CBO TESTIMONY

Statement of
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Director

How Reserve Call-Ups Affect Civilian Employers

before the
Subcommittee on Regulatory Reform and Oversight
Committee on Small Business
U.S. House of Representatives

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Chairman Akin and Members of the Subcommittee, thank you for inviting me to discuss the Congressional Budget Office's (CBO's) recent analysis of the effects of reserve call-ups on civilian employers. The military reserves provide trained service members and units that are available for active military duty during peacetime and war.[1] Over the past decade, the Department of Defense (DoD) has dramatically increased its reliance on the reserve forces, particularly since the terrorist attacks of September 11, 2001. The reserves are integral to current operations—of service members deployed in November 2004 in Iraq and Afghanistan, about 33 percent were reservists—and DoD foresees continued reliance on them. (Throughout my testimony, "reserves" refers to the individual services' National Guard and reserve components: the Air Force Reserve, the Air National Guard, the Army Reserve, the Army National Guard, the Coast Guard Reserve, the Marine Corps Reserve, and the Navy Reserve.)

Yet many reservists, when they joined the military, probably did not anticipate the increased frequency and duration of the activations that have occurred during the past several years and may be finding those mobilizations more disruptive than they might have expected.[2] To alleviate difficulties with call-ups, the Congress has enacted legislation to provide civil and employment protections and financial relief. The Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA), the primary legislation governing service members' employment rights, guarantees the right of reservists to be reemployed by their civilian employer after serving on active duty, prohibits employers from discriminating against individuals in any aspect of employment because of their service in the reserves, and mandates some continuation of benefits to reservists who have been activated.[3] By ensuring that people who are interested in military service can retain their jobs and participate in the reserve forces without fear of reprisal by their civilian employers, those provisions may also aid DoD in its recruiting and retention efforts.

The increased pace of reservist activations has focused attention on how call-ups affect the civilian employers of reservists, including reservists who are self-employed. Yet there is little information about the type and magnitude of the disruption that firms experience when their reservist employees or reservist owners

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1. See 10 U.S.C. §10102, added by Pub. L. 103-337, Div. A, Title XVI, Subtitle C, § 1661(a)(1), 108 Stat. 2970, and most recently amended by the Ronald W. Reagan National Defense Authorization Act for Fiscal Year 2005, Pub. L. 108-375 §511, 118 Stat. 1877.

2. Although in some contexts the terms "mobilization," "activation," and "call-up" may have different meanings, they are used interchangeably in this testimony.

3. Codified at 38 U.S.C. § § 4301-4333 (2000), as most recently amended by the Veterans Benefits Improvement Act of 2004, Pub. L. 108-454, § 201-204, 118 Stat. 3606. The protections of USERRA do not apply to self-employed reservists or reservist business owners, terms that are used synonymously here to refer to both incorporated and unincorporated businesses owned by reservists.

are activated. As a result, the impact of call-ups on businesses has not been systematically examined.

The Congressional Budget Office (CBO) examined the combined effects of reservists' activations and federal job protections on civilian employers in its recent report *The Effects of Reserve Call-Ups on Civilian Employers*, published in May of this year. That report also addressed the question of financial losses among self-employed reservists, a group that some people maintain deserve special assistance because they may have experienced particularly negative effects from the recent rise in activations. For its recent analysis, CBO used survey information collected by the Departments of Defense and Labor and by other organizations; it also interviewed reservists, manpower experts, business and reserve associations, and others. Although such data are limited and any conclusions drawn from them cannot be generalized to all employers, they provide insight into the problems that some employers are confronting.

CBO's Findings

CBO's analysis revealed that most employers are unaffected by the activation of reservists. Only about 6 percent of business establishments employ reservists, and fewer than half a percent of self-employed people are in the reserves. Among firms with reservist employees and owners, substantial variation is seen in their ability to adjust to a reservist's call-up. Activations create vacancies that firms would not otherwise have had. Some businesses may absorb the loss of personnel at little cost, but others may experience slowdowns in production, lost sales, or additional expenses as they attempt to compensate for a reservist's absence. A smaller number yet may find that they are unable to operate for lengthy periods—or at all—without their reservist and may experience financial losses or insolvency. Such problems are likely to be more severe for:

- Small businesses that lose essential (key) employees;
- Businesses that require workers with highly specialized skills; and
- Self-employed reservists.

Small businesses (generally those with fewer than 100 employees) employ about 18 percent of all reservists who hold civilian jobs; businesses with fewer than 500 employees and self-employed reservists employ about 35 percent. But there are no precise data on the number of reservists who are key employees or who have highly specialized skills. On the basis of survey information about reservists' civilian occupations, CBO estimates that out of the 860,000 reservists in the Selected Reserves (the primary source of reserve personnel), between 8,000 and 30,000 of them probably hold key positions in small businesses. In addition, about 55,000 reservists are self-employed. Considering that snapshot of reservists' employment, CBO expects that as many as 30,000 small businesses (0.6 percent of all such

firms) and 55,000 self-employed individuals (less than 0.5 percent of the self-employed) may be more severely affected than other reservist employers if their reservist employee or owner is activated.

In addition, CBO found that although USERRA provided employment protections to reservist employees, it might be exacerbating the difficulties that call-ups present for those individuals' employers. The legislation limits firms' flexibility in avoiding vacancies and imposes additional costs on some employers.

Options for Mitigating the Effects of Reservists' Activations

To help lessen the adverse effects of call-ups, two broad approaches are available: policymakers could enact legislation, or DoD could change its policies. Either approach, however, would require balancing a number of goals that sometimes conflict, such as providing reservists with a wide range of protected civilian employment, assisting DoD's efforts to recruit and retain the military personnel that it requires, minimizing the value of the labor resources being diverted from the civilian economy and improving DoD's allocation of personnel, and avoiding harm to small businesses. In its analysis, CBO considered several potential measures to mitigate the undesirable effects of call-ups, evaluating the measures in terms of those goals and their effects on DoD, reservists, and their employers. Options might include:

- Compensating businesses through tax credits or direct payments;
- Subsidizing loans to employers;
- Providing or subsidizing call-up insurance for businesses; or
- Exempting certain reservists from call-ups.

The first three options, depending on how they were structured, could advance the goals listed above, including that of maintaining the legislated employment protections that reservists now enjoy. The options would at least partially offset financial losses for firms that had reservist employees or owners who had been activated. In addition, the measures might increase employers' support for reservists' military service, which could in turn encourage more individuals to either join or remain in the reserves. Moreover, if mechanisms could be developed so that DoD faced more of the costs associated with call-ups, it would then be better able to evaluate the most cost-efficient mix of reserve and active-duty personnel. In particular, it might have an incentive to recruit civilians whose absence from their positions would pose less cost to employers and thus decrease any amounts DoD might pay in compensation.

The final option features a different mechanism from that of the others: it would reduce the number or frequency of call-ups rather than compensate employers for activations that had occurred. For example, DoD could exempt certain reservists or particular civilian positions from call-ups. Employers might benefit from that option, but if it was formulated too broadly, it might interfere with DoD's efforts to provide sufficient forces for war and other military contingencies. In addition, if call-ups were limited, reservists who were eager to serve and who wanted to be activated might be less satisfied with reserve service. By the same token, reservists who found the current levels of activation too high might be more satisfied.

All of the options would assist at least some of the businesses affected by call-ups. But none of the measures are likely to completely eliminate the problems that firms face. The rules that established which businesses were eligible for assistance and the extent of that aid would determine the degree to which a particular measure reduced the losses that some reservist employers and owners incurred from a call-up.

Another consideration is that the options entail either direct or indirect costs for the federal government and, consequently, for taxpayers. Even the fourth option, which calls for limiting certain reservists' call-ups, would entail indirect costs. Declaring some individuals ineligible for activation might impede DoD's ability to mobilize sufficient personnel and might discourage participation in the reserves. DoD would then need to use pecuniary or other incentives to attract additional people to reserve service.

The direct costs of compensating businesses through tax credits or direct payments, or by offering loans or insurance—the first three options—could be substantial, depending on how a measure was structured. The more targeted a remedy is, the more cost-effective the solution will be. That notion implies that any remuneration should be based on the actual loss that a firm experiences. However, calculating the decrease in profitability associated with call-ups may be virtually impossible. As CBO's interviews revealed, some business owners, even when they could quantify a change in profits, could not isolate how much of the decline was due to a reservist's activation and how much was due to other causes, such as a downturn in the economy, shifts in demand for the firm's products, or increased competition. Instead, the basis for compensating an employer's loss might be approximated. For example, the reservist's civilian salary or the costs of replacing the reservist could be used as measures of the firm's financial loss. Another approach would be to base compensation more broadly on the type or size of the business.