kinds of different pilot programs. I wonder if you guys could explore that.

It seem to me if we are using Reserve Components and things like this, we might be able to get some kind of programs going if not save us from that train wreck, but at least will make the service members happier and it would be less costly. I'm curious as to how we got Congress to agree to let all of the experimentations go with the welfare.

DR. HOLTZ-EAKIN: I can say a couple things on that. It may not answer the question. Mike mentioned the pilot programs. I don't know in terms of the defense budget. Medicare pilot programs never happen. The experience is given to different places.

The welfare reform example is very different but the key there was that the states did it. The Congress can say, "We didn't subject any of our constituents to anything. We didn't do it. We gave the states some flexibility so if they could choose to, if they so desire, apply for a waiver from the standard welfare rules. It might actually save money, and if it doesn't, we will actually pay the bill."

The key there was two things that I don't know would be present in this circumstance. Number one, they picked up some extras in terms of sharing of the cost,

and they didn't have their fingerprints directly on the pilot program. It was a state-level initiative in most cases, and that changed the politics of it considerably.

FROM THE AUDIENCE: Can I comment on this? This is an issue I dealt with when I was in the Reagan Administration. The reason we could do that was that there was an extraordinary provision in the Social Security Act, which I think it is Section 1511, but it has the following wording and meaning.

It says the Secretary of HHS can waive any provision of law for the purposes of research and demonstration. They can change benefit levels, change the duration of benefits, change eligibility for benefits, change the whole package for purposes of research and demonstration, a phenomenal ability.

What we did in the Reagan Administration, which I was [inaudible phrase] the states could come in and apply for these research and demonstration programs [inaudible phrase] that we approved in the Department with its own scrutinization and finally got OMB to agree. But the purpose was always a report of research and demonstration results coming out at the end.

That laid the groundwork, I would argue, for the welfare reform that Clinton pushed through in the middle of the 1990s. We tried to recommend very much the same welfare reforms that we have come up with.

It was only with the demonstration programs that we had that authority for the Social Security Act. There is nothing like it in the service.

DR. HOLTZ-EAKIN: I would agree. I think the waivers were the key. The states in principle came to our Government. In principle, the states say, "Gee. We would like to try this. We will apply for a waiver from the rules."

MR. LOFGREN: Then in 1995 and 1996, when the debate was going on, the state governors had enormous influence with the Congress.

DR. HOLTZ-EAKIN: By analogy, if you can call the service a state and try to implement the same kind of mechanism, could you do it?

FROM THE AUDIENCE: If the GAO came and looked at the [inaudible word], what do you all think [about] a demonstration or an experiment?

MR. HINTON: It might work, but you've got to make the case that you can make and try it on an experimental basis. Nothing ventured, nothing gained. I don't know how they would entertain that.

FROM THE AUDIENCE: It seems to me there are already two parts to this. One is if it had anything to do with recruiting, the answer would be no. If it had to do with retention, possibly yes because you already own that personnel asset. If it had to do with utilization, I don't think there is any cross-service interest.

The big issue would become jointness. We can have different rules and regulations, for example, in special pays. The issue was, during my tenure, were you going to treat an airman, a pilot in the Marine Corps, different from a pilot in the Air Force. The states wanted to treat everybody in the force the same. It was more important to the Marine Corps that all marines be treated the same. The states had a lot of leverage in those situations.

You have to work out the jointness where a lot of people now from different services will be working together in substantially the same jobs, in the same environment, and have very different levels of compensation. We tend to think in [inaudible word], but that's become less important in the decisionmaking in the Department.

FROM THE AUDIENCE: I'm not sure if the concern on the Hill seems to resolve people thinking there aren't enough military personnel to carry out all missions in Iraq, Afghanistan, and elsewhere, or that there is too much stress on the people on who are there now because they are deployed for too long. In a sense, those are kind of the mirror images for the same dilemma.

What I'm interested in is if you look at the dilemma in the broadest sense, to what extent do you think it's an issue that has to do with the mix of personnel, either within the active duty or within the guard and reserve, or the use of contractors and you play around with those pieces versus an issue of compensation?

I mean, if the problem is really stress or not enough people to carry it out, how do you fix it? Do you tinker with the compensation side or is it really more a mix issue?

MR. LOFGREN: You have to ask yourself [about] the personnel benefits enacted over the last several years. If those had never been enacted, how would it have changed the force? I'm not convinced that it would have changed all that much. It would not have changed retention appreciably.

FROM THE AUDIENCE: Do you think it's more a mix issue?

MR. LOFGREN: Apparently. Of course, when you have stop losses, it becomes irrelevant.

MR. HINTON: We are doing work in the Navy right now looking at the mix and the skill imbalances and the whole dynamics of tempo issues that will maybe shed some light in time.

DR. HOLTZ-EAKIN: I don't think it's a complete answer, but I think you can get something out of changing the mix. Look at the current situation.

FROM THE AUDIENCE: That's what Rumsfeld is arguing.

DR. HOLTZ-EAKIN: Given the constraints elsewhere on the globe, we don't have enough bodies to do what we want to do in Iraq. We are keeping people longer, doing all these things to maintain the force level in Iraq.

[Inaudible word] at a sustainable rate given the preferred levels of tempo and time for recovery. You might be able to fix that a little bit by changing the mix of the forces, but I think if you step back, the big question is one Mike raised.

If this is the way wars will be conducted for the remainder of our lifetime, we have to think about whether we have got the right kinds of people. Part of what you're going to do is be on the ground in a very intensive situation for a long time.

That's different than being able to fight an active engagement with a smaller troop and move quickly and things like that. That's a different situation. What do we have to do to prepare for it? I think that's what I heard you say.

MR. LOFGREN: Yes, absolutely.

FROM THE AUDIENCE: In your view, is this a good time to tackle the compensation with the war going on and all that, or is it better to wait? In an ideal world, would we rather wait until—

DR. HOLTZ-EAKIN: If you want to optimize up, this is it.

FROM THE AUDIENCE: On the larger issue you raised about contractors, is there any recognition to really get a handle on that? Do you have to collect data on the contracts being signed and then counter it to all of the acquisition reform?

MR. LOFGREN: DOD is painfully forthcoming with data on contractors.

FROM THE AUDIENCE: In seriousness, is there a recognition that we have to start collecting that data?

DR. HOLTZ-EAKIN: We have recognition but there is not enough data to do that.

FROM THE AUDIENCE: Someone mentioned that you can find other examples where Congress sort of guides. They just can't control something; the line item veto, Gramm-Rudman[-Hollings Act]. This isn't something Congress can do by going to elected officials. BRAC is a clear example, and I would say the line item veto is another one.

Is there any sense that we're getting to a point, like in military compensation, where Congress will give that power to [inaudible phrase] up?

DR. HOLTZ-EAKIN: On just the point focus, no. I don't think there is any sense I felt on the Hill that we were close to that point. I will point out in the two examples that you mentioned, they are unconstitutional.

MR. LOFGREN: BRAC has been delayed.

FROM THE AUDIENCE: They were the only ones that came to—

DR. HOLTZ-EAKIN: There was the Greenspan Commission on Social Security. That was going to fix the problem forever. You may want to go back to muddling through.

DR. HOLTZ-EAKIN: We may have a larger break than you planned.

MR. HOROWITZ: Thank you very much.

[A recess was taken before the proceedings continued.]

VII. SUMMARY

DR. PANNULLO: Welcome to the next session, which doesn't have a formal title. I would like to introduce the panel in reverse order of their speaking.

The third speaker will be Mr. Ken Krieg. He is the director of Program Analysis and Evaluation in the Office of the Secretary of Defense. When he came back to Government service in 2001, before being Director of PA&E, he was the Executive Secretary of the Senior Executive Council. Prior to that, for eleven years or so, he was with International Paper in the private sector as Vice President and General Manager of the Office and Consumer Papers Division. He also served as Executive Assistant to the Chairman and CEO of International Paper. He was very active in integrating the Federal Paper Board, Union Camp, and Champion companies into International Paper. Prior to that, he had quite a few years in Federal service in the White House, on the National Security Council and in the Office of the Secretary of Defense. His undergraduate degree is from Davidson College in history and he has a master's degree in public policy from Harvard University.

The second speaker is Dr. Bernie Rostker, whom we heard from this morning. He is currently with RAND as a Senior Fellow and has been an Under Secretary of Defense for Personnel and Readiness. He was an Under Secretary of the Army and Assistant Secretary of the Navy for Manpower and Reserve Affairs, and Special Assistant for Gulf War Illnesses to the Deputy Secretary of Defense. He was at RAND, prior to his current service there, in the role as Director of the Defense Manpower Research Center. He helped establish the Arroyo Center. He has held positions at the Center for Naval Analyses and also the Systems Research and Applications Corporation. His undergraduate degree is from New York University. His graduate degrees, including his doctorate in economics, are from Syracuse.

The first speaker that we will hear from on this panel is the Honorable David Chu. He is currently the Under Secretary of Defense for Personnel and Readiness. As you all probably know, in this position he is responsible for providing the Secretary with advice on policy matters involving recruitment, career development, pay, and benefits for active duty, Guard, and Reserve military personnel, as well as DOD civilians. He also oversees

the Defense Health Program, Defense Commissaries and Exchanges, DOD Educational Activity, and Defense Equal Opportunity Management Institute. Prior to that, he was with the RAND Corporation as the Director of the Arroyo Center and as a Director of RAND's Washington office. Before that, for about twelve years he was the head of Program Analysis and Evaluation. Prior to that, he was at the Congressional Budget Office as Assistant Director of National Security and International Affairs. All of his degrees are from Yale University; his undergraduate in economics and mathematics and his doctorate in economics.

DR. DAVID S. C. CHU (Under Secretary of Defense, Personnel and Readiness): Thank you very much. Let me offer a few words on our focus today that I think may be more positive than some of the presentations you have enjoyed.

I do think it's important to keep in mind that the military compensation system, whatever its idiosyncrasies, does work reasonably well in producing the results that we want. As evidence of that, I would point to [the] fact that the Department would in an instant trade its Title 5 civilian personnel system for a system like the one it has for its military personnel.

Whatever defects may have been identified over this day on the military side, I think we do have to keep the military system's merits in perspective as opposed to what the alternative could look like.

Someone at lunch made an important point: The decision to volunteer for military service, staying in uniform to serve your country, does involve more than just compensation. It's appropriate to recall that point on this day as we honor President Reagan, because I think one of his important roles in the early 1980s was to restore the luster of the military service.

On the other hand, I do part company with my colleagues on what it takes to create a successful volunteer force. An important concomitant of President Reagan's effort to celebrate military service was the 25 percent increase in military pay that was initiated by the Congress in the late 1970s as it watched the volunteer force stumble and almost fail, importantly because the country made a strategic mistake in the 1970s, in my judgment, about the level of compensation that will be needed to produce the results we want.

That is the main point I would like to make this afternoon. It's critical to keep in mind the compensation system is not an end of itself, nor should its reform be an end of itself.

The system is, after all, an instrument to reach the results we want, which is to supply young Americans who are willing to take on some of the most difficult and demanding tasks that society might ask them to do. It's not the only reason they serve, but it's an important element of their decision to serve, and it's certainly important in their family's decision to support such service.

I do think this is something about which we need to remind our colleagues in the resource community constantly, because too often these debates turn into the question of "how can I save money," not "how can I produce the intended results." I will just offer a small vignette as an example of how that failure to ask the right question will lead us to mistaken incentives and an overly expensive compensating system.

One of the things that we did attempt last year to do was to change, to revoke the additional unemployment compensation that the country awarded to military personnel when the drawdown was proceeding in the early 1990s. That was an appropriate step at that time, but it is, after all, an incentive to leave. But I wasn't able to get the Department to back that change. One of the reasons is, not to air the dirty linen here, but the resource community has never properly funded this program in the President's budget request. It relies on the under execution of the military personnel budget to pay these kinds of bills.

Now, I point to that example because it is the failure to focus on the outcome that we want, but I think, importantly, it damaged our ability to make a case. We don't want to give people an overly strong incentive to leave military service. You want to give strong incentives to stay in.

I also think, in talking about military compensation, one does need to take a strategic perspective and look beyond the immediate results that you're achieving and ask yourself, "Where are you going to be in a year, two years, five years down the line."

Although you may be doing fine today, that you not undercut the ability to sustain those results into the future. As we all know from many years of economic theory, that people take at least a multi-year perspective, if not a lifetime perspective. They look ahead to what they could enjoy as a result of making today's decision.

I would argue for a more positive view of the military compensation system than perhaps has been expressed earlier today, because we have been successful in making a number of changes that have been proposed in the last administration and this administration. Let me point to several that I think are important.

First, the Department has shifted its view of whom it is pursuing to provide the new generation of enlisted personnel. In the first 20 years or so of the volunteer force, the Department viewed itself as trying to attract high school diploma graduates who were going from high school to a job in the civil sector.

Now, we increasingly realize that we must attract young Americans who want to pursue a college education, because that is the ambition of 70 percent of young Americans who graduate from high school today. This is an example, I think, of the importance of focusing on results and then focusing on the instruments that produce those results.

Classically, until the last five or ten years, we actually made college a competitor with continued military service. The GI Bill was in fact an incentive to leave military service to cash in the education benefits that you had received.

It's to everyone's credit in the last decade that the services provide a variety of programs that make college consistent with military service. In fact, Bernie was instrumental in what I think is one of the most interesting innovations, the College First Program, because it is so counter-cultural for the Department to allow you to have your "dessert" first. You get to go to college first, to some extent at our expense, and then you serve in the military.

The fact that this was accepted by the military without much quarrel is quite an achievement. It has been very successful. We are seeing additional authority to make it a permanent program in the military services. Likewise, all the services are taking additional wider steps to make military service consistent with going to college, as opposed to the competition.

Second, over the last several years, I have seen the success of targeting pay changes in the military to areas of greater need, not having the same across-the-board pay raise for everybody in the basic compensation table. You may think that is a trivial accomplishment. Let me emphasize it is not.

We have not achieved the same success on the civil service side. The administration has started trying to change the paradigm for civil service.

The fact that we achieved this on the military side, against the wishes of some senior members of Congress, is a significant achievement. We have established a new principle. We have acted on the philosophy end of compensation, to emphasize that we have to think about pay as a function of both educational achievements and the amount of

experience in the military the service member might have. Those attributes will obviously change over time. These are important changes in the philosophy of the Department.

Similarly, we are beginning to implement what we call assignment incentive pay. We secured the right to pay up to \$1,500 a month, which is a rather significant amount of money for you to take a difficult-to-fill assignment. We did ask for more than that, but we were not granted that permission.

The United States Navy is, in my estimation, at the cutting edge in using this new authority. They are auctioning slots on an experimental basis on eBay. Not on eBay but an eBay-like site. Sorry to misspeak there—Freudian slip.

One of the most interesting things is their experience that an important fraction of the bids are zero. Just giving people an opportunity decisively to affect their next assignment is enough. While we have had wish lists for years, the detailers often ignored most of your requests, or perversely acted in a contrary manner to your requests!

FROM THE AUDIENCE: Are negative bids allowed?

DR. CHU: I asked that question. They only grinned. They thought I was teasing them. That was a serious question, and I will readdress that issue on a future date.

Third, we have tried to rethink the series of understandings that the Department has with its military families in what we call a “social compact.” It’s a term the services don’t particularly like, but it’s an effort to recognize that our fringe benefits and the way we treated people in the Department are still too much tied to the era of conscription. They may be consistent with what senior people in the Department think might be useful, but may not be in step with what the vast majority of those actually in uniform think is important.

Two of the important changes to which we are giving attention are spousal careers and the education that your kids get in the school system that they attend. These are important benefits to which we must pay attention over time.

Fifth, we are trying to revamp our view about what the reserves should look like. I think you talked earlier about the changes we are seeking.

Sixth, we are also trying to gain acceptance of the Secretary’s precept that senior officers, and perhaps all personnel, ought to spend more time in any particular position they hold, which implies some people, at least, will spend more time in uniform.

We made a determined effort to get the legislative changes to support that concept. Last year we got none of our requested changes. We may get a little bit of progress this year. It's very difficult to get Congress to agree to these changes. One interesting question is why change is so hard. Why is it so hard to make these changes?

An interesting case study is the airlines—a source of insight as to why it's hard to change the compensation culture in an organization. The existence of the major airlines is threatened by the so-called low-cost carriers. They tried all sorts of things. They cannot seem to get there. They tried airlines within airlines...which doesn't work. I do think that should make us respectful of how much change we can achieve at one time.

I mentioned already the conscription heritage. It is still with the Department in a whole range of issues like making junior enlisted personnel who are single live in the barracks. It's a major mistake in terms of how we treat people, but it's very hard to wean the Department away from it. We need to acknowledge that it's an issue and that we should look at it differently. There are officers in the senior ranks who say it's important to cohesion. Of course, since married personnel are exempt, we might ask, "Who is cohering in this model?"

I do think we need to move in the resource community away from an undue focus on how much things are going to cost. Cost is important and we want to be efficient, but it is critical to start with what our culture wants to achieve.

The Congress is very reluctant to endorse these changes. There are a variety of reasons for that. One hypothesis I think worth examining is Congress listens to what you might call "identified constituents." Military personnel vote—they actually vote at higher rates than the civil community—but I'm struck that the members don't see it that way. They have overruled the Executive Branch's recommendations in the last half dozen years to favor benefit programs that affect important identifiable constituencies, largely people who have already left military service. We're not going to get any additional recruiting effect from these benefit changes. And they are large.

MR. KRIEG: There are revenues from—

DR. CHU: I will just give you three minor examples as indicating how hard it is to change.

We have tried to work on the size of the subsidy that undergirds the commissary benefit. We were met by resistance from inside the Department and from Congress.

We have tried to bring a more efficient organizational structure to the exchange system. That's still an open issue, but we are getting significant push back from both quarters.

We have tried to rethink how we support education in the United States, which is, after all, a local responsibility. In certain locations, for historical reasons, DOD does pay for and run a rather good set of schools. Should we think about a long-term solution that returns to local control?

I mentioned the airlines as a source of inspiration. The example I'm going to cite to you is airline deregulation. One of the points that Alfred Kahn made about airplane deregulation was the repeated deregulation studies that he and others helped sponsor in the 1970s. It wasn't enough to do the study once to convince the political leadership to endorse change. In his view, it was critical to do the same study over and over again to make the case, to build the political support for a change.

It can be done. I think I can point with some pride to his achievement last year in getting the authority to pursue a new set of civil service rules. We did get that. It wasn't easy by any means, but we were successful in bringing together a variety of aspects that made success possible. These aren't easily repeated, I would acknowledge, but I do congratulate PA&E for making military compensation and its future structure the subject of this conference.

DR. ROSTKER: Well, I tell you. I have a problem. I have this watch and it's an electronic watch and it has all kinds of numbers and it keeps flashing 1973. I mean, I just don't understand why everything we have discussed today could well have been discussed in 1973.

In 1973, we were reeling from the increased wage bill of the all-volunteer force. The three gentlemen that were here representing the congressional view could have been three gentlemen representing the same jobs in that year.

Neil is exactly right. The impending doom is like *mañana*. Tomorrow it will be *mañana* and it keeps getting pushed off. David is absolutely correct. The resource folks—no offense.

DR. CHU: Present company excepted, of course.

DR. ROSTKER: [They] always looked at the percentage of the budget going to personnel and the trend lines and the like, and failed. If we could only bring that under

control. I don't know what that quite means because there are people and constituencies at the other end of that control.

We did have a commission. People were talking commissions. There was the Defense Manpower Commission that did some really good work and came to the conclusion, to the dismay of Congress, that it was going to cost maybe more to keep the volunteer force going but it was the right way to go.

The notion that there is some panacea, some item that we can wrestle out of the personnel budget and have a great deal of savings, and, of course, no one would notice it in their behavior or in their support from their allies. It is folly. The same arguments have gone year after year.

I think there are specific cases—David mentioned a few—where, as Cindy said, maybe there is a conversion if we can only get people to realize that conversion.

Efficiencies in the commissary system will be to the advantage of the people who are using the system. I think even an expansion of the system in terms of the reserve community can be an advantage.

My own pet was the housing program. I think we have about as purely conceived housing program as one could imagine. My own alternative, when endorsed by the Quality of Life Panel in the last administration, was to have a housing authority. The Australians have a housing authority.

It's able to do that magic thing, which is to borrow money so you build decent, adequate housing today and use your pay and allowance stream to pay for that housing over the next twenty or thirty years. That is very radical, a radical notion except we all do it when we go to the bank and get a mortgage.

You wouldn't want to live in a place where you had to save up for your life to buy a house that you would be too old to really enjoy. You do it through a pay structure with the assets of the house. The Australians do it with a pay commission or a housing authority that can issue the full faith and credit of the Government.

By the way, we do this with the New York Dormitory Authority. We do this in other places but, of course, they have a notion of capital budget, a distinction which we have not quite yet discovered in the Federal Government. We follow the most advanced accounting principles of the 18th century and have not quite yet—

DR. CHU: Actually, 1921, which is 100 years now.

DR. ROSTKER: That's true. But I think it goes back to the Congress. In the first Continental Congress, we decided that we would have a pay-as-you-go type of system.

By the way, the Australian Housing Authority not only provided adequate housing to the Australian military, it also turned a profit and returned money to the Australian government.

When this was proposed, the chief opposition came from the service chiefs who, although they would sit on the board of the housing authorities, felt they would lose control. My question was: Lose control of what, dilapidated housing? But this was clearly important and that proposal went down.

I think I would like to see that kind of thing resurrected in terms of some of the provisions of in-kind services. We're not going to wrestle in-kind things out of the system. That is a long tradition.

To be serious, I think we need to respect that tradition. I don't do battle with the senior enlisted advisors over their notions of how the compensation system needed to be structured. I think we need to accept that and work around that and see what common ground can be [found].

A long time ago, I gave up the notion of a salary system that was implicit in a lot of discussion here. I think we need to find common ground across the Department.

In terms of the various commissions and studies, unlike BRAC, there was a group of people that had a veto over this. It was called the service chiefs. No comprehensive pay reform has passed the Congress that has not had the support of the service chiefs.

I didn't hear anything today that would convince me that the message that I gave this morning was wrong, and that was that the way to address this question is to figure out what kind of military we want for the twenty-first century and then work backwards as to how we get a personnel system. I think that is the strength of the changing environment. To just argue cost and how to wrestle dollars out of the existing system without knowing whether that system is where it needs to go in the future is not very encouraging.

I would share one thing that I think David and I have in common having shared this job, and that is a sense of not trying to wrestle the last degree of efficiency out of the military personnel system. We tried to do that in 1976.

One of our predecessors, Bill Brehm, who had carried the ball for the all-volunteer force, bowed to the pressure of the budget and cut recruiting resources by 40 percent and

in Congressional testimony said, “No problem. If I see the numbers drop, I will just pump up recruiting.” Well, that was the start of the slippery slope that brought us the late 1970s.

I think it’s more important that we have a robust system so that we can have a military that is fully responsive and has the resilience that we see today rather than a system that is operating on a margin. Did I misspeak for you, David?

DR. CHU: Could I add a comment? I think that’s very important. One of the reasons that present events underscore is that it is difficult to foresee, since we must request these changes in the [inaudible word], the environment in which you will have to execute the budget. If that environment proves tougher, you don’t have the ability, given the American political system, which is not a parliamentary system, suddenly to change everything in order to meet the exigent needs.

We have seen this and it has been the hallmark. As was acknowledged by one of my colleagues, the Department, on a go-forward basis, has to look ahead to what it’s going to be like in January of next year, what is going to be the possible environment. That is two hard things.

You cannot cut this too thin. As Bernie indicated, it is very hard to recover from mistakes, because you lose the sense of the country. It is critical to people that they are joining the winning team and rebuilding that sense takes far more time and resources.

DR. ROSTKER: I think in general, to the economists in the room, we want to be in an excess supply situation. You heard a little bit about that in the opposite from the director of the CBO. He said, “Well, if we’ve got this higher educated force with the current personnel system or the present compensation, maybe that’s why we don’t need to go further.”

David and I had taken the position, and this was in some ways shared, that we would like to see enhanced levels of compensation for the senior enlisted people who have survived this system and bring that level up. That not only provides an incentive for people to strive for higher rank, which is exceedingly important. It’s also the right thing to do.

I would rather not look in my rear-view mirror and see what efficiencies and costs I could get out, but look forward to see how I can fairly compensate the force if it has in fact moved in this way and be in a position to have excess supply and increasing levels of quality, [which] to me are more important than that last added ounce of efficiency.

With that, I will pass to the person who we have now convinced not to ring out the last bit of cost.

DR. CHU: In fact, he said more money.

MR. KRIEG: I'm going to put some charts up. I don't know if you want to sit here and be blinded by that.

I would like to start by saying that unless and until July 16th, or the Senate of the United States adds to that nomination, I still am the Director of Program Analysis and Evaluation, and the director of the Program Analysis and Evaluation, as David will remember, is as much about cost effectiveness as it is just about cost. I'm pretty interested in the effectiveness of the system as well.

First of all, I want to start by saying it is now 4:15. We have been at this for well over six hours. I thank all of you for your capacity to sit through this. I recognize that I am the last speaker between you and a glass or two of wine. Therefore, I'm in a very dangerous position.

I do want to thank you because I think this is a really critical issue. What I will try to do is not so much determine whether pay is better than in-kind or many of the details that got described, but instead try to put some numbers around what I think is the coming reality that we must face, which is the nation will not have enough money to do everything it wants to do and, therefore, it must make choices.

The degree to which it makes choices, particularly when it comes to people, better be in the right direction because we are, as much as we would like to think we are a technologically driven force, we are still a people driven force. The operations that we have just seen take place are facilitated by technology, but they are operated by individuals. I think that is something that can't be lost by any of us.

[I'll make] a couple of observations. First, I was struck by one set of themes that came through over and over again. That was that while we look at this as a military compensation question, it became clear to me that this is more about careers, talent, and pay in Government than it is simply about the compensation of the military.

What do I mean by that? If I look at some of the hallmarks of the system we're talking about, it's heavy on deferred compensation. It is aimed at inequities that were formed sometime in at least the mid-20th century, if not before, and that we have increasingly over time shifted resources from today's needs to a retiree class.

I could argue that those are many of the same hallmarks that describe both the civilian personnel system and the military system, and the striking nature of what the Volker Commission has talked about and what many of the things we talked about today in similarities were obvious.

I do say, as David pointed out, the Department is taking a big step with Congressional support to drive NSPS. The question is: Where do we want to go on the military side?

Secondly, I was struck [by]—and I thank Cindy for bringing this up—three constituencies. As a history major by training, I try to reduce all things to three. I don't know whether that's based on Hegelian training or the trinity or whatever you want to talk about. I am more likely to think that it is associated with the fact that historians can't count higher than three.

But I want to lay out some triangles that I think we've got to deal with [and] I feel are important, and then [I'll] come back around to, "So what? What are you going to do?"

In this environment, pay and compensation in particular, there is a very strong triangle between Congress, the military represented by the institution, and various constituencies who don't necessarily have similar outcomes in mind. As they think about it they have, as David pointed out, a very highly differentiated degree of political clout when it comes to being able to do things.

I will come back to that triangle of Congress, the military, and the various constituencies. I think it's critical in trying to come to a conclusion.

We tried to start laying out some of the fact base on which we described a lot of the reality in front of us. We are going to try to lay out a fact base.

The first point that I would make is that I think the nation's body politic in the next ten to twenty years has three relevant priorities. Priority one, they want their taxes lower rather than higher. Priority two is they want their benefits higher rather than lower, and Priority three is they want their security local rather than global.

When I think about those three priorities, the ranking of defense, as we think about our business, is some challenge. I think that's an important to think about as we go into it.

Let's look at some of the projections that we've got laid out. [Here's a] typical scene. Let's start with the growth and estimates, brown being PB01. PB00 and PB01 started the big increase in this administration...largely driven by three components. Pay

was one; benefits, paying for TRICARE for Life was two; and only a very small portion of that add was associated with transformation in the classical sense.

We see the increase in supplementals start to play. Then you see ever-optimistic expectations in the future. Then we will talk about that to the degree in which we have been successful with that in the past in a minute.

Since Bernie and David chastised me and the resource community for always talking about percentages and whining about dollars, I do think it is important for us to think about that.

This is a chart where we tried our best because it is hard to figure out where the money is for people because it is all over the place. What we tried to do is roll up—and this is only inside the Department of Defense budget. We will try in a minute to show the trends outside the defense budget as best we can.

The personnel and entitlement, both military and civilian, you can see we have taken a crack at taking the civilian out of the O&M community, which is where the bulk of that is paid for. You can see that's a little bit different than you see in the normal appropriations.

What I find striking about it is that the budget in real terms—and this will be the last time I do real terms...between about 1989, 1990, and 2004, the budget is roughly the same in real terms. We are 35 percent lower in both civilian and military manpower, and the percentage of money associated with totally loaded manpower costs is only slightly smaller than it was in 1989.

Why is that? Well, there are a lot of reasons associated with it. Let's think about that for a minute.

There you can see the reduction over time, and we programmed to be fairly flat into the future. At the same time, we have seen...a rise in both civilian and military pay. These are the military retirement and health care and family housing that we pay for.

We have tried to draw on this notion of contracts for services. By the way, it wasn't zero there. It was just the best data we could get.

I would argue I'm not even happy with these contracts for services. That's all services. That could be private sector maintenance to do lawn mowing at a base. Therefore, getting some differentiation here in understanding it is something we're going to work on. But I want to tell you that at least some portion of that was associated with the drawdown of manpower.

You can see that the non-compensation has been over time the flex category, particularly procurement. Procurement is the buffer zone to changing commitment to the Department of Defense over time.

Then this black line is an attempt to begin to show, as best we can get it, the liability of retirement and then TRICARE for Life that's captured outside the Department of Defense by the Treasury. We didn't have those fully loaded costs before, but you can see we're going to start showing it. I think it becomes very important here in a minute. When you put these two together, you can see what's of some concern.

[Inaudible sentence.] Quality is not free. In great measure, we have gotten a great degree of output for the input we put into it. That is not at all the claim.

The military, the capacity of both the individual servicemen and the individual servicemen working in concert today is mind boggling in comparison to what it was in 1990 and phenomenal in comparison to what it was in 1972.

A big chunk of that investment has been very well spent, and we're not going to try to determine what was efficient, what was slop, and we are really more looking to the future.

Secondly, the professionalization of that force, and particularly the notion of driving a much higher tech and a much more information-heavy force has moved us from an unskilled work force to an industrial age work force to a top 25 percentile of the capacity in the average population work force of the day. Definitionally, that's more expensive.

I think those are both a given. I do not think we would want to go back to a minimum wage work force with the kinds of challenges that are put in front of them.

The question then becomes: What are the challenges ahead? We see at least two great challenges. The first one, as I laid out in the questions earlier, is that we're not sure that the next margin of dollar we're spending is associated with the outputs we want. David Chu was referring to this. It's actually work his guys have led to look at the new benefits late into the system, not asked for by the President, laid in by the Congress, since the year 2000, that came into effect in about FY02, and then tried to allocate those to the class of beneficiary that takes the benefit of it.

Now, what it shows is that by the year 2009, this is about \$130 billion of cost annually to the Department of Defense. I will note that there is another \$30 billion covered by the Treasury in 2009. It grows over a period of time at about this same time

frame because it's largely driven by the difference between accrual payments and real payments to TRICARE for Life among other things.

The reality that struck me in looking at this is that if there is \$60 billion here in FY09, \$60 billion was the procurement budget for the Department of Defense in the year 2000. We have added into the system what I think is a fixed—being a business guy, this is really hard for me to say—labor is a fixed cost.

We have added a fixed cost into the system that was roughly the same size, not accounting for inflation, of our flex money at the beginning of the decade. I think that is a strategic issue that we must deal with because the challenge we have ahead of us is that we will be lucky to see the kind of future financially that we would like to project.

Why is that? Well, I think our previous speakers laid this picture out. It's the happy picture of deficits over time played out by the DOD budget. This is the irrational exuberance of dot-com life with some discipline on the part of Congress and the executive branch during the same period of time on spending.

But you can see that the deficit picture is not attractive. In fact, this ends at about 2010, I think. What we know is that the boomers' retirements really kick in between 2010 and 2015. We heard the earlier presentation about what happens during that period.

I will skip over this chart to say deficits, to me, of this magnitude are not politically sustainable over time. That's all I will say about that chart.

Now I will turn to this. This is the DOD budget, projected versus actual retirement. Other than a great story of the power of hope over reality, what it shows is the actual budget, and then the little tails falling off of it, the various FYDPs at year of budget execution.

The one thing it does show is, even if you put it in [inaudible word], when you take it out of your military dollars and put it into real dollars, what David Chu tells me is I'm a real piker as a PA&E director because my expectations for the future are actually what we could actually put together during the early 1980s.

DR. CHU: Ah, the glory days.

MR. KRIEG: This number, when you account for inflation, is really big. You have \$700 billion.

But what I put it up to say is that the difference between sitting here or sitting there and sitting here [indicating] is that the modernization of the military, the technology in

the military that had taken place during this period has only begun here. Most of this increase is associated with the modernization and transformation of the Department of Defense in a technical perspective. All right? Problem one.

Problem two is this drop was associated with the reality that we could give up a lot of things post-cold war that we didn't need in the future and our future does not look like that going forward in terms of demand. It looks more like, I would argue, something in here [indicating] in terms of demand.

The reality we're in and what worries me as sort of a financial guy is if anybody thinks we're here [indicating] and that this is what the Department of Defense is going to be able to take the pain [of] in [terms of] finances in the future, we will not get the output in terms of defense capabilities.

Why do I say that? Why did I do that? This is a chart that, at the end of the day, worries me the most. This is back to the fact that I think that the body politic wants its taxes lower rather than higher and its personal benefits higher rather than lower.

What we did was we have mapped the Government over time, mandatory DOD and non-discretionary DOD. There is nominal GDP growth, and zero real growth. When one looks at that, then, blown out at what is often referred to as the discretionary account in the Federal Government, you see that—I mean, obviously it's not going to come out of discretionary and non-DOD. This is before we kick in the real problem with the baby boomers.

The reason we lay this out is simply to say that I believe that the Department of Defense, even before the rest of the Government realizes it, is in a financially very challenged position.

This area, which accounts for something between 40 and 50 percent of the budget, growing well above inflation primarily driven by health care, which is the problem that all businesses have, is really going to challenge the Department of Defense. I come back and say—let me try to answer the four questions that I posed at the beginning.

Should we be concerned about growth in personnel costs? I think the answer is yes, we have no choice. We must be, not just from a cost perspective, but an [inaudible word] perspective.

I do think that Cindy Williams is right. The challenge here is to define what it cost in real terms and what we get out of it in real terms, and then say what is the strategic

trade space between this investment, between changing the model, and between other investments we can make.

Secondly, and Bernie Rostker laid out a challenge to us. How do we know if we're doing a good job? Well, we've got to do that by what kind of core structure do we want in the future. I heard a lot of them. I will throw a few in of my own but I will lay a couple out from what I heard today.

I think it's more joint than separate. It will be about smaller units and driving decisionmaking down and into networks. It will be more around brigades and smaller, not divisions and larger. I would argue there is an opportunity, as you view that, to change the structure of the military in ways that will get us lower cost in structure if we're willing to do that.

We'll shift mix and totals from heavy and industrial to faster, more precise, and more knowledge based. And we will shift mix among reserve and active, particularly when, as we have seen in the last five years, reserves become almost as effective to have as ever.

If we continue [to] increase the cost of the reserves, why have them as reserves? I can't use them but they cost almost as much. It will be more about education, leadership and knowledge management and less about road training. We heard that from a couple of discussions today.

I think this is the one that we didn't really touch on but is going to be a real challenge for us: it will be more about all elements of national power, which will begin to shift mix among not just active and reserve, but among active, reserve and civilians.

And it will demand flexibility in a way that our system, which is built upon predictability and consistency that one was able to do in a cold war, we will not have the luxury of doing in the global war on terror. That will be a big challenge for us.

Third, does compensation, deferred compensation seem to support the core structure? You know, I think David Chu is right. The answer is if we can get there, but it will be really expensive unless we're willing to try to drive changes, or pilots, and tools as mentioned by ADM Vern Clark, and a number of our speakers talked about choice, about targeting, about market forces.

I think we're willing, the executives are willing, to play with those tools and to try them. I don't think that executives—while this administration is working on it, I don't think that is a partisan issue among the executive branch.

I think once you're an executive and dealing with this system, you realize you must change it. This is a question of whether we can build the business case to convince the Congress that we need to build that flexibility into the system.

Lastly, is DOD providing benefits that cost more than the recipient's value? This is where I would argue that...the answer is, absolutely, it is.

We have started to play with things like assignment actions, assignment auctions, but the reality is we spend more on benefits than the average person's value to the benefits they receive. That's a challenge.

I am struck by the difference that we saw in the execution of the termination of Crusader and the termination of Comanche. I think the triangle is important for that in that it drives [inaudible word]. What's the difference? The triangle—in that case, the military industrial triangle—is between contractors, the military, and Congress.

Crusader was imposed from outside that triangle on the system. It was OSD's inserting a decision on that triangle. Now, mind you, it was less than \$9 billion of investment over a period which we were going to spend somewhere north of \$3.5 trillion.

But [look at] the amount of blood, energy, senior management time, political capital that was spent in making that decision; it took us six months to execute it. At the end of the day, it was incredibly painful.

Fast forward 18 months, the Army was the only party to the triangle. The Army was telling us it was going to build the best helicopter that will ever be built on the face of the earth. It decides itself what it's going to do. The Secretary supports it. The President supports it. It was a half-day news story.

The reality of this is the triangle is defective at keeping coherence and continuing the current status quo. If one of the parties of the triangle were to step outside of this and lead it, it can also change very rapidly.

That leads to the final point. This will not be a debate that will be won by suits. We will never win this debate. The military must believe that this is the right thing to do and they must lead the discussion as we go forward because they are the only parties to the triangle that have credibility in the discussion.

With that, I will end and we'll take some questions. You guys want to join up here?

DR. CHU: Surely.

MR. KRIEG: Questions?

FROM THE AUDIENCE: I guess I'm not sure what I heard from Bernie earlier today because we heard some great changes. From David, I think I heard that things are going. They are getting a good force. Things are going pretty well.

I'm not sure. Are you reflecting on the compensation given the personnel structure that we have? It sounds inconsistent to me.

DR. CHU: I may have been overly influenced by reading the opening chapter of "Filling the Ranks," which I thought took a pessimistic view of the efficacy of the current compensation system. It has its failings. However, we have succeeded despite its flaws in using to produce, in my judgment, a first rate force.

Now, could we get there for less money? Probably yes. How much less in terms of what actually goes to the force in uniform? I think this is an interesting, open question. That's the import of Ken's charts. Only a fraction of the military compensation budget goes to the people currently serving.

CBO is posing the cash/noncash compensation issue. It's an interesting issue. As a practical matter, we are delighted to have the Treasury Department help us with the non-tax compensation. To sustain the quality of our forces, we believe compensation must roughly equate to the 70th percentile of civil earnings, adjusted for experience in education.

Given that, receiving income on a tax-free basis is very powerful. We see that in the behavior of our troops. As we all know, these guys are clever. They wait to make their reenlistment decision until they enter a combat zone and re-enlistment bonuses are tax-free, which is mucking up all our projections of reenlistment!

I think the more important issue in the compensation system is how much is immediate compensation versus deferred compensation. That's where the trend that Ken identified as developing over in the last six years is so destructive.

The important message in the chart is that these changes are unasked for—and this is a new development. You have to go back to the early 1980s, in my judgment, to find Congress importantly overruling the President's advice as to what military compensation should be.

You have to go back to [former Defense Secretary Les] Aspen's change in the retirement, which was a reduction. Before that, you have to go back to the 1979 debate over military pay, where Congress overruled the administration and said, "This ain't working. We have got to pay more."

Starting with 1999—fiscal year 2000—we have a very interesting [situation], in my judgment, in which Congress has decided every year to make an important decision about compensation policy that overrules the President. What's changed? That is my question, because what Congress is doing is adding to a system that already backloads a lot of the compensation package.

I do believe Mr. England's personal point at lunch was right on the mark. Maybe 22-year olds ought to pay attention to their retirement package, but they don't.

Maybe we do want to serve in loco parentis and make sure they have a retirement annuity. I think we probably have to do some of that. Do we have to do as much as we're doing? I would certainly challenge whether we should do substantially more, which is where we're headed.

The numbers that came up on the chart, the \$30 billion a year by fiscal year 2009, most of that number is already enacted. We would have to have a huge effort to reverse that.

DR. ROSTKER: This is what Admiral Richard Danzig talked about, that the system was not in crisis. It's a system that can do better. I would submit, consistent with this view of the future and Secretary Rumsfeld's view of the future, we want a system that emphasizes experience and performance, not a system that emphasizes youth and vigor.

The times have changed and we need to have a personnel force structure and a matching compensation structure that emphasizes experience and performance. To me, that's where the future lies.

DR. CHU: Also, we should not view the military personnel system in isolation from the other parts of the Department. That's part of the Secretary's strategic view and his insistence, or his reluctance, to allow a permanent, politically sanctioned increase in the military strength, which has become a presidential campaign issue, as you know.

His challenge is: Couldn't others equally well perform some of the responsibilities with which our military personnel are charged? Whatever failings the personnel system may have, they pale beside the alternatives. He has some authority to make changes, and we are charged with executing that authority reasonably, which is not going to be trivial.

To give the civil alternative a fair hearing, there are all sorts of issues that must be considered, tied into the whole debate of outsourcing. How do we use contract services?

We have this issue right now in Iraq. What should the contractors do? May contractors carry arms? Mr. Bremer's personal security detail is contracted.

We have another issue right now. The Navy, as a pioneer, has gone beyond the Military Sealift Command model, which uses civil service crews, and has mixed contractor/civilian/military crews for the AOE-6 class oilers. Now, is that okay? Well, we're doing it.

Should we think about innovations like the U.K. got its parliament to approve—sponsored reserve status, so you could give the people military character if the need should arise? That is one of the issues the Department needs to look at.

I think this is a three-legged personnel stool. We have military personnel. We have the civil service community. Then we have the contractor services.

DR. ROSTKER: The contractors are not new. I mean, we had contractors building fire bases in Vietnam. This has come to the forefront mainly because of the strength the forces is under and we're seeing contractors on the news in ways we haven't.

I have some deep concerns, but they are hypotheses at this point. I think it is a very open question on how we organize ourselves, and it is a question that certainly has moral and legal implications.

DR. CHU: Back to the iron triangle point. We all, I think, need to do a better job of framing the debate for the public. The question we get from the Congress, the question the Secretary gets from the Congress on contractors, is not what the performance of the contractors might be, not what's the cost of the contractors. It's how many people do the contractors have in Iraq?

I cannot think of a more irrelevant question. One of the reasons to turn to a contractor is you are making the contractor your agent for that decision. It would be nice to know, but not very relevant. Yet that was the question about which the Secretary was badgered at the hearing, and denounced because he couldn't produce a number.

FROM THE AUDIENCE: I would like to make another point about that chart. What strikes me is this is exactly the opposite of what the private sector is doing. We ought to be concerned about [the fact that] the private sector seems to be focusing more on the people who are on active roles and view retiree benefits as reducible. At some point, the Department does compete with the private sector for people. In the future, if this continues, I wonder what our ability to compete with the private sector [will be] in terms of people coming on the active side.

DR. CHU: I think one of the reasons we are seeing this push to give TRICARE to the reserves is because private sector health insurance has gotten weaker as an alternative. We have been surprised by the rate at which eligible retirees are signing up for TRICARE. TRICARE, which was once viewed as not all that generous, now looks terrific.

We have gone to a situation where 60 to 70 percent of those eligible use TRICARE to a projection that by the end of the decade, 95 percent of those eligible will use TRICARE.

FROM THE AUDIENCE: One question. David, you mentioned the difficulties in your efforts to increase career lengths to keep people in jobs longer, and the Congress hasn't gone along with that.

As I understand the law, that [need to increase career lengths] seems like requirements that can all be waived. I was wondering why you haven't just waived them and established a policy in that way?

DR. CHU: A great deal is within the Department's control but some things aren't. For example, there is an absolute bar to the service after age 62. The President can waive the limit for ten officers. Vern Clark, if he is confirmed, as he almost surely will be, would require a waiver. There are certain things we can't do. There are some hard stops in the system.

Even more important, in my judgment, is the signal of political support to the institution the Congress sanctioning these changes would give. I will give you a very small example that you are not going to get in this year's bill. One of the oddities of the system, when you think about it, is the annuity. The annuity calculator stops at 30 years of service.

Congress has already given the authority is to keep O-9s to 38 years of service and O-10s to 40 years of service. It would be gracious to allow the annuity clock to run past 30 years of service. It's not expensive, after all.

One of the things people worry about is the surviving spouse. That spouse's pension is tied to this calculation, so, it's important from a family perspective. It mystifies why we can't get this through the Congress, but we're not going to succeed this year.

MR. KRIEG: Let me add one other note. We found this when we went up and started to do the fiscal year 2004. The reaction in many cases—in the end, NSPS

supported it and they got it through—[but] the reaction in many cases was, “Tell us specifically what is wrong and we will give you waiver authority for that specific problem.” Our reaction to that as we debated it was, if we, as public policy, make all these flexibilities full of restrictions and very difficult to do, in reality, no one will ever do them.

I think debate will have to take place around the issue of whether we are managing flexibility at the margin, and if the system requires more flexibility. The U.S. Congress clearly does not want to give the Department of Defense any more flexibility than it has to. I think that would be an important part of this debate as we go through.

FROM THE AUDIENCE: It seems that if you exercise the waiver and you have the success, that gives you justification to go in and get the law changed.

DR. ROSTKER: You finally found the fault line between me and these gentlemen here because I fundamentally disagree in the sense that there is untapped flexibility in the existing structure. One of the great problems is to get personnel to actually use that flexibility. Before we go for a wholesale change, I think we need to use the tools we have.

I’m reminded that there was some law that we had in the last administration that allowed some increased flexibility for IT professionals. Yet, the scientific community came in and asked for a total relief from all, notwithstanding any law in the United States.

When I pointed out to Jacques Gansler that that included that there was a standards act, that there are child labor laws, and what was it they wanted to do, they couldn’t respond. So Jack withdrew his support for this initiative.

It’s all too easy to blame the system and not look at the flexibility in the system. I have had senior civilian personnel say, “Stop talking about that. Somebody might want us to do it.”

I mean, we can streamline the hiring process. There is no reason that it has to take as long as it does. We can structure a system in the existing provisions to hire literally on the spot for certain jobs, and we don’t do it.

My fear is that we will design a new personnel system brought to you by the same people who refused to use the flexibility in the old personnel system. It’s a great opportunity but we have to be really vigilant that we will in fact use that flexibility because we haven’t up to this time.

DR. CHU: This is an issue that does divide us. In my view, we support these flexibilities because without such authorities, we will have a very tough time changing the culture of the organization.

DR. PANNULLO: I want to say thank you to the panelists. I'd like to acknowledge the behind-the-scenes people that made the conference come off so smoothly.

The conference is cosponsored by PA&E and IDA. Dave Trybula is our principal coordinator, who had support from Chris Meyer, Bob Daigle, and John Whitley, and on the IDA side, Stan Horowitz, our principal coordinator, with strong support from Ayeh Bandeh-Ahmadi, Sonnja Settle, and Cynthia Turner.

The conference also benefited from conversation [with] and advice from David McNicol, Carla Tighe Murray, and Cindy Williams. Next is the reception, which is downstairs until 6:30.

[The proceedings concluded at 5:00 p.m.]

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