

REPORT OF

The Tenth Quadrennial Review of Military Compensation



VOLUME II

Deferred and Noncash Compensation

July 2008



Report Documentation Page				Form Approved OMB No. 0704-0188	
Public reporting burden for the collection of information is estimated to average 1 hour per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to Washington Headquarters Services, Directorate for Information Operations and Reports, 1215 Jefferson Davis Highway, Suite 1204, Arlington VA 22202-4302. Respondents should be aware that notwithstanding any other provision of law, no person shall be subject to a penalty for failing to comply with a collection of information if it does not display a currently valid OMB control number.					
1. REPORT DATE JUL 2008		2. REPORT TYPE		3. DATES COVERED 00-00-2008 to 00-00-2008	
4. TITLE AND SUBTITLE Report of the Tenth Quadrennial Review of Military Compensation				5a. CONTRACT NUMBER	
				5b. GRANT NUMBER	
				5c. PROGRAM ELEMENT NUMBER	
6. AUTHOR(S)				5d. PROJECT NUMBER	
				5e. TASK NUMBER	
				5f. WORK UNIT NUMBER	
7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES) Department of Defense, Washington, DC				8. PERFORMING ORGANIZATION REPORT NUMBER	
9. SPONSORING/MONITORING AGENCY NAME(S) AND ADDRESS(ES)				10. SPONSOR/MONITOR'S ACRONYM(S)	
				11. SPONSOR/MONITOR'S REPORT NUMBER(S)	
12. DISTRIBUTION/AVAILABILITY STATEMENT Approved for public release; distribution unlimited					
13. SUPPLEMENTARY NOTES					
14. ABSTRACT					
15. SUBJECT TERMS					
16. SECURITY CLASSIFICATION OF:			17. LIMITATION OF ABSTRACT Same as Report (SAR)	18. NUMBER OF PAGES 200	19a. NAME OF RESPONSIBLE PERSON
a. REPORT unclassified	b. ABSTRACT unclassified	c. THIS PAGE unclassified			

Report of

The Tenth Quadrennial Review of Military Compensation

Volume II

Deferred and Noncash Compensation

July 2008



For Immediate Release
Office of the Press Secretary
August 2, 2005

Memorandum for the Secretary of Defense

SUBJECT: Tenth Quadrennial Review of Military Compensation

Consistent with section 1008(b) of title 37, United States Code, every 4 years the President directs a complete review of the principles and concepts of the compensation system for members of the uniformed services. You shall conduct the tenth such Quadrennial Review of Military Compensation as my Executive Agent.

The Army, Navy, Marine Corps, and Air Force in the Department of Defense; the Coast Guard in the Department of Homeland Security; the commissioned corps of the National Oceanic and Atmospheric Administration in the Department of Commerce; and the commissioned corps of the Public Health Service in the Department of Health and Human Services perform important roles in the protection of the American people and advancement of their interests at home and abroad. To continue to recruit and retain highly qualified personnel for the uniformed services as they transform themselves to meet new challenges, the departments concerned must offer, in addition to challenging and rewarding duties, compensation appropriate to the services rendered to the Nation. The departments also must apply the substantial taxpayer resources devoted to uniformed services compensation in the most effective manner possible.

In the review of the principles and concepts of the compensation system, particular attention should be paid to:

1. ensuring that personnel in the uniformed services have the abilities and experience necessary to meet the challenges expected in the future, especially with respect to the War on Terror, defense of the homeland, and public warning and health in emergencies;
2. maintaining the quality of life for members of the uniformed services and their families;
3. the potential for consolidation of special pays and bonuses into fewer, broader, and more flexible authorities and for the substantial reduction or elimination of community-specific continuation and career pays in favor of more flexible and effective compensation alternatives;
4. the potential need for enactment of broader and more flexible authorities for recruitment and retention of uniformed services personnel; and
5. the implications of changing expectations of present and potential members of the uniformed services relating to retirement.

Please ensure that the Secretaries of Commerce, Health and Human Services, and Homeland Security participate as appropriate in the conduct of the review. I look forward to reviewing your findings and recommendations in this important undertaking.

GEORGE W. BUSH

Contents

List of Illustrationsvii

Preface ix

Executive Summary xi

Chapter 1

Introduction 1

Chapter 2

Military Retirement 7

Chapter 3

Health Care 41

Chapter 4

Quality of Life Programs 85

Chapter 5

Summary 131

Appendix A

Federal and State Police and Firefighter Retirement Programs 135

Appendix B

Air Force Compensation Fact Sheet 139

Supporting Research Papers 153

References 155

Glossary 161



Illustrations

Tables

Chapter 2. Military Retirement

Table 2-1. Impact of Discount Rates on the Value and Cost of Retirement Benefits	19
Table 2-2. Features of QRMC Alternatives for the Army	32
Table 2-3. Outcomes Under QRMC Alternatives and Current Retirement System	33
Table 2-4. Benefits Available to Separating Personnel, Current System Versus QRMC Proposal (thousands of dollars)	34
Table 2-5. Army Outcomes Under Various QRMC Options and Current Retirement System	37

Chapter 3. Health Care

Table 3-1. TRICARE Fees for Active Duty Personnel, Eligible Reservists, and Dependents	44
Table 3-2. TRICARE Fees for Retirees Under Age 65 and Their Dependents	45
Table 3-3. Medicare Part B Premiums for Singles by Income Bracket	48
Table 3-4. Estimated Medicare Premiums, 2009	57
Table 3-5. Annual TRICARE Prime Premiums Under QRMC Recommendation: 40 Percent of 2009 Medicare Part B Premium	58
Table 3-6. Annual TRICARE Standard/Extra Premiums Under QRMC Recommendation: 15 percent of 2009 Medicare Part B Premium	58
Table 3-7. Recommended TRICARE Prescription Drug Fees	61
Table 3-8. Inventories and Authorizations of Active Duty Physicians, Dentists, and Nurses, Fiscal Year 2006	64
Table 3-9. Special and Incentive Retention Pays	73

Chapter 4. Quality of Life Programs

Table 4-1. Quality of Life Programs Available to Military Personnel and Their Families ...	87
Table 4-2. Appropriated Funds for Largest Quality of Life Programs, Fiscal Year 2007	89
Table 4-3. Military Personnel Perceptions of DOD Expenditures on Benefits	92
Table 4-4. Military Personnel Perceptions on Finding Civilian Employment with Comparable Income and Benefits, and Impact on Continuation Rates	93

Figures

Chapter 1. Introduction

Figure 1-1. Major Components of Military Compensation, Fiscal Year 2006.....	2
--	---

Chapter 2. Military Retirement

Figure 2-1. Enlisted Loss Distribution.....	11
Figure 2-2. Officer Loss Distribution.....	12
Figure 2-3. Army Enlisted Member Profile, Current System.....	25
Figure 2-4. Army Enlisted Member Profile Under DACMC Defined Benefit, Defined Contribution, and Gate Pay.....	25
Figure 2-5. Army Enlisted Member Profile Under DACMC Deferred Payments with Separation Pay.....	27
Figure 2-6. Army Enlisted Member Profile Under DACMC Deferred Payments with Separation and Gate Pays.....	27
Figure 2-7. Army Enlisted Member Profile Under QRMC Shorter and Longer Options.....	36

Chapter 3. Health Care

Figure 3-1. Military Health Care Costs by Beneficiary Group.....	46
Figure 3-2. Average Annual Worker Premium Contributions for Single and Family Coverage.....	47
Figure 3-3. Medicare Part B Premiums, Single Rates.....	48
Figure 3-4. Military Medical System Costs.....	50
Figure 3-5. TRICARE Prime and Medicare Individual Premiums.....	57

Chapter 4. Quality of Life Programs

Figure 4-1. Predicted Continuation Intentions by Use of Quality of Life Programs.....	90
Figure 4-2. Annual Costs of Providing Child Care.....	107
Figure 4-3. Primary Child Care Arrangements for Children Aged 12 and Under.....	109
Figure 4-4. Primary Child Care Arrangements for Children Aged Five and Under.....	109
Figure 4-5. Value of Child Development Center Subsidy.....	110
Figure 4-6. Extent of Problems Resulting from Increased Need for Child Care During Deployment.....	116
Figure 4-7. Extent of Problems Finding Child Care During Deployment, When Not Previously Needed.....	116
Figure 4-8. Spendable Income for an E-6 with Three Dependents.....	124
Figure 4-9. Change in Consumer Price Index in United States, Germany, and Japan ...	127

Preface

Under federal law, every four years the President directs “a complete review of the principles and concepts of the compensation system for members of the uniformed services.”¹ The First Quadrennial Review of Military Compensation (QRMC) was convened in 1965. Since that time, eight subsequent quadrennial reviews have taken place, with the most recent—the 9th QRMC—issuing its report in 2002.

In August 2005, President George W. Bush instructed the Secretary of Defense to conduct the Tenth Quadrennial Review of Military Compensation (10th QRMC). In his charge to the Secretary, the President stated:

To continue to recruit and retain highly qualified personnel for the uniformed services as they transform themselves to meet new challenges, the departments concerned must offer, in addition to challenging and rewarding duties, compensation appropriate to the services rendered to the Nation. The departments also must apply the substantial taxpayer resources devoted to uniformed services compensation in the most effective manner possible.

Totaling over \$118 billion in 2007, military personnel costs make up 23 percent of defense spending. It is critically important that these resources are spent wisely and in ways that help the Services quickly and effectively respond to changes in mission objectives and the supply and demand for high-quality personnel. Past QRMCs have provided the Services with valuable analyses and recommendations, which have led to important improvements in the compensation system and enabled the Services to better address increasingly competitive labor markets and more effectively respond to rapidly changing operational needs. The work of the 10th QRMC furthers these efforts.

The 10th QRMC used the recently completed Defense Advisory Committee on Military Compensation (DACMC) report, published in April 2006, as the point of departure for its own assessment of the military compensation system. The DACMC was directed to

... provide the Secretary of Defense, through the Under Secretary of Defense (Personnel and Readiness), with assistance and advice on matters pertaining to military compensation. More specifically, the Committee shall identify approaches to balance military pay and benefits in sustaining recruitment and retention of high-quality people, as well as a cost-effective and ready military force.²

1. 37 U.S. Code, Section 1008(b).

2. Defense Advisory Committee on Military Compensation, *The Military Compensation System: Completing the Transition to an All-Volunteer Force*, April 2006.

Preface

During its deliberations, the DACMC focused on the following areas: the active component retirement system, pay for performance, differences in compensation by dependency status, Special and Incentive pays, the military health benefit, quality of life, and reserve compensation.

As part of its review of these same areas, the QRMC evaluated the DACMC's conclusions about the compensation system, and carefully considered each of its recommendations for change. However, while the data, analysis, and analytic framework included in the DACMC report contributed greatly to the 10th QRMC's efforts, the QRMC did not concur with all of the DACMC conclusions and recommendations. Instead, in some areas, the QRMC poses alternative recommendations—the question of strengthening the link between pay and performance being one such example. In other cases, the QRMC used the general strategies conceived by the DACMC to develop more specific recommendations focused on implementation, such as consolidation of Special and Incentive pays and retirement reform. But in the broadest philosophical terms, there is agreement between the two reviews about the crucial issues facing the compensation system and force management, as well as the key tenets for evaluating needed reforms.



The 10th QRMC's recommendations are presented in multiple volumes. Volume 1 focuses on cash components of the military compensation system, while Volume 2 covers noncash and deferred benefits. Subsequent volumes contain research papers, sponsored by the QRMC, that address in analytic detail each of the areas covered in this review.

During the course of its deliberations, the 10th QRMC received support for many of its major recommendations. In a number of cases, steps toward implementation began before the release of this final report. Legislation supporting the consolidation of Special and Incentive pays was included in the 2008 National Defense Authorization Act. Actions on other recommendations that did not require legislative changes have also been initiated; these include increasing the Basic Allowance for Housing rate for those without dependents (discussed in Volume 1) and negotiations regarding the use of flexible spending accounts (discussed in this volume).

The analyses and recommendations included in this report result from the substantial efforts of many talented and dedicated individuals, as well as a spirit of collaboration and support from the uniformed services. The rigorous analysis of complex compensation issues has resulted in a set of recommendations that will greatly improve the military compensation system in the future for both force management and the men and women in uniform.

Executive Summary

The military compensation system includes a complex package of cash, deferred, and noncash benefits. In general, this system works effectively to attract and retain the high-quality personnel needed in the uniformed services of the 21st century. That said, there is room for improvement to increase the system's flexibility and better enable force managers to respond to changing requirements in support of national security missions. Improvements can also increase member choice, serving to enhance recruiting and retention efforts in the uniformed services.

Volume 1 of the *Report of the Tenth Quadrennial Review of Military Compensation* (10th QRMC) covered cash compensation—the single largest component of military compensation. This volume, Volume 2, builds upon that effort with the results of the QRMC's evaluation of deferred and noncash compensation—an evaluation that examined military retirement, health care, and quality of life programs.

Cash compensation accounts for almost half of service members' compensation; deferred, or future, benefits another 31 percent; and noncash compensation, such as health care, educational benefits, and many quality of life programs, the remaining 21 percent. The combination of deferred and noncash compensation is significantly higher than what is typically seen in civilian compensation plans, where these elements account for only one third of employee compensation.

As compensation tools, deferred and noncash (or in-kind) benefits present unique challenges to force managers seeking to optimize the use of compensation resources. They are less efficient, their value is less easily understood by military personnel and their families, and, at least in many cases in the current system, they are relatively inflexible. With deferred and noncash compensation making up over half of military compensation resources, the QRMC believes that it is critical for the Services to address these issues and ensure that these substantial resources are being employed as effectively and equitably as possible.

Summarized below are the key findings and recommendations for the three elements of deferred and noncash compensation reviewed during the 10th QRMC's deliberations.

Military Retirement

The military retirement benefit is a major component of military compensation, costing approximately \$13 billion per year, or over 7 percent of current active duty personnel costs. It is a noncontributory, defined benefit plan that is available immediately upon retirement to active duty military personnel who have served a minimum of 20 years. Members of the reserve components are also provided a retirement benefit after 20 years of creditable service, but reservists generally must wait until age 60 before drawing retired pay. Although the retirement system provides a substantial benefit to eligible retirees, it is important to note that the vast majority of service members never receive a retirement payment. According to the Department of Defense (DOD), less than 15 percent of enlisted personnel and 47 percent of officers become eligible for the military retirement benefit.

Military retirement reform has been a topic of lengthy review and discussion, dating back to the 1948 Hook Commission and continuing to the present day. Concerns with the system tend to focus on three areas: the system is inequitable, inflexible, and inefficient. The *equity argument* stems from the fact that the benefit does not vest until 20 years of service, so only a small fraction of the force ever receives retirement pay. The different treatment of reserve component members is another area of concern, particularly as their contributions to military operations have expanded over the past decade, making them an increasingly essential part of the total force.

An equally important argument involves the impact of the current system on the shape of the force and on member retention patterns, which *greatly reduces the flexibility* force managers have to influence military careers. Personnel who reach 10 to 20 years of service have a strong incentive to remain in the military for a 20-year career; similarly, the Services are reluctant to separate members after they reach 15 years of service, knowing that they will leave with no retirement benefit.

This “one-size-fits-all” approach encourages all personnel to follow the same career path regardless of whether it is consistent with Service needs or appropriate for a particular occupation. It is often desirable, for example, for “youth and vigor” occupations to have shorter careers, while in certain professional fields longer careers are desirable. Because of the 20-year vesting point, it is difficult for force managers to shape careers in ways that would better match changing Service requirements.

Finally, the fact is that the current military retirement system is made up entirely of deferred compensation, *which is less efficient than cash*. It costs the government more to provide than its value to many military personnel, primarily due to the relatively

young population in the uniformed services, who tend to value cash in hand over compensation paid in the future. A retirement benefit with both cash and deferred elements would be more efficient than the current system of deferred benefits only—less costly to the government and of greater value to the service member.

QRMC Retirement Reform Proposal

Based on these concerns, the QRMC judged that retirement reform, leading to a more flexible, cost-effective, and equitable system, would benefit the uniformed services. The underlying philosophy of the QRMC proposal was to replace some of the current system's deferred benefits with cash compensation, thus improving cost-effectiveness and introducing flexibility. The foundation of the system would be a defined benefit plan and a defined contribution plan, as well as earlier vesting. The system would also include other elements of cash compensation that force managers could vary to achieve different retention patterns.

The key elements of the QRMC retirement plan are as follows:

- **A defined benefit plan** providing retirement pay equal to 2.5 percent of high-3 annual basic pay multiplied by the number of years of service. The benefit would be payable at age 57 for those with 20 years of service and at 60 for those with fewer than 20 years. The plan would vest at 10 years. Members who opt to receive the defined benefit immediately upon retirement would receive a reduced benefit.
- **A defined contribution plan** under which DOD would annually contribute up to 5 percent of basic pay (the precise contribution would vary based on years of service). The plan would vest at 10 years of service and begin paying benefits at age 60.
- **Gate pays** payable at specified year-of-service milestones.
- **Separation pay** provided to members when they leave the military.

The defined benefit and defined contribution elements would be the same across the uniformed services. However, requirements for gate pay and separation pay are expected to vary across the Services and by occupation depending on requirements. The QRMC plan does not distinguish between reserve and active duty service members—both would have the same vesting requirement and become eligible for the defined benefit and defined contribution benefit at the same age.

This system offers many benefits. Vesting the retirement benefit at 10 years of service would substantially expand the number of personnel eligible for a retirement benefit, resulting in a more equitable system. Earlier vesting, gate pays, and separation

Executive Summary

pays enable force managers to achieve more variation in career lengths, while continuing to allow personnel to choose how long they prefer to remain in the military. Such elements infuse flexibility into the system and would enable force managers to change the retention patterns that have long dominated the shape of the force. Further, the combination of current and deferred elements leads to greater efficiency and lower cost to the government.

This proposal, while sound in its construct, does represent a significant reform with potential for considerable impact on recruiting and retention. Thus, the QRMC believes that a field test of the reform proposal should be conducted before any system changes are implemented force wide.

RECOMMENDATION

DOD should conduct a multiyear demonstration project of the QRMC's proposed retirement benefit prior to implementing the new system force wide.

xiv >

DOD should undertake a demonstration project to better ascertain the new system's actual effects on the force—effects on retention, costs, vesting, and other critical elements of force management. The test should include a representative sample of enlisted personnel and officers who will substitute the new retirement system for the current system. The test should run for a minimum of five years. Participation should be voluntary but should be drawn from all four DOD Services, the active and reserve components, as well as from diverse occupational areas in which different career lengths are desired. A test constructed along these lines would enable the Department to determine whether the proposed system is sufficiently flexible to achieve a range of different retention patterns and career lengths. Precedent for such demonstration projects exists.

Health Care

No single benefit affects more of the active duty, reserve, retired, and dependent populations than the military health care benefit. From the perspective of compensation, health care is the largest and most important noncash incentive for personnel to join and remain in military service. Other than retirement pay, it is also the most significant component of compensation for retirees and their families. Maintaining a quality military health care system is essential—both to force readiness and as a highly valued element of compensation.

The QRMC examined two aspects of military health care: system costs of the health benefit and recruiting and retaining health care professionals.

Military Health Care Benefit

Health care benefits to the military are generally provided through TRICARE. Beneficiaries can choose among three health plans: TRICARE Prime, a health maintenance organization; TRICARE Extra, a preferred-provider network; and TRICARE Standard, a point-of-sale plan. In addition, TRICARE for Life, introduced in 2001, provides a lifetime benefit for Medicare-eligible military retirees age 65 and over and their dependents. A major attribute of the military health care package is its low cost to beneficiaries—premium contributions, copayments, and deductibles that are substantially lower than typically found in civilian health plans.

Although TRICARE costs have increased in recent years along with civilian health care costs, these costs have not been passed on to beneficiaries. Active duty personnel and their families continue to pay no premium for their TRICARE Prime coverage and the premiums charged to military retirees under age 65 have remained the same since 1996. Retirees over age 65 have experienced increased premium costs, as they are required to pay Medicare Part B premiums to participate in the TRICARE for Life program—premiums that have increased considerably. Other out-of-pocket costs, such as deductibles or copayments, have also remained fixed or have been reduced in recent years.

Since the creation of TRICARE more than a decade ago, the health care benefit has continued to improve and expand. But program costs have increased significantly as well and are expected to continue to do so into the future—which constitutes a growing budgetary problem for the Department of Defense. In part, increased costs simply reflect skyrocketing health care costs in the civilian sector purchased by the Department. They also reflect the fact that higher costs have not been passed along to beneficiaries in the form of higher premiums or out-of-pocket expenditures. Moreover, the number of military retirees continues to grow and, in fact, is a key driver in the growth of purchased care expenditures. Finally, the TRICARE system does little to encourage users to select cost-effective options for their health care.

While many groups have evaluated and recommended options for curbing the military health program's persistent cost increases, these proposals have not been adopted. The QRMCM believes that the Department must take steps to mitigate the upward trend in military health care costs and makes recommendations designed to improve the equity of the military health care benefit and promote more cost-effective choices among program participants.

TRICARE Premiums for Military Retirees

Military retirees under the age of 65, who are enrolled in TRICARE Prime, are still paying the same premiums paid in 1996, while those using TRICARE Standard/Extra pay no premiums. Yet older retirees, who are less likely to be employed and generally have lower incomes relative to their younger counterparts, are required to maintain Medicare Part B in order to qualify for TRICARE for Life—the costs of which have increased more than 85 percent since 2001. The QRMC finds this situation inherently inequitable. TRICARE fees should be fair to all retiree populations and—consistent with trends in Medicare—should cover a larger portion of health care costs and reflect beneficiaries’ ability to pay.

RECOMMENDATIONS

Set TRICARE Prime premiums for single retirees under age 65 at 40 percent of the Medicare Part B premium, with the family rate set at twice the single rate, regardless of family size. Set TRICARE Standard/Extra premiums for single retirees at 15 percent of the Part B Premium, with the family rate set at twice the single rate.

Link TRICARE deductibles to Medicare rates and eliminate copayments for preventative care.

Require military retirees and dependents wishing to participate in TRICARE to enroll during a designated open enrollment period.

Basing TRICARE premiums for younger retirees on the fees charged to TRICARE-for-Life beneficiaries would inject an element of equity into the health care system by treating all military retirees more consistently. Thus, retirees under age 65 would begin to pay premiums that cover a larger portion of their actual health care costs and that are adjusted to reflect health care cost increases. To lessen the impact of these cost increases, the QRMC recommends that the new rates be phased in over four years.

Consistent with changes in premium contributions, TRICARE deductibles and copayments should also be adjusted. The QRMC believes that the TRICARE system should be biased toward prevention, rather than treatment, and that copayments for preventative services should be eliminated. The aim is to encourage enrollees to seek out such care, improve their health status, and reduce their overall health care costs.

The QRMC also believes that participation in TRICARE should be consistent with civilian sector practices. Establishing an open enrollment period, for example, will encourage more retirees and their dependents to obtain ongoing health coverage and care, rather than episodic coverage. It will also result in more premium contributions from participants. All military personnel would be required to join TRICARE during open enrollment and would be precluded from doing so at other times during the year, except in special circumstances.

Prescription Drugs

Because the pharmacy benefit has been the fastest growing component of military health care since 2000, the QRMC believes steps should be taken to lower costs to the government.

RECOMMENDATIONS

Set prescription drug fees at levels that encourage beneficiaries to choose lower-cost purchasing options.

Set prescription drug copayments under TRICARE at no more than two thirds of the average copayments faced by civilians at retail pharmacies. Prescriptions filled at military treatment facilities should continue to be dispensed at no cost.

< xvii

TRICARE prescription drug program costs could be reduced if more beneficiaries filled their prescriptions at military treatment facilities or through the TRICARE mail order pharmacy. Today there is little incentive for beneficiaries to make more cost-effective choices, but the QRMC believes that implementing such incentives would produce significant cost savings while maintaining member benefits at current levels.

Program Funding

The cost of health care for retirees under age 65 is significant, yet the present funding methodology does not make these costs clear to decision makers. All significant and separable costs related to military retirees should be explicitly identified in the DOD budget. It makes little sense to fund health care for older retirees using accrual accounting while using a current outlays methodology for retirees under age 65.

RECOMMENDATION

Finance health care for retirees under age 65 through accrual accounting.

Changing to accrual accounting will shed light on how current manning decisions will affect future costs. When implementing this recommendation, DOD needs to make a one-time adjustment to the budget to account for the impact of the change. It is essential that other DOD accounts not be penalized in order to make this transition.

TRICARE Reimbursement

Access to civilian health care providers, outside the military treatment facilities, is an important aspect of the military health care benefit. If such access is limited, the value of the benefit declines. TRICARE reimbursement rates are, in general, much lower than those normally paid by private insurers. Lower reimbursement rates in turn result in fewer providers willing to serve the TRICARE population. Dependents and retirees could, as a result, face an ever-shrinking pool of providers who are willing to treat them.

xviii >

RECOMMENDATION

Periodically evaluate TRICARE reimbursement rates to guarantee sufficient provider access so that appropriate care is available.

DOD has the authority to establish higher rates in geographic areas and for those specialties where access to providers becomes and remains a problem. The Department should be more aggressive in exercising this authority. Congress, as well, should take action to prevent gaps between TRICARE and private sector reimbursement rates from increasing.

Health Care Professionals

Essential to the military health care system is a corps of experienced health care professionals capable of providing a full range of general and specialized care. Because health care professionals have attractive and lucrative career opportunities in the private sector, recruiting and retaining them into the military has long been a challenge, but personnel shortfalls in these professions have increased in recent years. While there are many programs in place—such as scholarship programs, accession bonuses, and special pays—the military services have increasingly struggled to meet requirements for uniformed medical personnel, even as requirements have fallen.

As a result of these trends, Congress asked the QPMC in 2007 to examine compensation issues pertaining to uniformed medical personnel in DOD.

In its evaluation, the QPMC identified a number of factors contributing to the current shortages of military health care professionals. Part of the challenge stems from high demand for health care professionals in the civilian sector, creating a more competitive market and higher salaries. The military work environment, which in some cases compares unfavorably to conditions enjoyed in the civilian sector, also has an impact on recruiting and retention in this occupational area. In addition, changing demographics of medical and dental school students create challenges for the uniformed services: more students are from affluent families, reducing the attractiveness of financial assistance; more students are women, who are less inclined to serve in uniform; and the percentage of students who are not U.S. citizens, and therefore ineligible to become commissioned officers, is on the rise.

The QPMC developed a series of recommendations to respond to these factors and aid the uniformed services in filling requirements for personnel in these fields. They are designed to make existing recruiting and retention tools more attractive to health care professionals considering military service and will promote recruiting opportunities in previously untapped markets.

Health Professionals Scholarship Program

The Health Professionals Scholarship Program (HPSP) is the most widely used program for recruiting physicians and dentists. The program pays tuition, books, fees, and a monthly stipend in exchange for a commitment to military service—typically four years for physicians and dentists. Despite the substantial financial assistance available under this program, it is attracting fewer recruits. In part, this simply reflects the challenges of the recruiting environment described above, but the QPMC believes that some of the problem may be due to weaknesses in the program itself that discourage participation. The QPMC believes that changes could be made to help make the HPSP program more attractive to medical and dental students considering military service.

RECOMMENDATIONS

Give HPSP participants access to TRICARE Reserve Select, or, if coming directly from active duty, allow them to retain their active duty TRICARE coverage.

Provide a Basic Allowance for Housing to HPSP students.

HPSP should cover the costs of all required equipment at medical and dental schools.

Expand HPSP to cover the costs of additional training requirements for U.S. citizens who attend foreign medical schools. The Services should also offer residency slots to certified foreign medical school graduates.

XX > Together these recommendations can help offset additional expenses of medical school not currently covered under HPSP and enhance the value of the HPSP benefit. HPSP students only have limited access to the military's health care system. Health care coverage, particularly family coverage, is expensive and difficult for HPSP students to afford on their monthly stipend. Defraying health care costs can serve as an additional incentive. Similarly, providing a housing allowance and resources to cover all equipment costs will help offset expenses in areas where the cost of living is high and many students still struggle to make ends meet. In addition, doctors educated in foreign medical schools, once fully certified to practice in the United States, represent a potentially valuable source of military physicians. Offering them access to HPSP in exchange for a service commitment could help DOD tap into this market.

Nurses

Like the civilian sector, the military is finding it increasingly difficult to recruit and retain the nurses necessary to meet force management needs. Targeting new markets could help the Services expand their nursing inventories.

RECOMMENDATIONS

The Services should expand their recruiting pool to include registered nurses with associate degrees and create a program for these nurses to complete their Bachelor of Science Nursing (BSN) degrees.

To encourage military nurses without BSN degrees to complete their four-year degrees, the Services should create programs that enable nurses to earn their degrees while in the military, and subsequently compete for commissions as O-1s.

The Services should offer nurse training to currently serving officers or enlisted personnel.

Today, the military nurse corps is reluctant to recruit nurses who do not have BSN degrees. However, the QRMC could find no evidence that the quality of care and leadership provided by non-BSN nurses is significantly different. Tapping into this market could substantially alleviate current nursing shortages without sacrificing quality of care. Furthermore, the Services could offer training opportunities to help nurses without BSN degrees complete the requirements. In addition, programs that provide nurse training to currently serving enlisted personnel should be expanded.

All Health Professionals

A final set of recommendations pertaining to health care professionals is designed to maximize contributions from existing military personnel—both health care personnel and other service members who are available for retraining.

RECOMMENDATIONS

DOD should ask Congress to raise the mandatory retirement age for health professionals from 62 to 68.

Where appropriate, expand current programs that train enlisted personnel as physician assistants to cover training in other medical areas.

The Services should use an auction mechanism to induce health care personnel to volunteer for specific hard-to-fill billets.

Allow non-citizen health care professionals, who are licensed to practice in the United States, to enlist in the military and apply for expedited citizenship.

DOD should use the inter-Service bonus program to encourage surplus health professionals to transfer to a Service where their skills are needed.

Executive Summary

In general, health professionals are subject to mandatory retirement at age 62. The QRMC believes that health professionals between the ages of 62 and 68 can still make valuable contributions to the military health care system and should be allowed to remain in service for longer careers, thus expanding the pool of qualified professionals.

Tapping into existing military personnel is another potentially valuable source of health professionals. The services should explore whether existing physician assistant training programs could be expanded to other medical fields as a way of increasing health care personnel.

As with the rest of the military, the burdens of deployment have fallen on military health professionals. Instituting a bidding system for duty assignments would be one way to offer health professionals more control over their assignments and the deployment process, thus helping to offset the less flexible nature of the military work environment.

Many health care professionals practicing in the United States are not U.S. citizens. The QRMC believes that military service may be an attractive opportunity for some foreign-born health professionals, particularly if military service provides them access to an expedited citizenship program. If a health care professional who enters the military under such an initiative fails to complete his or her contract, there is a five-year window under federal law in which the citizenship may be revoked—a provision the Services could invoke if circumstances warranted.

xxii >

Quality of Life Programs

The military services offer a wide array of quality of life programs. Many of these programs can be described as morale, welfare, and recreation programs, which include programs such as commissaries, exchanges, fitness centers, and libraries—typically located on military installations. DOD also offers an array of community and family support services designed to help families cope with the hardships sometimes associated with military service, as well as with other issues that can confront both military and civilian families—programs such as marriage and family counseling, child care services, youth/adolescent programs, and financial counseling.

Quality of life benefits represent a significant portion of service members' compensation. Yet despite this substantial investment, it is not clear how much quality of life

programs promote force management goals or whether the dollars invested are being used as efficiently or effectively as possible, or in ways that maximize member choice. Furthermore, it is unclear whether programs developed decades ago to support families of a conscript military are as relevant and valuable to the all-volunteer force of the 21st century. Moreover, while service members and their families may appreciate these benefits, survey data show that their value is often underestimated—thus diminishing their effectiveness as a recruiting and retention incentive. In light of all this, the Services need to take a different approach to quality of life benefits—an approach where they structure, use, and evaluate quality of life programs as *valuable elements of the military compensation package*.

While sophisticated tools exist to evaluate how various pays and allowances influence recruiting, retention, and readiness, no such analysis exists for quality of life benefits. The cost of the programs is not well understood, nor is consistent and comprehensive utilization data available. Without this data, which needs to be developed, it is difficult to evaluate the effectiveness of the quality of life programs and whether they are contributing to force management goals. It is also difficult to measure the impact of the benefit, and target and structure program resources accordingly.

A critical part of treating the quality of life benefit as part of compensation is educating military personnel about the benefit so that they appreciate its value and understand that it is, in fact, compensation. In contrast to cash compensation, it is difficult for members to quantify the worth of the in-kind benefits they receive—such as the savings associated with shopping in a commissary or the value of military child care services.

As it turns out, nearly half of all service members believe that benefits cost DOD less than 25 cents per dollar that they earn, when in fact the costs to the Department are over 40 cents per dollar earned. A consequence of this misunderstanding is that more than half of service members think it is easy to find a civilian job with comparable salary and benefits—although analysis indicates that military compensation of both enlisted personnel and officers is significantly higher than compensation paid to comparable civilians, even without including retirement, health care, and quality of life benefits in the calculations. Whether service member perceptions are accurate or not, these perceptions do affect members' continuation plans. Thus, if service members do not consider quality of life services as part of their compensation package, nor appreciate the value of these services, they will have little impact as continuation incentives.

RECOMMENDATIONS

The Services should develop a more comprehensive system to educate personnel on an ongoing basis about the variety of quality of life programs available to service members, the value of those programs, and the fact that they represent a substantial component of military compensation.

The Department of Defense should conduct periodic reviews of its quality of life programs to assess their ongoing role and effectiveness as compensation tools.

xxiv > DOD officials have indicated that educating personnel about their compensation package has not been a department-wide priority. Nor has the Department ever undertaken a comprehensive effort to inform service members about the value of military compensation compared to compensation in the civilian sector. To maximize the impact of quality of life resources on force management goals and member reenlistment decisions, service members and their families need to more fully appreciate the true value of quality of life benefits and how those benefits compare to civilian sector compensation. The Services need to develop accessible and easy-to-understand ways to communicate this information through education programs that are conducted throughout a service member's career. Armed with a better understanding of the value of their compensation, potential recruits and service members will be able to make more informed decisions about joining or staying in the military.

While there is a general sense among force managers that personnel and their families appreciate quality of life services and possibly factor these benefits into their continuation decisions, there is no hard data to quantify their impact on either recruiting or retention. The QRMC believes that an analysis of the recruiting, retention, and readiness impacts of specific programs needs to be conducted to guide decision makers in allocating resources among programs. In addition, DOD needs to develop more sophisticated survey tools to better measure member preferences and satisfaction regarding quality of life benefits. Better data will enable DOD to more efficiently and effectively allocate resources devoted to quality of life programs—to make investments that are based on the actual needs of military families and focused on areas of greatest return to the Services.

Flexible Spending Accounts

In the civilian sector, there has been a growing trend toward flexible benefits that give employees more say over the types of benefits and levels of coverage in their compensation package—enabling them to tailor their benefit plans to specific needs.

Flexible spending accounts are one of the most common flexible benefit programs. Employees place pretax income, up to specified annual caps, into these accounts to cover costs of specific goods or services, such as medical or dependent care—the two most frequently used flexible spending accounts. Funds are placed into the accounts, typically through payroll deductions, and must be used within a specified period or they are lost to the employee. Because they use pretax income, flexible spending accounts enable employees to increase their purchasing power.

RECOMMENDATION

The Services should adopt dependent care and health care flexible spending accounts for uniformed service members.

The QRMC believes that offering these types of flexible spending accounts to service members will enable them to increase their purchasing power to buy benefits that meet their particular needs, preferences, and circumstances. The main benefit to employees is the ability to shelter income from taxation. However, the accounts do carry some risk in that employees forfeit any unspent funds at the end of the use period. Hence, such accounts make the most sense for employees who have a good idea of their medical and dependent care expenses for the coming year.

Flexible spending accounts for medical and dependent care are available to federal employees. These programs could be easily applied in the military setting. In order for flexible spending accounts to be workable in a military context, the federal rules governing the accounts—specifically, those policies regulating forfeiture of unused funds—will have to be modified to acknowledge the unique and often uncertain nature of military service, particularly deployments and relocation to a new assignment.

To that end, the QRMC recommends that the law governing flexible spending accounts be modified to provide deployed or transferred military personnel with the authority to both modify their contribution plan and carry forward unused dollars into the first full year following a transfer or return from deployment. The QRMC does not believe it would be fair for members to be financially penalized for personnel actions outside of their control.

Dependent Education

Given the frequent changes of station that are a reality of military life, maintaining quality education and smooth transitions for their children is a critical priority for military parents and a goal shared by DOD. While most children of

Executive Summary

military personnel stationed in the United States attend local civilian schools, there are a few areas where concern about the quality of local schools makes parents of school-aged children reluctant to accept assignments. Personnel in those locations often send their children to private school or home school them—alternatives that have financial impacts on members and their families. To mitigate such situations, consideration needs to be given to providing military families with more attractive alternatives for educating their children.

RECOMMENDATIONS

In designated parts of the country, DOD, in cooperation with the Department of Education, should institute a voucher program in which military parents could choose the school on which to spend the Impact Aid dollars associated with their child.

Parents should be allowed to form charter schools at military installations, similar to civilian charter schools currently operating under state laws.

Congress needs to fully fund Impact Aid associated with the children of uniformed service members, and transition to a current-year enrollment basis for distribution of the funds.

xxvi >

The QRMC recommends that in implementing a voucher program, DOD begin with a pilot program in which federal funds currently provided to public schools for military dependents—called Impact Aid—instead be given to parents in the form of vouchers to be used at the school of their choice. The voucher option would be offered at a limited number of locations considered to have less desirable designated public schools, potentially making these assignments more palatable and ultimately improve retention and readiness. Since the voucher amount under this proposal would equal the amount already being spent on each child through the Impact Aid program, it would not increase total federal spending, aside from some administrative costs.

Charter schools, operated at military installations, could offer yet another education option for military children. Like civilian charter schools, military charter schools would be considered part of the local system and funded in the same manner. In areas with substandard local schools, charter schools would offer another option to parents in addition to private school or home schooling. In implementing such a program, rules governing waiting lists would have to be modified to give highest priority to the children of military personnel.

Finally, Impact Aid does not fully compensate schools for the additional costs associated with educating children of service members. As military populations shift

over the coming years through base closures and realignment decisions, Impact Aid funding needs to be more timely and robust. Thus, the QRMC believes that Congress should provide sufficient appropriations to fully fund Impact Aid associated with dependent children.

Child Care

The Department of Defense operates the largest employer-sponsored child care program in the United States, spending approximately \$530 million annually to provide services to the children of military personnel. The two main government-sponsored options for care are child development centers and family child care programs. After-school care is also available for older children through school-age care.

It is unclear, however, whether this substantial investment in child care has a significant or cost-effective impact on key force management goals such as recruitment, retention, or readiness. In fact, there is little analysis of the program's effectiveness and it is well documented that many service members significantly underestimate the program's value, which can exceed \$10,000 per year. Nor is it clear that the child care benefit—which is available to only a fraction of the force—is being utilized as efficiently and equitably as possible in order to maximize the benefit to personnel. Wait list policies, for example, do not appear to give priority to personnel most in need of child care services and centers have limited hours, offering little help to members who work nights and weekends.

The QRMC believes that many of the concerns with military child care arise from the fact that DOD does not manage its child care program as an element of the military compensation package; instead, most of the management focus on the program has revolved around improving the quality of care. This contrasts sharply to the approach to child care benefits in the private sector. Thus, the QRMC recommends three reforms that would improve the effectiveness, equity, and efficiency of the child care benefit, as well as expand services to cover more members.

RECOMMENDATIONS

The Services should prioritize allocation of child care slots based on force management needs.

DOD should implement a voucher program to help service members pay for child care costs.

DOD should increase investment in family child care.

Executive Summary

To have the maximum impact on force management needs and readiness, the child care benefit should be targeted to those personnel most valued by the Services, and to those members most in need of child care assistance in order to meet their service obligations. In peacetime, priority should be given to personnel serving in skill areas with high temporary duty time, or to service members in occupational areas that are highly valued by the Services or that are experiencing critical shortages. During wartime, priority should be given to families of deployed service members.

The QRMC recommends that DOD implement a pilot program to evaluate different program designs that could supplement or replace the current in-kind child care benefits with vouchers that personnel could apply towards the cost of child care. Part of this evaluation would need to consider the likely impact of a voucher program on the child development centers and family child care providers. Depending on its structure, a voucher program could offer a number of improvements to the current system: financial assistance to families who currently receive no child care benefit, a benefit with more tangible value to service members, and greater choice for service members and their families.

xxviii >

Like a voucher program, increased financial support to family child care providers would enhance the effectiveness and efficiency of the child care benefit, as well as expand families' access to services. To fund such an effort, DOD could request additional appropriations or reallocate resources currently assigned to child development centers. Even though an increased investment in family child care offers many advantages—particularly the ability to leverage the lower cost of care to expand service to more families—the system would still be predominantly offered on military installations. As such, it would not improve access or convenience to the many personnel who live off base and who prefer child care options closer to home. Thus, DOD should also consider whether greater utilization of private sector providers offers any advantages over the current child care network, which is dominated by DOD-operated facilities.

Commissaries

DOD operates approximately 280 commissaries worldwide. Commissaries are one of the most costly quality of life benefits offered to military personnel, with DOD spending approximately \$1.2 billion each year to support the system. DOD estimates that commissaries save service members roughly 30 percent on their groceries and household supply purchases compared to regular retail stores. Like the other quality of life benefits discussed in this report, the commissary benefit is also a component

of military compensation. As such, DOD should evaluate whether commissaries improve recruiting and retention, and whether they do so in an efficient, rational, and cost-effective manner.

In that context, however, the commissary is an interesting benefit because not only does it serve the practical purpose of providing goods at reduced cost, it also plays a central role in military life. Many service members would view attempts to reduce commissary activities as DOD abandoning its commitment to quality of life. Thus, force morale and satisfaction need to be considered in evaluating the commissary benefit.

RECOMMENDATION

DOD should seek to develop relationships with national and regional grocery chains to provide discounts to service members.

In areas in the continental United States where off-base alternatives are available, this proposal would offer several advantages—including convenient shopping for members who live off base, and greater accessibility to reduced pricing for reservists and retirees who do not live in proximity to an installation.



Overseas Cost-of-Living Allowance

The overseas cost-of-living allowance (COLA) is intended to ensure that military personnel assigned to overseas duty locations are not financially disadvantaged by such an assignment. To that end, the COLA provides additional compensation to offset higher costs of food, transportation, recreation, and similar expenditures. The COLA rate-setting process uses a “market basket” approach with the allowance based on the differential between the cost of a typical basket of goods and services purchased at an overseas location and the cost of the same items in the continental United States. The COLA varies based on a variety of factors: product availability, changes in overseas prices relative to prices in the United States, and fluctuations in the monetary exchange rate.

The QRMC evaluated the current rate-setting process and found that the methodology is sound and mirrors best practices in the private sector. COLA rate changes clearly reflect economic trends. There are two small changes, however, that the QRMC believes would provide additional improvements in the overall COLA process.

RECOMMENDATIONS

Rates for the overseas cost-of-living allowance should be based on the size of commissaries and exchanges located at each overseas site to prevent shifts in shopping patterns alone from causing changes in COLA rates.

DOD and the Services should develop a clearer explanation of how COLA rates are established and educate personnel on this benefit before they arrive at a new overseas duty station. In addition, DOD should publish frequent updates of the change in the cost of the U.S. market basket, so that members have appropriate expectations regarding changes in the cost-of-living allowance.

Service members overseas face different shopping choices than members in the United States. In the United States, commissary and exchange prices tend to move in tandem with prices in civilian establishments. This linkage does not occur in overseas locations. When off-base prices rise, members tend to shift their purchases away from the local economy and toward commissaries and exchanges. In locations where the on-base establishments are smaller, the ability to shift purchasing patterns is more limited. Linking adjustments to the size of the commissaries and exchanges will achieve more consistency across COLA programs. It would also bring to an end the current practice of effectively penalizing members for shifting shopping patterns in response to prices in the local economy.

As with many quality of life benefits, a significant issue with the current COLA system appears to be a lack of understanding about the purpose of the allowance, how it is calculated, and how it changes over time. The QRMC believes the Department should invest in a professionally prepared, tested presentation of the allowance that it can make available to service members and their families. In addition, by publishing quarterly changes in the U.S. cost of living allowance, members should be able to better anticipate changes in the overseas allowance.

Conclusion

In Volume 1 of this report, the QRMC identified two themes that dominated its deliberations and served as critical drivers of system improvement: flexibility for the uniformed services and choice for the member. Force managers need *flexibility* to adjust resources to address emerging issues or shifting priorities. They also need to be able to make targeted adjustments to address specific problem areas. By offering *greater choice to the service member*—in assignment selection, frequency and duration of deployment, and benefits—when those choices are consistent with operational

requirements, member satisfaction is increased. Member satisfaction ultimately impacts reenlistment decisions, and potentially even enlistment decisions as reflected in youth perceptions of military life.

The many recommendations in this report measure well against these two factors. The military retirement reform proposal, for example, offers force managers much more flexibility to shape force profiles and manage service members' careers. In addition, recommendations regarding health professionals provide force managers with additional tools and flexibility to more effectively recruit and retain these personnel.

The retirement reform proposal offers service members more flexibility in how long they choose to serve by offering earlier vesting and variable exit points during the course of a career. Many of the recommendations to enhance quality of life programs also expand member choice: flexible spending accounts, voucher programs for dependent education and child care services, and commissary alternatives are several examples. Collectively, the recommendations offered here serve to improve system responsiveness, ensure fair and equitable compensation, and enhance recruiting and retention—all goals that will serve to sustain and strengthen the all-volunteer force.

Introduction

The federal government spends over \$173 billion annually on military compensation—a system that includes cash, deferred, and noncash benefits (Figure 1-1). In general, the military compensation system works effectively to attract and retain the high-quality personnel needed in the uniformed services of the 21st century. However, in its review of the compensation system, the Tenth Quadrennial Review of Military Compensation (10th QRMC) identified some areas where improvements could be made that would increase management flexibility and member choice—two themes of this study, as outlined in the previous volume.

Volume 1 of the QRMC report covered cash compensation—the single largest component of military compensation. This volume follows with the results of the QRMC’s evaluation of deferred and noncash (in-kind) compensation—an evaluation that examined military retirement, health care, and quality of life programs. As compensation tools, deferred and in-kind benefits present unique challenges to force managers seeking to optimize the use of compensation resources. They are less efficient, their value is less easily understood by military personnel and their families, and, at least in many cases in the current system, they are relatively inflexible. With deferred and noncash compensation making up over half of military compensation resources, the QRMC believes that it is critical for the Services to address these issues and ensure that these substantial resources are being employed as effectively and equitably as possible.



Elements of Compensation

Military personnel receive a complex compensation package made up of cash, as well as deferred and noncash compensation. A 2007 study by the Government Accountability Office (GAO) found that cash compensation accounts for approximately 48 percent of average military compensation, deferred compensation 31 percent, and noncash benefits 21 percent. Figure 1-1 shows the major elements of military compensation.

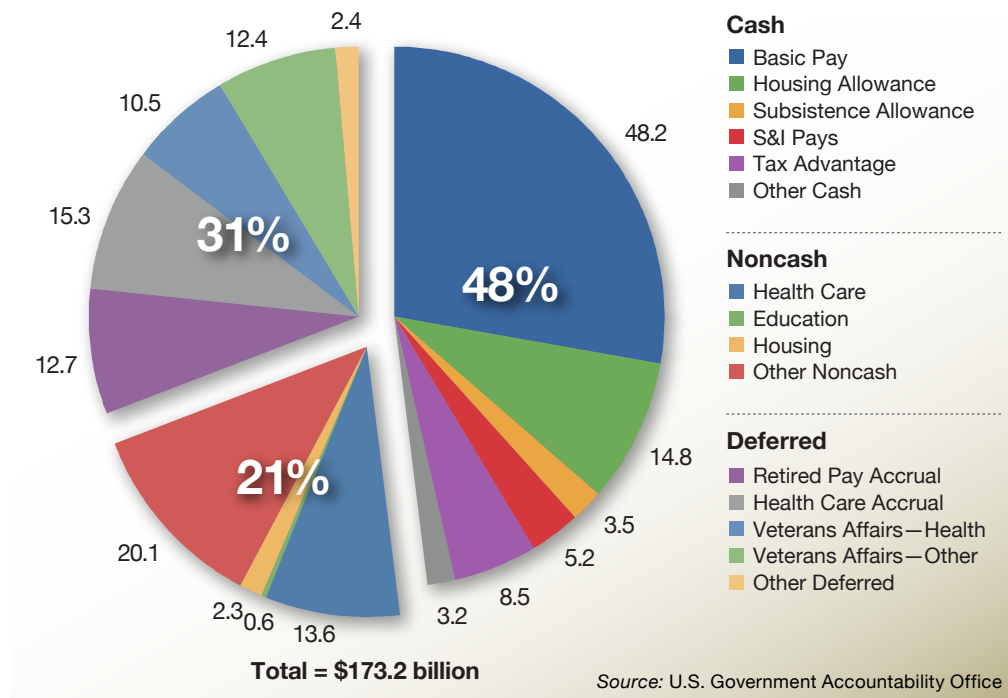


Figure 1-1. Major Components of Military Compensation, Fiscal Year 2006

Cash compensation accounts for almost half of service members' compensation. Major elements of cash compensation include basic pay, the Basic Allowance for Housing, the Basic Allowance for Subsistence, Special and Incentive pays, the federal tax advantage from nontaxed allowances, and other cash pays, such as cost of living allowances.

Another 31 percent of military compensation dollars are used to cover the costs of deferred, or future, benefits. The major elements of deferred compensation are military retirement and retiree health care benefits. Although retirement benefits are not provided to members currently serving on active duty, the accrual costs of financing these future liabilities are included in the military personnel budget. While the per-member costs of future retirement pay and retiree health care are substantial, only a fraction of military personnel will ultimately receive either benefit. In fact, the Department of Defense (DOD) estimates that among the current force, less than 15 percent of enlisted personnel and 47 percent of officers will ultimately qualify for retirement payments.

The remaining 21 percent of military compensation is made up of an array of noncash benefits including health care; educational benefits; on-base housing;

and installation-based benefits such as commissaries, exchanges, fitness facilities, libraries, and other family-oriented services.

Concerns with Deferred and Noncash Benefits

As noted above, over 50 percent of military compensation is made up of deferred and noncash benefits. This is significantly higher than what is typically seen in civilian compensation plans, where deferred and noncash benefits account for only about one third of employee compensation. Civilian employers rely predominantly on cash pays to compensate their workforce and to advance recruiting, retention, and productivity goals.

Cash compensation is generally recognized as a more efficient compensation tool than either deferred or in-kind benefits. As a result, the military system's reliance on deferred and noncash compensation can make it more challenging for the uniformed services to use some elements of the compensation system to influence force management outcomes. In reviewing the deferred and in-kind elements of the military compensation system, the QRMC explored several issues unique to deferred and noncash benefits:

- the inefficiency of deferred benefits compared to cash compensation
- the limited choice afforded to members by in-kind benefits
- the need for the Services to make better use of noncash benefits to meet key force management goals
- the challenges of educating service members about the value of in-kind benefits



Deferred Benefits are Less Efficient

Deferred compensation, which accounts for nearly one third of military compensation, is spent primarily on military retirement and retiree health care. Compared to cash compensation, deferred benefits are a less efficient form of compensation because of how individuals value future benefits relative to cash in hand today *and* how individual preferences compare to that of the government. As it turns out, individuals discount future benefits at a higher rate than the government discounts future costs, which means that future benefits are worth less to the individual than they cost the government to supply.

Moreover, the preference for cash over deferred benefits is especially strong among young people—who comprise a large share of military personnel. As a result, deferred compensation will be valued even less by military personnel, as a group,

compared to the general population. In fact, one study found that 90 percent of enlisted personnel (and more than half of all officers) had personal discount rates of 18 percent or higher. For those individuals, a dollar paid in 20 years would be worth only about 4 cents today.³ This is less than the amount of money the government must invest today in order to pay that dollar 20 years from now. In other words, military personnel do not value retirement pay and other deferred benefits as much as it costs the government to provide them. Hence, personal discount rates, which are particularly high among military personnel, have a profound effect on the relative value and cost-effectiveness of deferred military compensation.

Despite preferences among personnel for current, over deferred, compensation, the military will continue to provide deferred benefits. The question that arises, however, is whether alternatives to the current benefit structure could change the balance between cash and deferred benefits—resulting in greater satisfaction to service members and greater efficiency and effectiveness for the uniformed services. The QRMC believes that the answer is yes, and proposes an alternative military retirement benefit that would replace the current system’s deferred retirement pay with a mix of current and deferred compensation. Because it includes more efficient cash pays as well as deferred benefits, the QRMC’s retirement alternative can replicate the current system’s force-shaping results for less cost, while at the same time enhance management flexibility (to, for example, change the current force profile) and increase member access to retirement benefits.



Noncash Benefits Reduce Choice and Efficiency

Noncash compensation is also considered less efficient than cash compensation, which can be used to purchase whatever good or service is most preferred by the individual member. The value of noncash benefits, in contrast, varies depending on each member’s unique needs, interests, and personal circumstances—whether a member has children, lives near an on-base commissary, or has an interest in the use of fitness centers, for example.

There are some instances, however, where in-kind benefits are preferable to cash payments. For instance, when in-kind benefits are tax exempt, converting to a cash alternative may increase employer and employee taxes, making the in-kind benefit less costly to the employer and more valuable to the employee. In-kind benefits also may be justified when an employer can purchase the benefit—such as

3. John T. Warner and Saul Pleeter, “The Personal Discount Rate: Evidence from Military Downsizing Programs,” *The American Economic Review* (March 2001).

health insurance—for less than it would cost an individual employee to purchase it. In addition, some in-kind benefits may encourage desirable behavior among the workforce. Offering employee fitness facilities, for example, may improve employee health and reduce absenteeism.

Using these criteria, some of the in-kind benefits in the military compensation package are reasonable and should continue to be provided. Yet, when such benefits are offered, employees often prefer more flexible benefits over more costly programs that limit choice. The QRMC believes that the in-kind elements of the military compensation package will be more effective if the Services develop ways to infuse a greater degree of member choice into the system.

The effectiveness of in-kind benefits will also be enhanced if DOD develops a better understanding of how such benefits influence key force management objectives and treats such benefits as elements of compensation. Private sector employers continually reevaluate their compensation packages to maximize the efficiency of their payroll dollars. Likewise, DOD has developed sophisticated analyses that estimate how various cash payments impact recruitment, retention, and readiness. No similar analysis exists for in-kind benefits. With in-kind benefits accounting for over 20 percent of military compensation, the Department needs to develop better strategies for assessing and improving the value of these benefits as compensation tools.



Educating the Force

Individuals often make decisions to join or remain in the military based on how military compensation compares with compensation in the civilian sector. Yet when making that determination, personnel typically limit the comparison to cash pay, ignoring the substantial deferred and noncash benefits included in the military compensation package. Moreover, survey data suggest that service members often underestimate the value of in-kind benefits.

Because deferred and in-kind earnings account for a larger portion of compensation in the military than in the civilian sector, the QRMC believes that the uniformed services need to more aggressively educate service members about the true value of the compensation benefit. Providing individuals with a better understanding of all elements of the military compensation package, including the substantial in-kind benefits available to service members and their families, would enable them to make more informed comparisons between military compensation and opportunities in the civilian sector—leading, in turn, to more informed decisions to join or remain in the military.

Scope of this Volume

The findings and recommendations of the QRMC are presented in two volumes. Volume 1 contains the findings and recommendations associated with cash elements of military compensation. This volume, Volume 2, includes assessments of deferred and noncash compensation—the chapters of which are outlined briefly below:

- Chapter 2 reviews the military retirement system and proposes reforms that will make the system more equitable to military personnel, provide managers with more flexibility to shape the force, and increase the efficiency of retirement resources.
- Chapter 3 evaluates the health care system and recommends changes that will improve the equity of the retiree health care benefit, encourage beneficiaries to make cost-effective choices, and provide the Services with additional tools to mitigate the challenges they face in recruiting and retaining health care professionals.
- Chapter 4 offers an overview of the wide array of quality of life programs available to military personnel and their families—the benefits of which are not well understood in the context of compensation. The chapter focuses on four particular programs—flexible spending accounts, dependent education, child care services, and commissaries—offering recommendations to increase member choice and Service efficiency.

The volume concludes with a summary of the findings and recommendations in the context of the themes of this study—flexibility and member choice.

Military Retirement

Military retirement is a major component of the military compensation system, providing generous and immediate lifetime pay to retiring personnel who have served a minimum of 20 years. Retired pay has a number of purposes:

- to provide members and former members of the nation's uniformed services with a socially acceptable level of payment during their old age
- to provide members with a retirement system that is competitive with those provided by the private sector and the federal civil service
- to provide a force-shaping tool that offers an incentive for members to stay until 20 years of service and an incentive to leave thereafter, thereby providing promotion opportunities for younger members
- to provide a pool of experienced military manpower that the nation can call on in time of war or national emergency to augment active duty forces

The current military retirement system provides all this at an annual cost of approximately \$13 billion, or over 7 percent of current military compensation. Yet, despite the superb performance of the all-volunteer military, due in some measure to the current retirement system, many concerns have arisen about the efficiency, fairness, and effectiveness of the retirement benefit as a force management tool.

In response to these concerns, the QRMC has developed a retirement reform proposal designed to increase the system's potential as a force-management tool and to make the retirement benefit more widely available throughout the force. The QRMC alternative contains a mix of deferred and current compensation, and includes policy levers that will provide force managers with greater flexibility to shape the force in ways that better meet current needs and objectives.

This chapter describes the issues raised by the current retirement system and the analysis conducted by the QRMC to assess how various reform alternatives would influence retention, retirement behavior, vesting, program costs, and the value of the benefit to service members. Based on these outcomes, the QRMC developed a reform proposal that it believes will result in a more flexible, equitable, and efficient retirement benefit.



Background

History

The current military retirement system was established in the 1940s, following the end of World War II. The retirement reform of 1948 created a substantial pension for long-serving military personnel, and also provided a compelling incentive for personnel to retire from the military once they reached 20 years of service. At the time the retirement benefit was created, there was a concern that too many senior personnel were serving in the post-war force. Providing an immediate and generous retirement benefit to those members with 20 years of service encouraged many senior personnel to retire.⁴

But while the 1948 legislation established a 20-year retirement benefit, Congress did not envision that a 20-year career would become the norm for military retirement eligibility. For although the legislation *authorized* the Services to confer an immediate retirement benefit to members with 20 years of service, in requesting that authority the Services indicated that the 20-year retirement option would be used sparingly. As initially envisioned, personnel typically would have to achieve 30 years of service before they would be granted an immediate retirement benefit.

8 >

Making the retirement benefit available to personnel immediately upon retirement was based in part on the belief that military experience was not easily transferable to the civilian sector, meaning that personnel retiring from military service would earn lower salaries than civilians with comparable education and years of experience. Immediate retirement pay would supplement retirees' lower earnings, making their total income more comparable to that of their civilian counterparts. But while earlier studies in this area lent some support to the notion of lower earnings for military retirees, the most recent research suggests that earnings of retirees with at least 20 years of military service compare favorably to the earnings of civilians with similar education and years in the workforce.⁵

The Retirement Benefit Today

The military retirement system is a noncontributory, defined benefit plan that is available immediately upon retirement to active duty military personnel with 20

-
4. Defense Advisory Committee on Military Compensation, *The Military Compensation System: Completing the Transition to an All-Volunteer Force*, April 2006.
 5. For a more detailed comparison of civilian and military retiree earnings, see *Report of the Tenth Quadrennial Review of Military Compensation*, Volume 1, Chapter 2: The Military Compensation System.

years of service. Enlisted personnel are generally between the ages of 38 and 40 when they attain 20 years of service, while officers are slightly older, usually reaching the 20-year point between 42 and 44 years of age.

For personnel who joined the military before September 8, 1980, retirement pay is calculated as 2.5 percent of the final rate of monthly pay multiplied by the number of years of service. For those entering the service between September 8, 1980 and July 31, 1986, retirement pay is calculated in the same manner, but using the average of a member's "high-3" years of basic pay rather than final pay. Retirement paid under these two options is adjusted annually for inflation, as measured by the consumer price index (CPI).

For an average enlisted member in pay grade E-8 who retires with 20 years of service, the high-3 plan translates into an annual payment of approximately \$23,700. For an enlisted member who retires after 30 years as an E-9, retirement benefits under high-3 are approximately \$53,900 per year. Among officers, a typical O-4 who leaves the service after 20 years of service receives annual retirement pay of approximately \$37,000; while an officer who stays for 30 years and retires as an O-6 receives \$85,800 per year.

Personnel who entered the military after July 31, 1986 can choose to participate in the high-3 plan discussed above or in an alternative retirement option, commonly referred to as REDUX. Those personnel opting for REDUX receive a \$30,000 Career Status Bonus at their 15th year of service, in exchange for (1) a commitment to complete 20 years of service and (2) a somewhat lower multiplier to calculate their retirement payments (except for those with 30 or more years of service). Specifically, REDUX participants retiring with between 20 and 30 years of service receive retirement payments equal to 2.5 percent of their high-3 years of basic pay multiplied by years of service, with that total reduced by one percentage point for each year that the member is short of 30 years. For example, a service member retiring with 26 years of service would receive 61 percent of his high-3 pay (2.5 percent of 26, or 65 percent, minus 4 percentage points). Hence, under REDUX, the longer a service member remains in the military, the closer the multiplier gets to the multiplier available under high-3. Similar to the other two retirement options, REDUX pay is adjusted annually for inflation, but by the CPI minus 1 percent, rather than full inflation protection.

When REDUX retirees reach age 62, their retirement pay is modified in two ways. First, the multiplier is changed to what it would have been under high-3. The second modification involves adjusting this amount by the full CPI for every retirement year to calculate a new retirement pay. This cost-of-living adjustment,

Chapter 2

however, is not sustained beyond age 62, as REDUX adjustments for all subsequent years revert to CPI minus 1 percent.

Similar to their active duty counterparts, members of the reserves are eligible for military retirement benefits after attaining 20 years of creditable service. The method for determining reservists' eligible years of service, however, differs somewhat from the approach used for active duty personnel. Reservists' eligibility is determined through a point system, under which reservists are awarded points for participating in the reserves (15 points), taking part in drills (one point for each four-hour drill period), and for days on active duty (one point for each day on active duty). In order for a year to be creditable towards the 20-year requirement, a reservist must earn at least 50 points. A reservist typically earns 78 points per year.

In addition to the point system for determining eligibility, reservists begin to draw retirement benefits at a different time than do their active duty counterparts. While active duty retirees begin receiving benefits as soon as they retire, reservists generally must wait until age 60 before they can begin drawing retirement benefits. The one exception to this policy (described later in this chapter) involves reserve or guard members who have been deployed since January 28, 2008.

10 >

Reserve retired pay is calculated somewhat differently from active duty retirement as well. First, the points accumulated during each creditable year are added together and divided by 360 to produce the number of years of service. Second, the pay used in the calculation is based on the pay table in effect at the time the retired pay begins. These two factors are both advantageous to the reservist. One drill day counts the same toward years of service as two days of active duty, and the 15 points for participation are over and above days spent on duty. Using the pay table in effect at the time the reservist turns 60 means that retired pay is based on a much higher pay level than that which the reservist was paid while serving. Since, for the last several years, pay raises have been higher than the cost-of-living raises provided to retirees, reserve retired pay will reflect a pay base higher than that provided to active duty retirees.

Impact on the Force

The military retirement benefit has a pronounced effect on retention patterns. It creates a strong incentive for personnel who have reached 10–12 years of service to continue their service until they reach 20 years, and an equally strong incentive for those who reach the 20-year threshold to leave and immediately begin drawing retirement benefits. This dynamic also affects force management decisions. Since involuntarily separating service members who reach the 10–12 year mark may be

perceived as unfair, managers often prefer not to retain personnel to that point unless they also intend to keep them in the force until they reach the 20-year threshold for benefits.⁶ If service members are retained beyond the 10-year mark, force managers feel obligated to retain them until they reach 20 years, even if their skills are not needed to meet mission goals or if they are not making productive contributions to the force.

Because it encourages personnel to leave after reaching 20 years of service, the retirement benefit has also allowed the military to minimize the use of involuntary separations, and avoid the negative impact such separations would likely have on force morale. With large portions of each 20-year cohort leaving every year, the system has also ensured the availability of senior positions for upcoming junior personnel.

The influence of the retirement system on retention patterns is illustrated in Figures 2-1 and 2-2, which depict losses by years of service for enlisted personnel and officers. Once members complete their initial obligations, loss rates are small until the initial qualification for retirement.

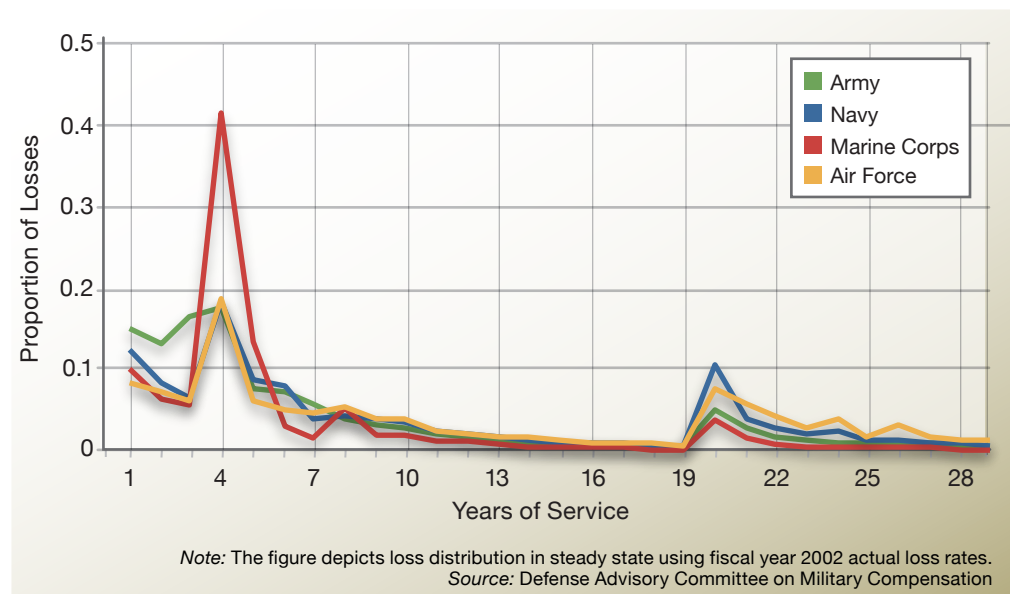


Figure 2-1. Enlisted Loss Distribution

6. Defense Advisory Committee on Military Compensation.

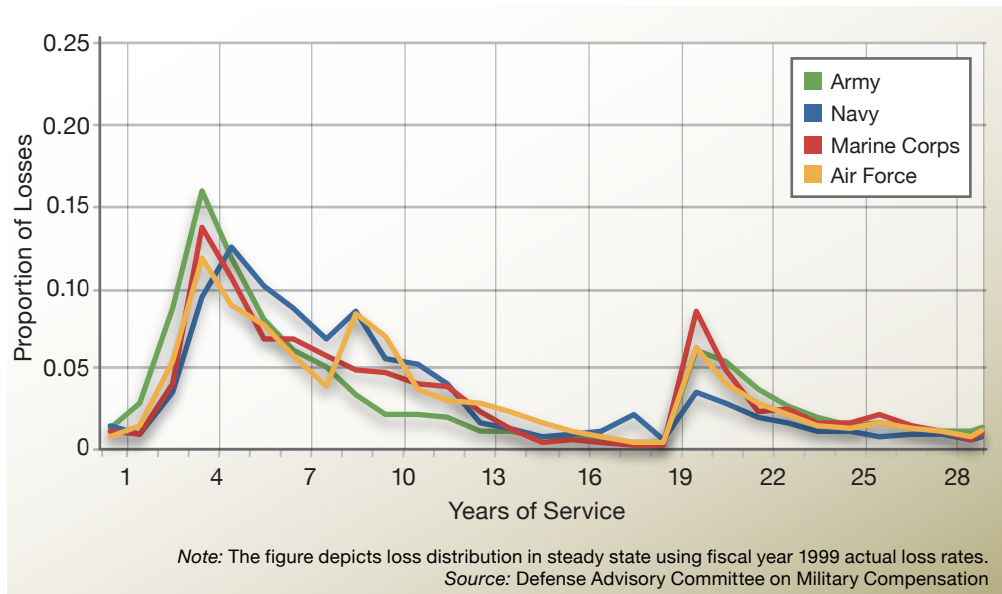


Figure 2-2. Officer Loss Distribution

12 >

Although the military retirement system provides a substantial annuity benefit to eligible retirees, it is important to note that the vast majority of service members never receive a military retirement payment. According to the Department of Defense, less than 15 percent of enlisted personnel and 47 percent of officers become eligible for the military retirement benefit.^{7, 8}

Concerns with Current System

Many concerns have been raised about the military retirement benefit, principally that the system is inequitable, inflexible, and inefficient.

Equity

As mentioned above, the military retirement system provides a generous benefit to eligible service members. However, because the benefit does not vest until a

7. U.S. Department of Defense, *Valuation of the Military Retirement System* (Washington, D.C.: Office of the Actuary, September 30, 2003) p. 12.

8. Other estimates suggest the portion of the force eligible for retirement benefits may be even smaller. For example, Defense Advisory Committee on Military Compensation (DACMC) staff analysis based on continuation rates from the Defense Manpower Data Center estimated that less than 10 percent of the enlisted force and less than 40 percent of officers would earn benefits.

member reaches 20 years of service, only a small fraction of the force ever receives retirement pay. Moreover, enlisted members are substantially less likely than officers to qualify for the benefit, with less than 15 percent of enlisted personnel force wide ultimately receiving retirement payments. That percentage is even lower in the Army and Marine Corps, where many of the military's ground forces are concentrated.

Hence, despite the nearly \$13 billion annual cost of military retirement, the system only provides old-age income to a fraction of military personnel. For the vast majority of the force—particularly enlisted personnel—there is no military retirement benefit. Moreover, the probability of reaching 20 years of service and qualifying for retirement pay is even lower among the “youth and vigor” occupations, such as combat arms, where personnel seldom serve more than two terms.

In addition to limiting the number of personnel eligible for retirement benefits, the military system's 20-year vesting requirement is also inconsistent with eligibility policies in private sector pension plans. Federal law requires that private sector employers who offer retirement benefits must vest their employees to 80 percent within five years and 100 percent after seven years, depending on the type of vesting. As a result of these requirements, a much higher percentage of private sector workers ultimately receive some sort of retirement benefit. Moreover, most paramilitary personnel (*i.e.*, police and firefighters) in federal, state, and local governments also are vested in their retirements after five years of service.

But although private sector employees are usually vested after only five years of employment, they typically must work for longer periods and must wait until age 59½ or later before they can begin to draw a full retirement benefit. Concerns about lower earnings for military retirees—originally an important rationale for the immediate retirement benefit—no longer appear warranted. In fact, a number of panels that examined the military retirement system recommended that the age at which retirees access retirement pay be increased. The Grace Commission, for example, recommended delaying the payout of retirement benefits until age 60 or 62, making it more comparable with civilian sector pension plans.

The different treatment of reservists within the retirement system is also an area of concern. As mentioned above, reservists who attain 20 years of creditable service must generally wait until age 60 before they can begin to receive benefits, while their active duty counterparts begin drawing retirement pay immediately upon retiring, potentially as early as age 38. (Reservists who have been deployed since January of 2008 can begin drawing retirement pay somewhat earlier.)

When the system was put in place over 60 years ago, there may have been sound policy reasons for this differential between reserve and active duty retirement. An early rationale for immediate retirement pay was the concern that military experience translated poorly in the civilian sector and retirees would experience lower earnings than their civilian counterparts when transferring to civilian occupations. Most reservists, in contrast, already had civilian careers, and therefore would not need additional income assistance to offset lower earnings. But current research suggests that military retirees do not experience lower earnings when they transition to the civilian workforce, calling into question the differential treatment of active duty and reserve personnel.

The role of the reserve forces—along with the nature of reserve service—has also changed since the retirement system was first established, evolving from a strategic reserve that was rarely called to active duty, to a more operational role where reservists are more frequently mobilized and play a critical part in military operations worldwide. Many believe that, as fully integrated and heavily utilized elements of the U.S. military force, the reserve components merit a compensation system that reflects and supports this role. In the new “total force” environment, it is unclear why reservists are required to wait upwards of 20 years longer than their active duty counterparts to access retirement benefits. In fact, several bills have been introduced in Congress that would lower the age at which reservists can begin receiving retirement benefits, thereby increasing comparability between the active and reserve components. One such initiative (P.L. 110-181), enacted in 2008, lowers the retirement age for reserve or guard members who have qualifying active service. Under this initiative, the date at which qualifying reservists begin receiving retirement pay is now reduced by 90 days for each 90 days of active service performed since January 28, 2008.⁹

Management Flexibility

Another concern that has been the focus of many recent studies of the military retirement system is the issue of management flexibility.

As mentioned above, the incentives embedded in the current system have a substantial effect on the shape of the force and on member retention patterns. Personnel who reach 10–12 years of service have a strong incentive to remain in the military until they reach 20 years of service, and those who reach 20 years of service have a strong incentive to leave. Furthermore, once a member has 15 years of service, the Services are reluctant to separate even poor performers knowing that they will

9. Library of Congress, Thomas, <http://thomas.loc.gov/cgi-bin/bdquery/z?d110:h.r.04986>. Accessed June 25, 2008.

leave with nothing. While this career profile may be appropriate for some elements of the force, it is not necessarily the best fit for all personnel. Nor does the retirement system provide a mechanism to adjust the profile in response to changing force needs or mission objectives.

Today's military has evolved from the large standing army of the Cold War era to a more modular and expeditionary force structure that must adapt to a wide range of military missions. In this environment, it is increasingly important to equip force managers with the flexibility to meet diverse and changing situations and to address emerging issues and shifting priorities. Yet the "one-size-fits-all" approach of the retirement system encourages all personnel to follow the same career path, regardless of whether it is consistent with Service needs or appropriate for their occupational profile.

There are literally hundreds of occupational designations in the uniformed services, ranging from mechanized infantrymen and neurosurgeons, to pilots and cryptologists. Training costs, recruitment challenges, and productivity profiles can vary considerably across these diverse occupational areas. In many professional fields—such as languages, health care, and information technology—longer career lengths may enhance productivity and expertise, while lowering training and recruitment costs. Yet as currently structured, the retirement system encourages personnel working in these professions to separate after 20 years, despite the fact that they might still offer valuable contributions to the force and to the achievement of mission goals.

The 20-year vesting point also results in personnel in some occupational fields separating before they reach the midcareer point, sooner than might otherwise occur. Because force managers prefer not to involuntarily separate personnel who have reached 10 or 12 years of service, they are often reluctant to encourage enlisted personnel in youth and vigor occupations (such as combat arms) to remain in service past their second term, because they cannot provide them with a 20-year career. As a result of this strategy, many individuals in the combat arms field leave the military earlier than warranted, simply because the retirement system's vesting policy makes it difficult for them to leave after they have reached 10 or 12 years of service.¹⁰

The dominance of the 20-year career also affects assignment lengths, which may be shorter than optimal, as more rotations are crowded into a 20-year career to provide service personnel with the appropriate number and combination of assignments necessary to develop the skills and expertise needed for senior positions.

10. Defense Advisory Committee on Military Compensation.

Abbreviated duty assignments may make it difficult for personnel to become wholly proficient in a given position before being transferred to their next assignment.

On the other hand, the 20-year vesting requirement can also lead to careers that are too long, or to the retention of individual personnel who are not making productive contributions to the force. There are some occupations, for instance, where the ideal career length is somewhere between 10 and 20 years. Pilots, for example, typically remain on flying duty for an average of 13 to 15 years. But because there is no way for them to gracefully exit the military at that point, they are kept on—in other, nonflight capacities—until they reach the 20-year mark.

Further, when Service requirements or mission objectives change, the demand for certain skills can decline. Yet surplus personnel in those skill areas are often retained because they are nearing the 20-year threshold. In fact, in those instances the Services sometimes resort to late-in-life retraining to transition personnel to other occupational areas in which they can continue to make contributions as they serve out their 20 years. The vesting requirement even hampers the Services' ability to separate midcareer service members who are poor performers. Here again, once personnel—even mediocre personnel—reach 10–12 years of service, force managers hesitate to involuntarily separate them.

16 >

Hence, the one-size-fits-all nature of the existing retirement system produces careers that are too uniform, too short, or too long, with career paths shaped by the structure of the retirement benefit rather than by the needs of the force or the characteristics of the occupation. In some instances, force managers use special pays, reenlistment bonuses, or separation incentives to encourage different career lengths or retention patterns in certain occupational areas. While such strategies have proven effective, they do not address the underlying inability of the current retirement system to encourage different career lengths. Instead, they require the expenditure of additional resources to counter the effects of the retirement benefit on the profile of the force and on retention behavior.

Efficiency

As detailed above, the force-shaping tools and retention incentives in the military retirement system are derived wholly from deferred compensation—that is, retirement pay that becomes available after personnel with 20 or more years of service leave the military. DOD expenditures on the military retirement system are considerable. Financed on an accrual basis, 2007 retirement costs totaled \$12.7

billion.¹¹ This represents 7 percent of total military compensation, and is equal to 26 percent of basic pay.

Such deferred compensation, however, is inefficient compared to bonuses or basic pay. This is because individuals discount future benefits at a higher rate than the government discounts future costs, making the benefit worth less to the individual than it costs the government to provide. Moreover, military personnel tend to be relatively young, and research has shown that young people typically discount the value of future benefits at much higher rates than the rate at which the government discounts future costs.¹² As the discussion below explains, personal discount rates have a profound impact on the effectiveness, efficiency, and perceived value of deferred military compensation, as well as on how deferred compensation compares to current compensation.

A discount rate is the rate at which individuals or organizations, such as the government, compare the value and cost of money over time. For individuals, it is the rate at which they are willing to trade current dollars for future dollars. For example, to a service member with a 15 percent discount rate, receiving 100 dollars today would be the same as receiving 115 dollars a year from now. Put another way, if allowed the choice, those personnel with discount rates above 15 percent would choose the \$100 today, while those with discount rates below 15 percent will opt for the \$115 a year from now.

There is considerable variation in discount rates, depending on personal characteristics such as gender, education, race, and age. Younger personnel, for example, tend to have higher discount rates, valuing cash in hand today more highly than cash received in the future. Older and more educated personnel generally have lower rates. One study of personal discount rates within the military found that personal discount rates among service members ranged from 0 to over 30 percent. The average enlisted member's discount rate was approximately 15 percent, while the average officer's rate was 10 percent. Personnel with higher education and income levels, as well as those who scored higher on ability tests, tended to have lower discount rates. Males had higher discount rates than females, and members with dependents had higher rates than those without dependents.¹³

11. U.S. Government Accountability Office, *Military Personnel: DOD Needs to Establish a Strategy and Improve Transparency over Reserve and National Guard Compensation to Manage Significant Growth in Cost*, "Appendix I: Updated Active Duty Compensation Costs," GAO-07-828 (Washington, D.C.: June 20, 2007).

12. Warner and Pleeter.

13. Ibid.

Chapter 2

Service members' high discount rates reveal their preference for current income over deferred compensation. While those rates vary based on a number of factors, they are nearly always substantially higher than the government's discount rate. In part, the government's lower rate is due to its greater access to credit markets, its credit worthiness, and better information. Hence, a dollar paid to a service member 10 years from now is worth less to the member today than the amount of money the government must invest today in order to pay out that dollar 10 years from now. Simply put, members do not value retirement pay as much as it costs the government to provide it.

Hence, personal discount rates affect the relative value and cost-effectiveness of deferred versus current compensation. Proposals with more current (and less deferred) benefits will be more attractive to individuals with higher discount rates. The military will nearly always be able to provide those benefits at lower cost because the government's cost of providing future benefits exceeds the value that personnel place on them.

18 > This impact of personal discount rates on deferred compensation is clearly illustrated in Table 2-1. As the table shows, a service member who has reached 20 years of service places a high value on the retirement benefit. Assuming a 15 percent personal discount rate, the value of the benefit, discounted to the 20-years-of-service point, is approximately \$140,400 for the average enlisted member and, using a 10-percent rate, \$385,200 for the average officer. Eight years earlier, at 12 years of service, the present value of that same benefit is much lower—\$45,900 for an enlisted member and \$179,700 for an officer.

However, the cost to the government of providing the retirement benefit is much higher than the benefit's value to the service member, due primarily to the government's substantially lower discount rate of 3.0–3.5 percent. In fact, in each instance shown in Table 2-1, the cost to the government of providing the benefit greatly exceeds its value to the service member. For example, the cost to the government of the enlisted member's retirement benefit is approximately \$458,000 at 20 years of service, which is more than the \$140,400 value that the member places on the benefit—in fact, more than three times the value.

This deferred compensation example contrasts sharply with current cash compensation, where there is no discrepancy between the cost to the government and the value to the service member—a dollar paid today is worth a dollar to the service member who receives it and costs the government a dollar to provide it. This makes current compensation more efficient than deferred compensation, such as retirement pay. In the situation depicted in Table 2-1, for example, DOD could offer the average

Table 2-1. Impact of Discount Rates on the Value and Cost of Retirement Benefits

Year of Service to Which Benefit is Discounted	Present Value to Member (10% discount rate)		Present Value to Member (15% discount rate)		Present Value of Cost to Government (3.25% discount rate)	
	Enlisted	Officer	Enlisted	Officer	Enlisted	Officer
20	\$206,000	\$385,200	\$140,400	\$265,000	\$458,000	\$817,800
12	96,100	179,700	45,900	86,622	354,600	633,200

enlisted service member with 20 years of service a lump sum, retirement cash-out of \$140,400 rather than the future retirement benefit. From the average service member's perspective, there should be no difference between the lump sum payment and the future payment stream—his 15 percent personal discount rate means that he places the same value on the lump sum payment as he does on the future benefit. But for the government, providing an upfront bonus payment is less than one third the \$458,000 cost of the retirement annuity. Thus, by substituting current compensation for deferred compensation, the military can supply greater value to personnel for less cost. In fact, offering a lump sum at even twice the rate at which a 20-year member would value his or her retirement would make both the individual and the government better off.

Evaluating Alternative Retirement Systems

Past Reviews of Retirement Systems

Many of the concerns discussed above have been raised before by other groups tasked with evaluating the military retirement system. Some recurring themes of those reform efforts were proposals to lower vesting requirements, delay payouts until age 60, reduce benefits to personnel with fewer than 30 years of service, and incorporate a defined contribution benefit into the retirement system. The reforms proposed by these panels provided the QRMC with a solid foundation upon which to build its recommendations for system improvement:¹⁴

14. More detailed descriptions of many of the reform efforts outlined in this section can be found in: Library of Congress, Federal Research Division, *A Summary of Major Military Retirement Reform Proposals, 1976–2006* (Washington, D.C.: Federal Research Division, November 2007) http://www.loc.gov/rr/frd/pdf-files/CNCR_Summary-Military-Retirement.pdf. Accessed June 20, 2008.

- **Hook Commission (1948).** The Hook Commission conducted a comprehensive review of the entire military compensation system. Its recommendations formed the basis of the Career Compensation Act of 1949, which established the military compensation structure still in place today. In terms of the military retirement system, the Hook Commission recommended that officers and enlisted personnel with 30 years of service be eligible for retirement benefits immediately after retiring. Officers with between 20 and 30 years of service would be eligible to draw retirement benefits beginning at age 60, while enlisted personnel with the same years of service could begin receiving benefits at age 50. Importantly, the Hook Commission also affirmed that the military retirement system should be noncontributory, that is, not require member contributions towards the retirement benefit.
- **1st QRMC (1967–1969).** Unlike many other reviews of military retirement, the 1st QRMC recommended a member contribution towards the retirement benefit, equal to 6.5 percent of salary and vested to the amount of the contribution. The QRMC proposal also included a lump sum separation payment for members leaving the military after 10 years of service.
- **3rd QRMC (1975–1976).** The 3rd QRMC recommended a retirement benefit that would vest at 10 years of service, with payouts beginning at age 60. The QRMC also recommended reduced retirement pays for members who retire with fewer than 30 years of service, and a graduated retirement pay multiplier that increased with years of service. In addition, the plan included separation pay that vested at five years of service.
- **Defense Manpower Commission (1976).** The Defense Manpower Commission recommended a pension plan that would become vested after 10 years of service and begin paying out at age 60. Personnel serving in combat arms would be eligible for an immediate annuity after 20 years of service, while all other service members would qualify for an immediate annuity after 30 years of service.
- **President's Commission on Military Compensation (1978).** Also known as the Zwick Commission, the President's Commission on Military Compensation proposed an old-age pension that would vest at 10 years of service. In addition, the commission recommended a cash transition fund supported by annual contributions from the government. Contributions would be made on behalf of all personnel with five or more years of service, and the fund would vest at 10 years of service. Available immediately upon

separation, the fund would assist members with the transition to civilian life and work.

- **President's Private-Sector Survey on Cost Control (1983).** The mandate of this group, commonly referred to as the Grace Commission, was to identify cost savings and efficiencies in the federal government. As part of its review, the commission recommended replacing immediate retirement payments with a pension that would vest at 12 years of service but not commence until age 65 (or as early as age 55 in exchange for a lower payout). The proposal also included a reduced benefit to retirees who leave the military before 30 years of service.
- **5th QRMC (1982–1984).** Many previous reviews of the military retirement system concluded that the system was too expensive and its benefits too generous. Focused on the retirement system's role in force management, the 5th QRMC rejected many of these conclusions, and noted that substantial retirement benefit cutbacks could cause recruiting and retention problems. Instead, the QRMC argued that the retirement system should support and complement force management, and that impact on the force—not cost reductions—should drive reform efforts.

The 5th QRMC also recommended providing an early withdrawal option to members who retire with at least 20 years of service, in exchange for a reduced cost-of-living adjustment, a reduced basic pay multiplier, or some other benefit reduction mechanism.

- **6th QRMC (1988).** In establishing the 6th QRMC, the President directed that it conduct a comprehensive review of reserve force compensation. As part of its recommendations in this area, the 6th QRMC recommended providing a second retirement alternative for reservists: a two-tiered, early payment option for reservists who have reached 20 years of service, in exchange for reduced benefit payments. The QRMC believed that this change would improve retention among midcareer and senior personnel and provide managers with additional flexibility to meet force needs.
- **Defense Science Board (2000).** In its review, the Defense Science Board concluded that the current retirement system resulted in careers that were too short. The board recommended a retirement benefit that vested earlier, as well as creation of a 401(k)-type plan that would include government contributions. Two other DOD panels—the Officer Management Study Group and the Review of Military Morale and Quality of Life—reached similar conclusions.

■ **Defense Advisory Committee on Military Compensation (2006).**

The DACMC report echoed the Defense Science Board's concerns that the retirement system results in career lengths that are too short, and also noted that it provides little flexibility for force managers to vary career lengths for different occupations. Although the DACMC did not propose a specific set of reforms, it did recommend that any new structure include the following elements:

- a thrift savings or 401(K)-type plan that would vest after 10 years and include a government contribution in the range of 5 percent of basic pay
- a defined retirement benefit beginning at age 60 that would vest after 10 years of service
- current compensation, such as separation pay for those leaving the service or gate pays for personnel who reach certain career milestones

The DACMC believed that a system that includes these components would enhance managers' flexibility to vary career lengths; provide a retirement benefit to personnel who serve more than 10, but less than 20, years; and improve cost-effectiveness by replacing some of the system's deferred benefits with current cash compensation.

Principles of Reform

Although the DACMC report did not include specific recommendations, it did identify several compensation incentives that could be used to address concerns with the current retirement system and make it more flexible, cost effective, and equitable.

Providing earlier vesting, for example, offers several advantages over the current retirement system. First, vesting the retirement benefit at 10 years of service would substantially expand the number of personnel eligible for a retirement benefit. Earlier vesting would also lengthen careers of some junior service members, since many of the personnel who leave the military after their first or second term would have an incentive to remain in service until they reach the 10-year vesting threshold, after which point they could separate as fully vested retirees. Moreover, because the earlier vesting point would increase retention and career lengths among junior personnel, it would also reduce the number of new accessions needed to meet end strength goals.

Gate pays can also be used to increase retention of junior personnel, by offering an incentive to remain in the military long enough to reach various time-in-service

milestones. Similarly, providing gate pays between 20 and 30 years of service can encourage more senior members to remain in service beyond the 20-year point. In fact, the DACMC estimated that providing gate pays at 25 and 30 years of service, in combination with some other reforms, would quadruple the portion of the force remaining in service for 30 years. Separation pay can also increase retention, as it provides an incentive for members to remain in service until they reach the separation pay threshold. Conversely, separation pay may also reduce retention among personnel who have reached the separation pay vesting point, as they are more likely to leave military service once they qualify for the pay.

From a theoretical perspective, the alternative compensation components included in the DACMC report could potentially yield a more equitable, flexible, and efficient military retirement system. But before it could endorse elements of the DACMC report or other retirement reforms, the QRMC had to evaluate how such changes would actually affect critical outcomes such as retention, career length, retirement behavior, vesting, costs, and the value of compensation from the perspective of the service member. In large part, these outcomes depend on how service members respond to alternative benefits. Thus, in order to get a better sense of how the DACMC and other retirement reforms would affect key metrics, the QRMC had a model developed that uses estimates of personnel behavior to simulate the impact of a range of compensation alternatives on force profiles.

Description of the Model

The purpose of the model was to evaluate how changes in military compensation affect a service member's willingness to continue on active duty or, if leaving active duty, to participate in the reserves. Individual choices were modeled using simulations estimated from actual member preferences. The model provided the QRMC with a tool to evaluate the impact of separate elements of retirement reform—the vesting age, the age at which the member draws retired pay, the defined benefit and defined contribution components, gate pays, and separation pay. The model, therefore, provides more insight into how various reform proposals would affect retention, vesting, and other key outcomes.

The model was estimated from data for enlisted personnel entering active duty between 1990 and 2007. Many of this cohort left active duty after their first or second term of enlistment while others continued in service. Some departing active duty personnel joined the reserves, and their subsequent participation in that force component was also followed. Others left active duty and became civilians. The model considered a 40-year work life and compared alternatives available to military

members during the course of that career—options such as remaining on active duty, joining the reserve components, or becoming civilians. For reservists, it considered the options of remaining in the reserves or becoming civilians. These comparisons took into account factors such as current and deferred military compensation and civilian earnings, as well as more intangible factors such as individual preference for military service, the value of unanticipated factors or events that affect satisfaction for each alternative, and personal discount rates. Thus, based on individual preferences for active and reserve service, the model evaluated the impact of changes in the retirement system on personal choices to stay in or leave the active duty or reserve force.¹⁵

Testing Reform Proposals

The QRMC evaluated how the various DACMC proposals would affect a range of crucial force outcomes, including retention, career lengths, and costs. Importantly, the model also allowed the QRMC to evaluate how layering additional elements into a compensation package could improve results, thus identifying the marginal impact of the various components. It also allowed the QRMC to craft a comprehensive reform package that addressed the full range of reform objectives.

24 >

In addition to the DACMC recommendations, the QRMC also evaluated the retirement system for federal civilian employees, as well as retirement systems for first responders such as police and firefighters.¹⁶ Specifically, the QRMC evaluated how elements of those compensation systems would operate if incorporated into the military compensation package. These alternatives were ultimately rejected, as the analysis demonstrated that they would not provide the desired flexibility and manning levels at reasonable cost.

Results from a sample of the simulations are presented here for Army enlisted personnel (analyses assume a personal discount rate of 15 percent). In Figure 2-3, the force profile—that is the number of personnel present at each year of service—is shown for the current high-3 compensation system. Under this system, it is expected that individuals entering the Army will serve an average of seven years, with 10.5 percent of personnel remaining in service for 20 years.

In Figure 2-4, these results are compared to an alternative retirement plan that includes three of the DACMC reform options: a defined benefit plan, a defined

15. For a more detailed description of how the model was constructed and simulation results, see Beth Asch, James Hosek, Michael Mattock, and Christina Panis, *Assessing Compensation Reform in Support of the 10th Quadrennial Review of Military Compensation: Theory, Estimation, and Policy Analysis*, in a subsequent volume of this report.

16. Appendix A contains a summary of the various retirement systems considered by the QRMC.

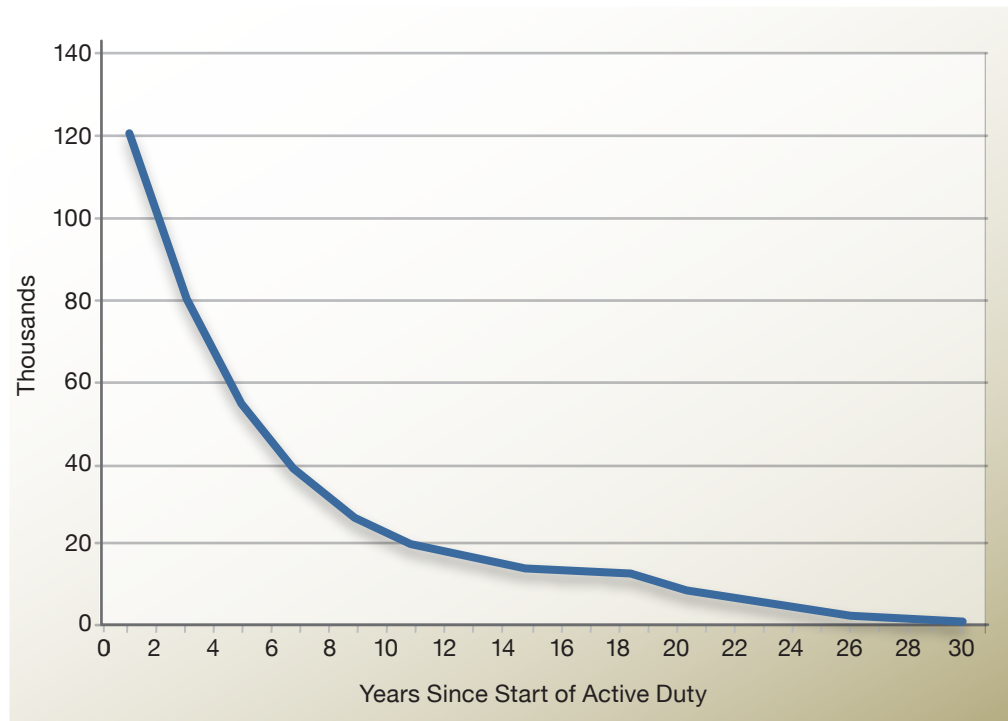


Figure 2-3. Army Enlisted Member Profile, Current System

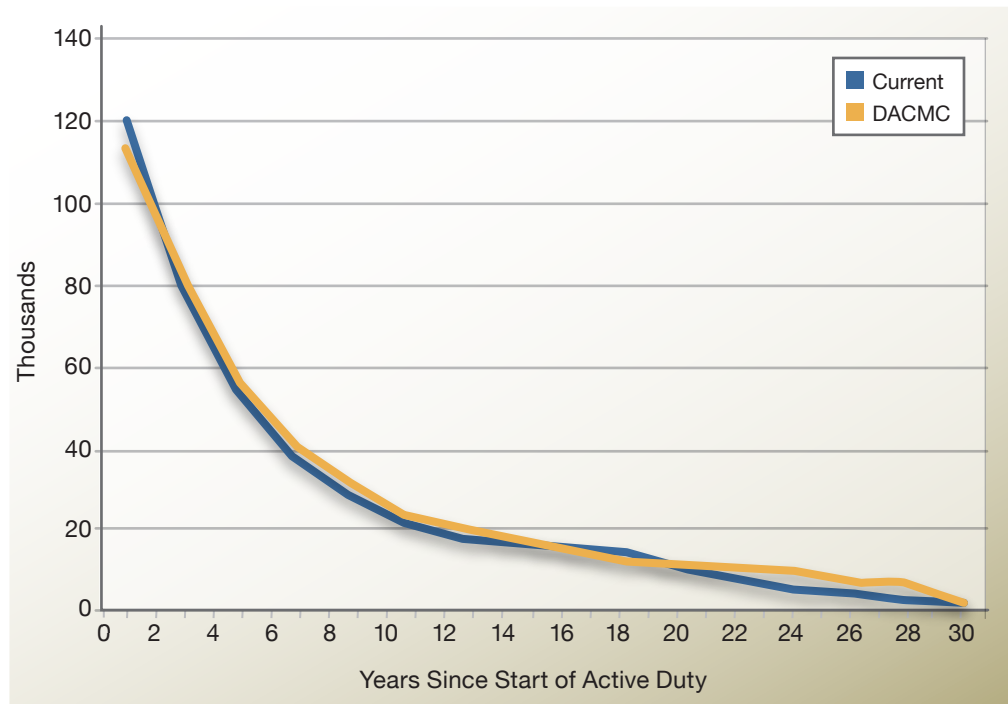


Figure 2-4. Army Enlisted Member Profile Under DACMC Defined Benefit, Defined Contribution, and Gate Pay

contribution plan, and gate pay. Under this scenario, personnel would be eligible for a defined benefit that uses the same formula as the current high-3 plan, as well as a defined contribution plan into which DOD would annually contribute an amount equal to 5 percent of annual basic pay. Both plans would vest at 10 years of service and begin paying out at age 60. In addition to the two deferred payments, each member would also be eligible for gate pay equal to 50 percent of annual basic pay upon completion of 10, 15, 25, and 30 years of service.

The analysis of this alternative showed that if the retirement proposal had been limited to the two deferred compensation pieces, the percent of personnel staying until both 10 and 20 years of service would have declined relative to retention in the existing system. These results are due in part to earlier vesting, which would effectively eliminate the current incentive to remain in service for 20 years in order to qualify for retirement pay. Expected man-years per accession would have declined as well, meaning that DOD would have to increase accessions in order to maintain its end strength objectives.

26 > But as Figure 2-4 shows, incorporating a current compensation element into the package—in this case gate pay—restores the percent of the force reaching 20 years of service to current system levels and increases retention beyond the 20 years-of-service threshold. Essentially, the gate pay provides interim incentives for personnel to remain in service in order to reach the gate pay milestones. And because some of the gate pays would be awarded after 20 years of service, the plan would encourage personnel to remain in service beyond the 20-year mark, when retention normally declines sharply. Including gate pay in the package also increases expected man-years per accession to 7.4 years, compared to seven years under the existing system. With higher man-years per accession, DOD could reduce the number of accessions necessary to maintain end strength objectives, thereby reducing recruiting and training costs. In addition to improving retention results, this system would also have slightly lower costs, suggesting a more cost-effective approach.

Figures 2-5 and 2-6 show the results from two other DACMC compensation plans. The first plan includes the defined benefit plan vested at 20 years of service (rather than 10), the defined contribution plan (vested at 10 years of service), and separation pay. Under this proposal, separation pay would be provided to all separating personnel who have served for at least 10 years (the payment would equal 50 percent of the monthly basic pay multiplied by the number of years of service). The second alternative is identical to the first, but would also include gate pays and would increase the separation pay multiplier from 50 to 75 percent.

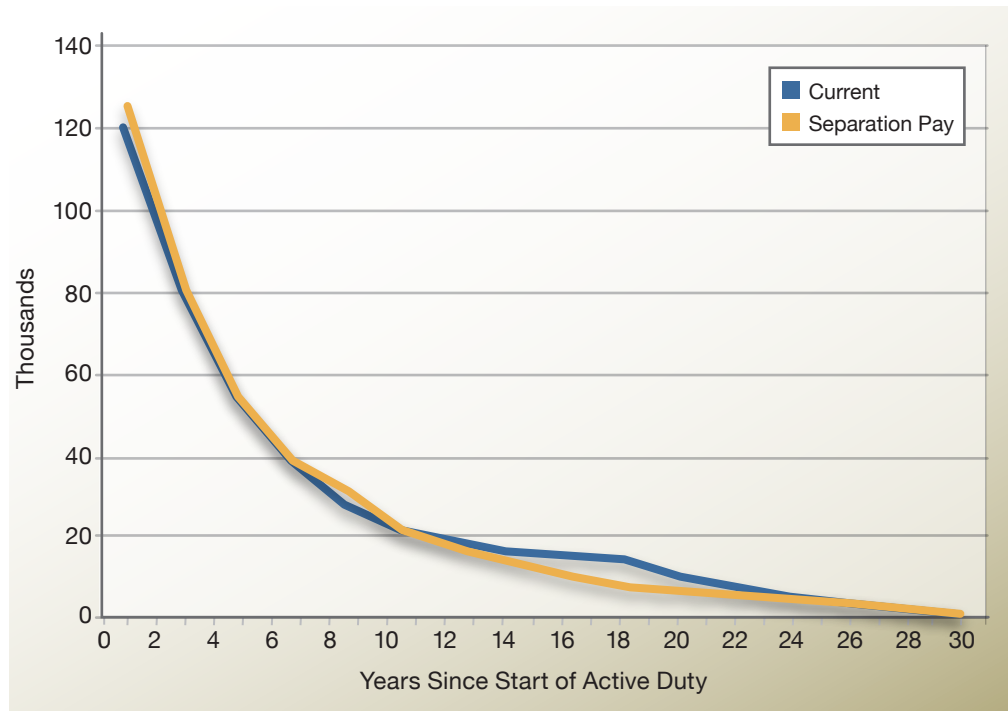


Figure 2-5. Army Enlisted Member Profile Under DACMC Deferred Payments with Separation Pay

27

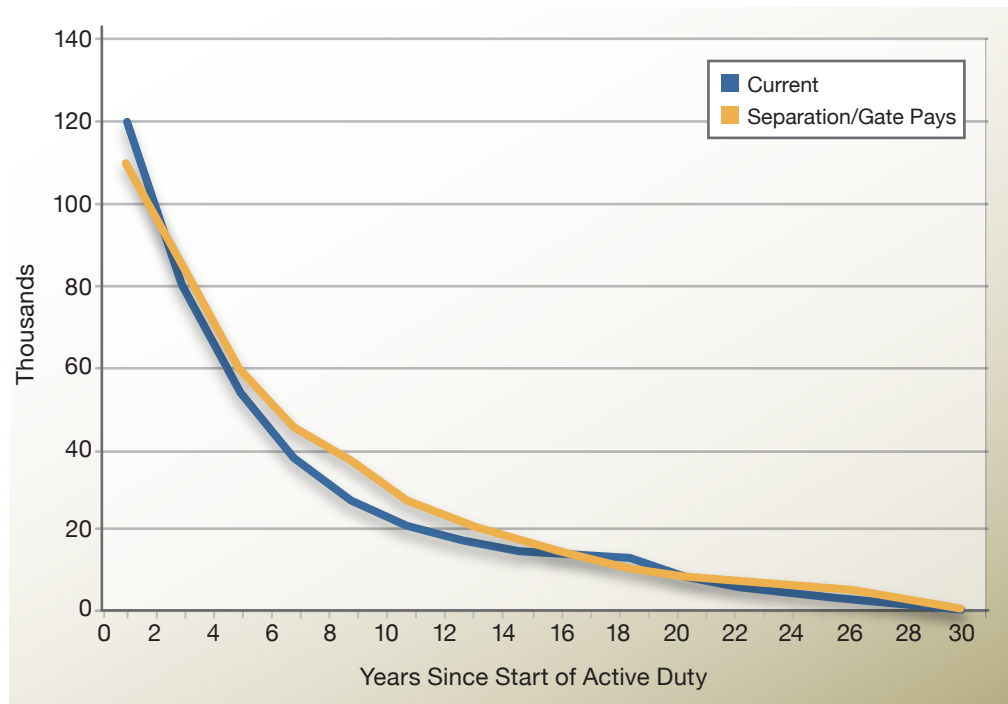


Figure 2-6. Army Enlisted Member Profile Under DACMC Deferred Payments with Separation and Gate Pays

As Figure 2-5 illustrates, introducing separation pay encourages shorter careers, as members opt to take the pay as early as 10 years of service, thereby reducing midcareer retention. Man-years per accession would also decline under the separation pay package, requiring increased recruitment in order to maintain existing end strength. But Figure 2-6 shows that adding gate pay into the equation restores midcareer retention and increases retention among personnel with six to eight years of service. Man-years per accession would also increase relative to the current system, and costs per man-year would decline slightly.

These results suggest that separation pay would be an effective tool for reducing career lengths in certain “youth and vigor” occupations where shorter careers are desirable. Separation pay could also be offered to personnel in professional fields where longer careers are preferable, as long as gate pays or other current incentives are in place to encourage retention.

The Defense Advisory Committee’s proposals would improve the military retirement benefit and address some of the major concerns with the current system. The DACMC alternatives would enable more personnel to vest in the system, making it more equitable. By varying the timing and levels of separation and gate pays, the reforms would provide force managers with greater flexibility to tailor careers to meet force objectives. For example, separation pays could encourage those in “youth and vigor” occupations to shorter careers, while gate pays could induce personnel in technical fields to remain in service longer. Finally, the current force profile can be achieved more efficiently with a compensation package that includes a mixture of current and deferred compensation.

QRMC Retirement System Proposal

Description of QRMC Proposal

Building on the groundwork laid by the DACMC, the QRMC has developed a comprehensive proposal for retirement system reform. The proposal includes earlier vesting of deferred benefits, as well as current incentives that will provide the Services with the flexibility to vary career lengths in a cost-effective manner.

The foundation of the QRMC proposal is a defined benefit plan and a defined contribution plan. While the QRMC anticipates that other elements of the proposed system could be varied to achieve different retention patterns, the defined benefit and defined contribution plans would remain consistent throughout the force.

- **Defined Benefit Plan.** The defined benefit would provide qualified members with retirement pay equal to 2.5 percent of high-3 annual basic

pay multiplied by the number of years of service. The plan would vest at 10 years of service, dramatically increasing the portion of the force that would be eligible for a defined retirement benefit and making military benefit vesting rules more comparable to vesting in civilian sector pension plans. The benefit would be payable beginning at age 60 for those with less than 20 years of service, and beginning at age 57 for those with 20 or more years of service. Retirees with 20 or more years of service could opt to receive the defined benefit immediately upon retirement, with the payment reduced by five percentage points for each year the member is short of age 57.¹⁷

- **Defined Contribution Plan.** Personnel would also be eligible for a defined contribution plan, under which the Services would annually contribute up to 5 percent of annual basic pay into a retirement account for each service member. The plan would vest at 10 years of service and begin paying out at age 60. A percent of annual basic pay, the contribution rate would vary based on years of service, with a maximum rate of 5 percent for those members with five or more years of service. Specifically, the contribution rate would equal zero percent of annual basic pay for those with less than a year of service; 2 percent for members with up to two years of service; 3 percent for those with more than two but less than four years of service; 4 percent for personnel with four but less than five years of service; and 5 percent for those with five or more years of service.

29

In addition to the defined benefit and defined contribution plans, the QRMC system would also include two current compensation incentives: gate pays and separation pay.

- **Gate Pays.** Gate pays are current compensation paid to members who reach specified years-of-service milestones. A multiple of basic pay, these payments would be made regardless of whether a member remains in service after reaching the specified year of service necessary to qualify for the pay.
- **Separation Pay.** This pay would equal monthly basic pay multiplied by years of service and a multiplier, and would be provided to qualifying members when they leave the military.

17. For example, a 45-year-old service member with 25 years of service, who waits until age 57 to begin drawing retirement benefits, would receive the full annuity of 62.5 percent of high-3 pay. If that same retiree opted for an immediate annuity at age 45, the benefit would be reduced by 12 years times 5 percentage points, or 60 percentage points. Thus, the member would receive 40 percent of the annuity he or she otherwise would have been paid at age 57.

The years of service necessary to qualify for these pays—as well as pay amounts—would depend on retention patterns and force-shaping needs of the individual Services. It is expected, therefore, that the requirements would vary across the Services and by occupation. For example, gate pays could be offered at years of service that would encourage longer careers in occupational areas where experience and expertise are important, such as technical professions. Alternatively, separation pay could be made available to personnel in combat arms to encourage them to stay beyond two terms of service but voluntarily leave before 20 years of service.

Unlike the current retirement system, the QRMC plan does not distinguish between reserve and active duty service members. Consistent with the 2008 report of the Commission on the National Guard and Reserves, active duty and reserve personnel would have the same vesting requirement, and become eligible for defined benefit and defined contribution benefits at the same age. However, because reservists serve fewer days than their active duty counterparts, the value of the reserve benefit would be less than the value of the active duty benefit.

Impact of QRMC Proposal on Force Management and Personnel

30 >

The reforms described above are designed to address concerns with the military retirement benefit and improve the equity, efficiency, and flexibility of the retirement system. The defined benefit and contribution plans, for example, offer important improvements over the current deferred benefit. Because the two plans would vest much earlier in a member's career, many more personnel would be eligible for retirement benefits under the QRMC alternative than are eligible under the current system, improving equity between service members.

Introducing gate and separation pays into the retirement system would provide force managers with cost-effective tools to more easily influence career lengths and retention patterns through incentives customized to meet different force-shaping needs. For example, both separation and gate pays could be used to encourage longer careers beyond 20 years of service, and separation pay could be used to induce members to voluntarily leave the military at a specified year of service.

The defined contribution plan, gate pays, and separation pays are all current compensation paid to members currently in service. As such, they will be more efficient than the defined benefit plan, the foundation of today's retirement system, which is made up entirely of deferred compensation.

The new system would also offer more choices to service members. Under the current system, members' career and retention decisions are often dictated by the

20-year vesting point. Under the QRMC alternative, incentives would be available to support other career lengths and continuation decisions. Because of the earlier vesting, members could leave between 10 and 20 years of service and still receive a retirement benefit. Separation and gate pays would provide additional opportunities to reward a range of career and continuation decisions.

In theory then, the QRMC recommendation should result in an improved retirement benefit that enhances force management flexibility and increases system equity and efficiency. Yet as mentioned above, how the new system would actually perform depends in large part on how service members respond to the new benefit regime. In order to get a better sense of how its recommended reforms would affect crucial force management outcomes, the QRMC used the behavioral model introduced earlier to assess the proposal's impact on retention, vesting, and other metrics. Two scenarios were evaluated. The first shows the impact from configuring the system to sustain current personnel strength and retention profiles. The second illustrates how gate pays and separation pay can be manipulated to encourage longer careers.

Impact on Force Management

A primary concern with retirement reform is whether a proposed alternative can replicate the experience mix of personnel in the existing system, which the QRMC proposal is able to do. In the Army, for example, the existing force profile can be achieved with the following levels of gate pay and separation pay (Table 2-2):

- gate pay equal to 15 percent of annual basic pay at years of service 12 and 18
- separation pay (equal to a multiplier of 1.0 times monthly basic pay times years of service) available to retiring personnel between 20 and 24 years of service

Compared to the existing system, the QRMC alternative would replicate the current force profile and existing retention rates, and produce the same number of man-years per accession (Table 2-3). Moreover, the QRMC alternative achieves these results in a more cost-effective, equitable, and flexible manner than does the current system. In terms of active duty cost per man-year, for example, the QRMC option replicates the Army's current retention behavior and force structure at a cost that is 6.9 percent lower than current spending. This lower cost results from the fact that the QRMC alternative reallocates compensation from the end of a career and instead awards it earlier, in the form of gate pays and separation pay. As noted earlier, current compensation is more valued—and cost efficient—than deferred compensation.

Chapter 2

The QRMC also evaluated whether its proposed retirement plan could be configured in a way that would extend career lengths and determined that longer careers could be encouraged through the following compensation package:

- gate pay equal to 35 percent of basic pay paid out at 12 years of service
- gate pay equal to 50 percent of basic pay paid out at 18 years of service
- separation pay (with a multiplier of 1.0) available to retiring personnel with 20 to 30 years of service

As Table 2-3 shows, this second configuration would result in a larger portion of the force reaching 20 years of service, and 9 percent more man-years per accession in the Army. With personnel remaining in the military for longer periods, the Services would need fewer new accessions to maintain their end strength objectives. This would reduce pressures on recruiting in a difficult market, and lower recruiting and

Table 2-2. Features of QRMC Alternatives for the Army

	Defined Contribution Plan		Separation Pay		Defined Benefit Plan		Defined Benefit Plan with Early Withdrawal Option		Gate Pay
	Value	Vest	Value	Vest	Value	Vest	Value	Vest	
QRMC Current Profile	0% x ABP 0<YOS<1 2% x ABP YOS=2 3% x ABP YOS=3 4% x ABP YOS=4 5% x ABP YOS 5+	10	1.0 x MBP x YOS	20	2.5% x Hi-3 Pay x YOS	10	Reduce Annuity by .05 x (57-age)	20	15% x ABP at YOS 12 18
QRMC Longer Careers	0% x ABP 0<YOS<1 2% x ABP YOS=2 3% x ABP YOS=3 4% x ABP YOS=4 5% x ABP YOS 5+	10	1.0 x MBP x YOS	20	2.5% x Hi-3 Pay x YOS	10	Reduce Annuity by .05 x (57-age)	20	25% x ABP at YOS 12, 35% x ABP at YOS 18

Note: ABP = Annual basic pay
MBP = Monthly basic pay
YOS = Years of service

training costs. Moreover, the force improvements would be achieved at a slightly lower cost than under the current system. Here again, the current compensation incentives included in the QRMC plan make it more cost effective than the existing retirement benefit.

Impact on Personnel

As the preceding section shows, the QRMC alternative offers several advantages to force managers in terms of flexibility and cost efficiency. But how would military personnel value the QRMC benefit compared to the existing retirement system?

Table 2-3. Outcomes Under QRMC Alternatives and Current Retirement System

	Percent Reaching 20 Years	Expected Active Years of Service per Accession	Expected Active Duty Accessions	Average Active Duty Cost per Man-Year ^a	Total Active Duty Cost ^b (\$ billions)
Army					
Current System	10.5%	7.0	59,483	\$46,346	\$19.234
QRMC (Base Case)	10.8	7.1	58,283	43,168	17.914
QRMC (Long)	12.5	7.6	54,964	45,839	19.023
Air Force					
Current System	22.4%	9.5	29,380	\$52,873	\$14.805
QRMC (Base Case)	23.6	10.1	27,829	49,565	13.878
QRMC (Long)	27.0	10.3	27,106	51,262	14.353
Navy					
Current System	14.8%	7.7	29,118	\$49,194	\$11.069
QRMC (Base Case)	12.6	7.7	29,360	44,503	10.013
QRMC (Long)	15.9	8.4	26,906	47,925	10.783
Marine Corps					
Current System	10.0%	6.7	26,813	\$46,780	\$8.420
QRMC (Base Case)	9.9	7.0	25,723	43,809	7.886
QRMC (Long)	12.5	7.8	23,137	46,142	8.306

- Costs include regular military compensation (including the federal tax advantage), an estimate of active duty retention bonuses, and an estimate of reserve affiliation bonuses, plus an amount needed to fund retirement benefits.
- Assumes the following end strengths: Army=415,000; Air Force=280,000; Navy=225,000; Marine Corp=180,000.

Chapter 2

Table 2-4 compares current retirement benefits to the benefits that would be available to personnel under the QRMC alternative. In this example, gate pay would be available and separation pay (equal to monthly basic pay multiplied by the number of years of service) would be paid to those service members leaving the military between 20 and 26 years of service. Because this comparison is based on the value to the service member, benefit values are discounted using a personal discount rate, in this case 15 percent. The table includes two outcomes for the QRMC alternative, one assuming an immediate annuity, the other an annuity deferred until age 57. Benefit amounts are shown for a range of personnel at different pay grades and with different years of service. In each case, the QRMC “immediate annuity” alternative provides the departing service member with a more valuable benefit than does the current system.

Take, for example, the case of an E-7 who separates after 20 years of service. Under the current system, the E-7 would receive a retirement benefit with a present discounted value of \$120,000. Under the QRMC alternative, if that same E-7 separated at 20 years of service and took the early withdrawal option for the defined

34

Table 2-4. Benefits Available to Separating Personnel, Current System Versus QRMC Proposal (thousands of dollars)

	E-5 YOS-10	E-7 YOS-20	E-8 YOS-24	E-9 YOS-30	O-3 YOS-10	O-5 YOS-20	O-6 YOS-24	O-6 YOS-30
Current System								
Annuity	0	120	183	330	0	233	354	541
QRMC Plan								
Immediate Annuity								
Defined Benefit	0	23	78	227	0	45	150	372
Defined Contribution	11	40	57	93	22	76	108	169
Separation Pay	0	67	98	0	0	131	190	0
Gate Pays	0	9	10	12	0	20	23	28
Total	11	138	243	333	22	271	470	569
Deferred Annuity								
	12	128	198	226	25	252	384	394

Notes: Data show present value of benefits, assuming a 15 percent personal discount rate; totals may not add due to rounding.

benefit plan, the retirement annuity would be worth \$138,000. Of course, any member who separates between 10 and 20 years of service will be better off under the QRMC plan, since that member will receive no retirement benefit under the current system, but would be eligible for defined contribution plan payments, and possibly gate pays, under the QRMC alternative.

Compared to the current system, the biggest gains are experienced by those enlisted personnel and officers with 24 years of service, suggesting that the proposal's separation pay provision provides a strong incentive for personnel to remain in service longer than the 20 years typical for military retirees under the current system. By modifying the years in which separation pay would be awarded, the Services could create incentives for personnel to stay longer, or leave earlier, depending on force needs.

When the QRMC benefit is deferred until age 57, its value drops relative to the QRMC's immediate annuity scenario—even though the deferred benefit would not be subject to a penalty, as under the early withdrawal option. In a few instances, the value of the deferred benefit alternative is also lower than the retirement benefit available under the existing retirement benefit.

Because the QRMC's defined benefit and defined contribution plans vest at 10 years—compared to 20 years of service under the current system—the portion of the force that is eligible for benefits would dramatically increase under the QRMC proposal. For example, in the QRMC base case, the percent of Army accessions that vest in the system would more than double, with 23.7 percent vesting at 10 years of service, compared to 10.5 percent who typically vest at 20 years of service under the current system. Under the longer career scenario, the percent of personnel who vest at 10 years of service would grow to 25.2 percent. While the portion of the force that vests for retirement pay would increase substantially under this proposal, this change would in no way affect eligibility for the retiree health benefit, which would continue to vest at 20 years.

35

Implications for Force Management

As illustrated in the cases above, the proposed QRMC retirement system can be configured in ways that replicate the current force structure or achieve a force profile with longer careers. Further, the QRMC alternative can achieve the current force profile at lower cost, while also expanding the percent of the force receiving benefits and increasing the value of the average benefit. Elements of the QRMC system can also be adjusted to achieve different career lengths. Specifically, different gate pays and separation pays could be used to vary retention results by Service, occupational area, or some other factor. Such flexibility would enable managers to leverage the

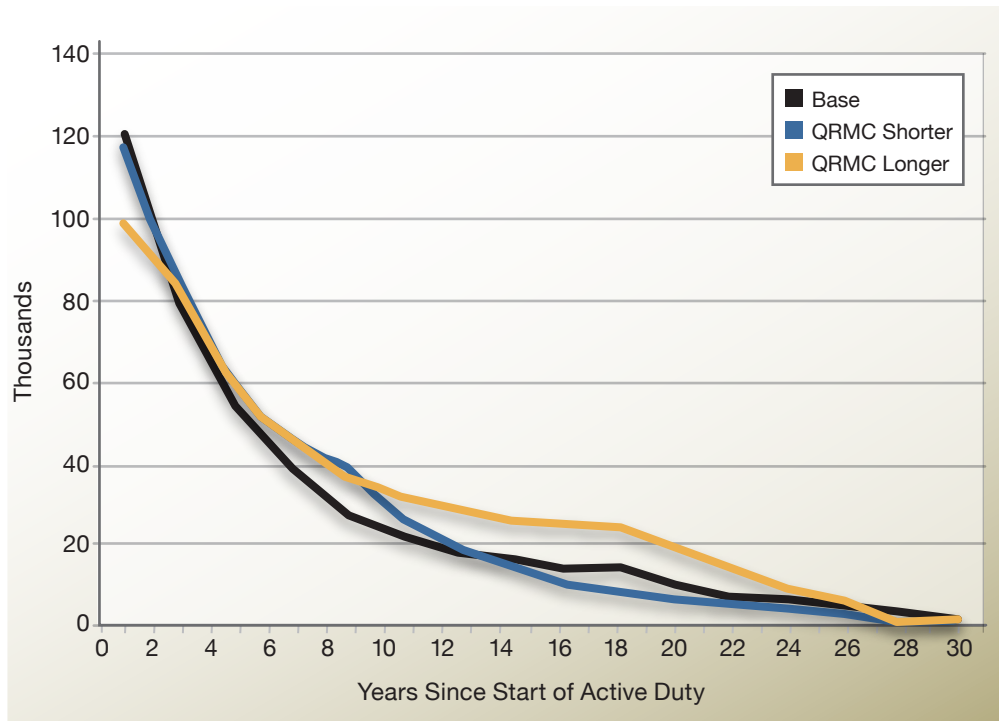


Figure 2-7. Army Enlisted Member Profile Under QRMC Shorter and Longer Options

retirement system to shape the force in a manner that best meets force management needs and mission objectives. This would represent a substantial improvement over the current system, which has no capacity to vary its impact on retention behavior or on the profile of the force.

To further illustrate the flexibility of the QRMC proposal, Figure 2-7 shows two additional alternatives that would produce a shorter and a longer career length in the Army. In the shorter career scenario, gate pays are eliminated and separation pay—equal to 175 percent of the monthly basic pay multiplied by the number of years of service—is paid to those who have at least 10 years of service. In the longer career case, gate pays are set at 40 percent of annual basic pay, and paid to those personnel who reach 12, 14, 16, or 18 years of service. Separation pay is vested at 20 years of service in the second scenario, and again equals 175 percent of monthly basic pay multiplied by years of service. As the figure shows, the shorter career option induces more individuals to stay until 10 years of service—when separation pay and the defined benefit plan become vested—but fewer individuals to remain until 20 years of service. The longer career version induces greater retention through 26 years of service.

Table 2-5. Army Outcomes Under Various QRMC Options and Current Retirement System

	Percent reaching 20 YOS	Expected Active Years of Service Per Accession	Expected Active Duty Accessions	Average Active Duty Cost per Man-Year	Assumed Strength	Total Active Duty Cost (\$ billions)
Base	10.5%	7.0	59,483	\$46,346	415,000	\$19.234
QRMC Current	10.8	7.1	58,283	43,168	415,000	17.914
QRMC Long	12.5	7.6	54,964	45,839	415,000	19.023
QRMC Shorter	5.4	7.1	58,309	43,560	415,000	18.077
QRMC Longer	19.0	8.5	48,572	50,388	415,000	20.911
Weighted Average of QRMC Base, Longer and Shorter	11.5	7.5	54,900	46,297	415,000	19.213

Table 2-5 shows the estimated cost to the Army of these alternatives. Relative to the current retirement system, the incentives necessary to achieve a shorter career cost less, while the compensation needed to encourage a longer career costs more. However, the average cost force wide is about the same or slightly less than current system costs. Assuming the force is divided equally among shorter, current, and longer career lengths, the current system costs \$46,346 per active man-year, while the weighted average of the QRMC alternative costs \$46,297 per active man-year.

These results suggest that the Army could achieve more variation in career lengths for about the same cost as the current system, while continuing to allow personnel to choose how long they prefer to remain in the military. Such flexibility would enable force managers to change the retention patterns that have long dominated the shape of the force. For example, the new system could encourage more members to complete 10 years of service and induce senior personnel to remain beyond 20 years of service. By providing current incentives such as separation and gate pays, the new benefit could provide midcareer personnel with an incentive to remain in the military beyond 10 years of service, but leave before reaching the 20-year point.

These conclusions, however, are based on a model, not on actual behavior. Thus, the actual impact of the retirement reform proposal on key outcomes such as recruitment and retention costs is not known. Because recruiting and retention are critical to the

viability of the all-volunteer force, the QRMC believes that a field test of the reform proposal should be conducted before any system changes are implemented.

A Demonstration Project

The military retirement benefit has a profound impact on force shape, retention patterns, assignment duration, recruitment requirements, and force readiness. Moreover, the system is a major and anticipated source of income for military retirees. For these reasons, the QRMC believes that any reform of the current system—including the proposal described here—should be undertaken carefully. The behavioral model employed by the QRMC has provided valuable estimates of the proposed system’s impact on retention, costs, and other key outcomes. But it is still a theoretical analysis. Before implementing the proposed retirement reforms force wide, the QRMC recommends that DOD undertake a demonstration project to better ascertain the new system’s actual effects on the force.

RECOMMENDATION

The QRMC recommends that DOD conduct a multiyear demonstration project of its proposed retirement benefit prior to implementing the new system force wide.

38 >

DOD has conducted a number of personnel demonstration projects in the past, including programs that examined recruiting, educational assistance, and enlistment bonuses. In the case of the proposed retirement reform, the QRMC recommends that the Department conduct a test in which a representative sample of enlisted personnel and officers will substitute the proposed retirement system for the current system.

Conducting such a demonstration project would reduce the uncertainties and risks associated with transitioning to the new system, as it would provide “real-life” evidence of how the proposed reforms would affect retention, costs, vesting, and other critical elements of force management. Essentially, it would allow DOD to observe and assess the consequences of the alternative system before deciding whether to implement it force wide. A demonstration project offers other advantages as well. It could reveal unanticipated problems with the new system that can be corrected before it is implemented throughout the force. Further, the project’s findings—as well as the experiences of colleagues participating in the demonstration project—could increase service members’ confidence in the new system.

The project should run for a minimum of five years, during which time retention behavior and other outcomes associated with participants in the alternative retirement system should be compared to similar personnel who remain in the existing system. Participation should be voluntary, but should include enlisted personnel and officers from all four DOD Services, both active duty and reserve components, as well as diverse occupational areas with different career length preferences. This would enable the Department to determine whether the proposed system is sufficiently flexible to achieve a range of different retention patterns and career lengths.

Prior to initiating the demonstration program, the Department would need to resolve a wide range of project design issues, including how to account for the possible effects of self-selection among program volunteers, how best to educate the force and leadership about the project, and how participants will transition out of the project when it concludes.¹⁸

Retirement reform affects a number of other programs, including survivor benefits, former spouse benefits, disability retirement, and actuarial calculations for the normal cost percentage. As part of the pilot, the Department should assess how the proposed reform may affect these areas, and determine whether any changes are necessary to keep the overall system balanced.¹⁹

Conclusion

For more than 60 years the military retirement system has helped shape the force profile and retention patterns of the U.S. military and provided a generous benefit to retiring personnel. But as this chapter has detailed, the current system has many shortcomings. Its reliance on deferred compensation makes the benefit less cost effective than other types of compensation. The “one-size-fits-all” nature of the benefit provides little flexibility to force managers to vary career lengths or modify the shape of the force. And although the retirement benefit accounts for more than 7 percent of total compensation, only a fraction of military personnel ultimately receive retirement pay.

The QPMC’s alternative retirement proposal would replace the current system’s deferred retirement pay with a more efficient mix of current and deferred

18. A detailed discussion of the design and objectives of the demonstration project can be found in Paul F. Hogan et al., *Military Retirement System Demonstration Test*, in a subsequent volume of this report.

19. For a more detailed discussion of this issue, see Tom Tower, *Comments and Concerns on Restructuring Military Retirement: Collateral Issues*, in a subsequent volume of this report.

Chapter 2

compensation that would enhance force management flexibility and increase cost-effectiveness. In addition, many more service members would become eligible for retirement benefits, addressing the fairness concern with the current system. Member choice would be increased, as personnel would have access to a range of compensation incentives that can support a variety of career lengths and continuation decisions. Service members would no longer face a choice of separating around 10 years of service or remaining through an entire 20-plus year career, but would instead have the flexibility to take portable retirement benefits with them at a variety of points of service.

Health Care

No single program affects more of the active duty, reserve, retired, and dependent populations than the military health care benefit. Health care for uniformed personnel is essential to ensuring the readiness of our forces. In peacetime, the military health care system ensures that uniformed personnel are physically ready and available to perform their duties. In times of national emergency, it provides assurance that casualties receive high-quality, responsive care. Maintaining a robust health care system for active duty dependents is also imperative, as it provides members with peace of mind that their families will receive care even when they are absent.

From the perspective of compensation, health care is the largest and most important noncash incentive for personnel to join and remain in military service. Other than retirement pay, it is also the most significant component of compensation for retirees and their families. The costs of providing health care to the military population are substantial, and continue to grow, accounting for an increasingly large share of total DOD spending. In fiscal year 2001, DOD's health care spending totaled \$19 billion. By 2009 costs are projected to reach \$42.9 billion.

41

The QRMC examined two critical aspects of military health care: system costs of the health benefit and recruiting and retention of health care professionals. This chapter provides background information on the military health care system, summarizes QRMC analyses of issues relating to system cost and health care professionals, and offers a number of recommendations that will increase the cost-effectiveness and equity of the military health benefit and improve the recruitment and retention of health care professionals.

Military Health Care Benefit

History of the Military Health Benefit

Providing health care to military personnel, their families, and retirees dates back over 200 years to the earliest days of the U.S. military. As the country's borders expanded to the west in the late 1700s, the remote nature of Army outposts required the Services to provide medical care directly to their personnel. To meet this need, the Act of March 2, 1799 authorized the Army and Navy to establish their own medical

departments to treat active duty personnel. Over time, military personnel began to bring their families with them to these remote posts, and the medical departments started to treat military dependents on a space-available basis. Because retirees were subject to recall, they too were given care when capacity permitted.

By the second half of the 20th century, the military health care system was straining to meet the needs of the evolving and expanding U.S. force. Following the Korean War, and the onset of the Cold War, the size of the U.S. military grew, and with it the populations of both active duty dependents and retirees. As demand for health services increased, space-available care became more and more difficult to obtain. Those who were shut out of military treatment facilities (MTFs) were forced to turn to civilian health care providers for their medical care and to pay for that care out of their own pocket. Exacerbating this reduced accessibility to health services were wide disparities among MTFs regarding the types of care provided and the populations considered eligible to receive treatment.

Recognizing the negative impact that this piecemeal approach to dependent and retiree care could have on recruiting and retention, Congress passed legislation in 1956 that provided civilian medical care to dependents who were unable to access space-available care at military treatment facilities. Specifically, the Dependent Medical Care Act of 1956 codified the rights of retirees and their dependents to obtain space-available care at MTFs. It also gave the Secretary of Defense authority to contract for civilian health care for active duty dependents—but not for retirees and their dependents, who were still forced to pay for their own civilian medical care if MTF services were not available.

In 1965, Congress created Medicare, a health insurance program for individuals age 65 and older. Medicare helped cover the costs of civilian medical care for older military retirees, but retirees under age 65 were still limited to either space-available care in MTFs or paying for their own care in the civilian sector. A year later, however, Congress addressed this problem by extending eligibility for contracted civilian care to include retirees under age 65 and their dependents.

As a result of the 1966 law change, DOD created the Civilian Health and Medical Program of the Uniformed Services (CHAMPUS). Modeled after the Blue Cross-Blue Shield High Option Plan in the Federal Employee's Health Benefits Program, CHAMPUS became one of the fastest growing components of the military manpower budget. While fewer types of medical services were available through CHAMPUS than in MTFs, the program did provide an attractive alternative for retirees and dependents who could not access care at

military treatment facilities. However, CHAMPUS was not available to military retirees age 65 and older, who instead continued to rely on Medicare to help cover the cost of their civilian health care.²⁰

In 1973 the United States abandoned the draft and its military became an all-volunteer force. In the years that followed, several elements of the military compensation system were revised to better support recruitment and retention of the high-quality individuals necessary to maintain a top caliber all-volunteer military.

The CHAMPUS system, however, remained relatively unchanged until 1987, when the National Defense Authorization Act directed DOD to conduct a demonstration project to improve the effectiveness of the CHAMPUS payment system. The 1987 authorization act also permitted DOD to contract for basic health care services and to set premiums, deductibles, and copayments for care received outside of MTFs.

Based on the success of those demonstration projects, in 1994 DOD launched TRICARE, a new program designed to improve the quality and accessibility of health care services and to address the growing costs of providing health care to military personnel, retirees, and their dependents. Fully operational by 1998, TRICARE allows beneficiaries to select among three health plans:

- TRICARE Prime, a health maintenance organization (HMO)-type program that relies primarily on MTFs to deliver services
- TRICARE Extra, a preferred-provider (PPO) network
- TRICARE Standard, a point-of-sale (POS) plan similar to CHAMPUS

These choices provided beneficiaries with continued eligibility for space-available care in MTFs, but gave active duty family members enrolled in TRICARE Prime priority over retirees and their dependents.

The last major change to the military health care benefit occurred in 2001 with the introduction of TRICARE for Life, a lifetime benefit for Medicare-eligible military retirees age 65 and over and their dependents. TRICARE for Life combines Medicare and TRICARE, making TRICARE the secondary payer for health care services covered by Medicare, and the primary payer for services not covered by Medicare. TRICARE for Life participants are required to pay the Medicare Part

20. U.S. Department of Defense, *Task Force on the Future of Military Health Care: Final Report*, December 2007.

Chapter 3

B premium in order to access the program, but do not have to pay an additional TRICARE premium.

Military Health Benefit Today

Today active duty personnel and their dependents, retirees and their dependents, and certain reserve component populations receive health care benefits through TRICARE. The military health benefit is quite generous compared to the health care package typically offered in the civilian sector, due primarily to substantially lower premium contributions, copays, and deductibles than are generally found in civilian health plans. The TRICARE fee structure for active duty and reserve personnel and their dependents is outlined in Table 3-1. Table 3-2 shows the fee structure for retirees under age 65.

Table 3-1. TRICARE Fees for Active Duty Personnel, Eligible Reservists, and Dependents

	Prime	Extra	Standard
Annual Deductible	None	\$150/individual or \$300/family for E-5 and above; \$50/\$100 under E-5	\$150/individual or \$300/family for E-5 and above; \$50/\$100 under E-5
Annual Premium	None	None	None
Civilian Outpatient Visit Cost Share	None	15% of negotiated fee	20% of allowed charges for covered services
Civilian Inpatient Admission Cost Share	None	Greater of \$25 per admission or \$14.35/day No cost for separately billed professional charges	Greater of \$25 per admission or \$14.35/day No cost for separately billed professional charges
Civilian Inpatient Behavioral Health Cost Share	None	Greater of \$25 or \$20/day No cost for separately billed professional charges	Greater of \$25 or \$20/day No cost for separately billed professional charges
Civilian Inpatient Skilled Nursing Facility Cost Share	None	Greater of \$25 per admission or \$11/day No cost for separately billed professional charges	Greater of \$25 per admission or \$11/day No cost for separately billed professional charges

As in the civilian sector, military health care costs have increased substantially in recent years. Budgetary projections for the next several years suggest that costs will continue to rise by more than 6.5 percent annually, with a large portion of that growth fueled by increased spending on military retirees. In fact, DOD estimates that care provided to retirees and their dependents will make up over 65 percent of DOD health care costs by 2015, up from 43 percent in 1999 (Figure 3-1).

Although TRICARE costs have increased substantially, DOD has not passed any of its increased expenses on to beneficiaries. Active duty personnel and their families continue to pay no premium for their TRICARE Prime health coverage, and the premiums charged to military retirees under age 65 have not changed since they were first put in place in 1996. This contrasts sharply with private sector health

Table 3-2. TRICARE Fees for Retirees Under Age 65 and Their Dependents

	Prime	Extra	Standard
Annual Deductible	None	\$150/individual or \$300/family	\$150/individual or \$300/family
Annual Premium	\$230/individual or \$460/family	None	None
Civilian Outpatient Visit Cost Share	None	20% of negotiated fee	25% of allowed charges for covered services
Civilian Inpatient Admission Cost Share	Greater of \$25 per admission or \$11/day No cost for separately billed professional charges	Lesser of \$250/day or 25% of negotiated fee, plus 20% of negotiated professional fees	Lesser of \$535/day or 25% of billed charges, plus 25% of allowed professional fees
Civilian Inpatient Behavioral Health Cost Share	\$40/day No cost for separately billed professional charges	20% of total charge plus 20% of allowable charge for separately billed professional services	Lesser of \$175/day or 25% of hospital per diem plus 25% of allowable charge for separately billed professional services
Civilian Inpatient Skilled Nursing Facility Cost Share	Greater of \$25 per admission or \$11/day	Lesser of \$250/day or 20% of negotiated fee, plus 20% of separately billed professional charges	25% of allowed charges plus 25% of allowable charges for separately billed professional services

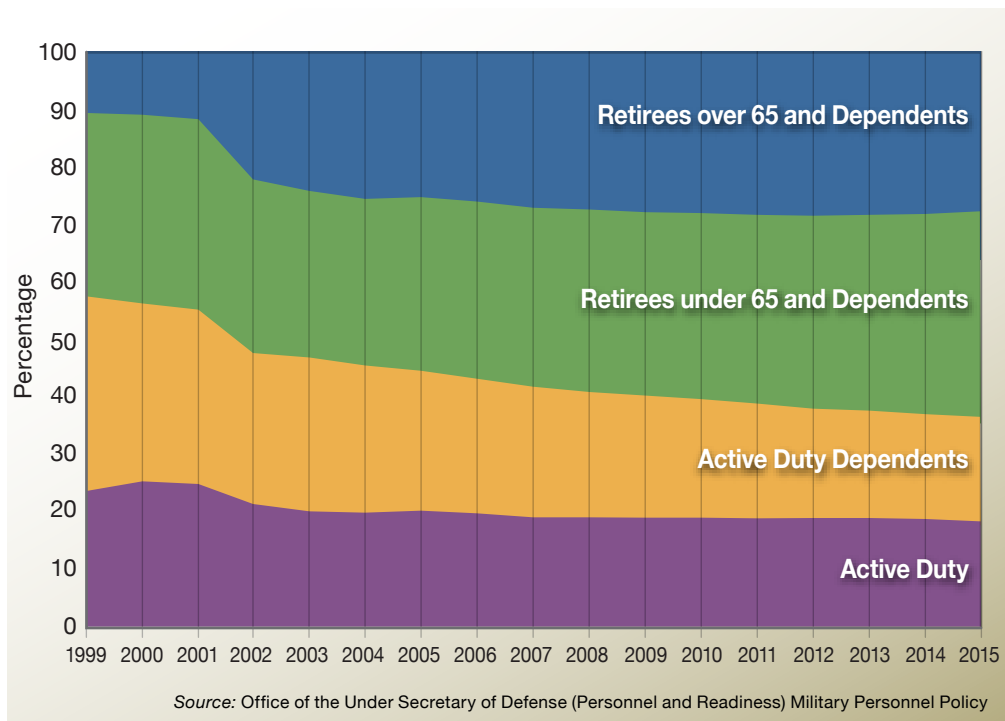


Figure 3-1. Military Health Care Costs by Beneficiary Group

plans and with the Medicare program, where individuals have seen their premium contributions increase in response to rising health costs.

Military retirees under age 65 participating in TRICARE Prime pay annual premiums of \$230 for single coverage and \$460 for family coverage.²¹ When these premium contributions were first put in place in 1996, total out of pocket expenses for retired beneficiaries (both Prime and Standard) represented 27 percent of retirees' health care costs. By 2006, however, with these same \$230 or \$460 annual contributions along with essentially the same copay structure, retiree out-of-pocket expenses equaled less than 12 percent of retirees' health care costs. Meanwhile, the cost to DOD of providing the TRICARE retiree health benefit had more than doubled, growing from \$3,727 in 1996 to \$8,967 in 2005.²²

In sharp contrast to TRICARE premiums for military retirees, employee premium contributions in the private sector have risen substantially, with single

21. There are no premium contributions for retirees under age 65 who are participating in TRICARE Extra or Standard.

22. Data provided by the Office of the Assistant Secretary of Defense for Health Affairs.

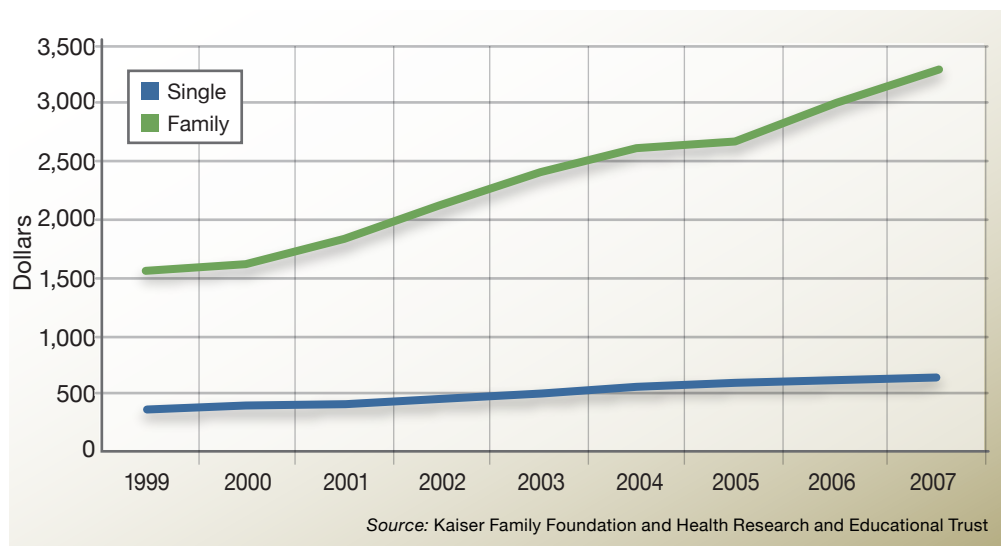


Figure 3-2. Average Annual Worker Premium Contributions for Single and Family Coverage

coverage contributions growing from \$324 in 1999 to \$694 in 2007, and family coverage increasing from \$1,548 to \$3,281 (Figure 3-2).²³ This represents a 114 percent increase for single coverage and a 112 percent increase for family coverage. As a percentage of total premium costs, private sector employee contributions remained virtually unchanged, rising from 27 percent in 1999 to 28 percent in 2007.

Like private sector employees, Medicare participants have also faced rising premium costs, with Part B rates for lower income participants increasing by 87 percent between 2001 and 2007. (As a percentage of Part B premium costs, Medicare beneficiaries' contributions have remained constant, required by law to equal 25 percent of total premium costs from 2001 to 2006.) In order to participate in TRICARE for Life, military retirees age 65 and over must pay Medicare Part B premiums, so they have faced the same substantial premium increases as civilian Medicare participants. In contrast, younger military retirees, who typically have higher income than their older counterparts, have continued to pay 1996 premium rates over the entire period.

Figure 3-3 shows the dramatic rise in Medicare Part B premiums faced by civilians and by military retirees age 65 and older over the last eight years, with

23. Kaiser Family Foundation and Health Research and Educational Trust, *Employer Health Benefits: 2007 Annual Survey*, September 2007.

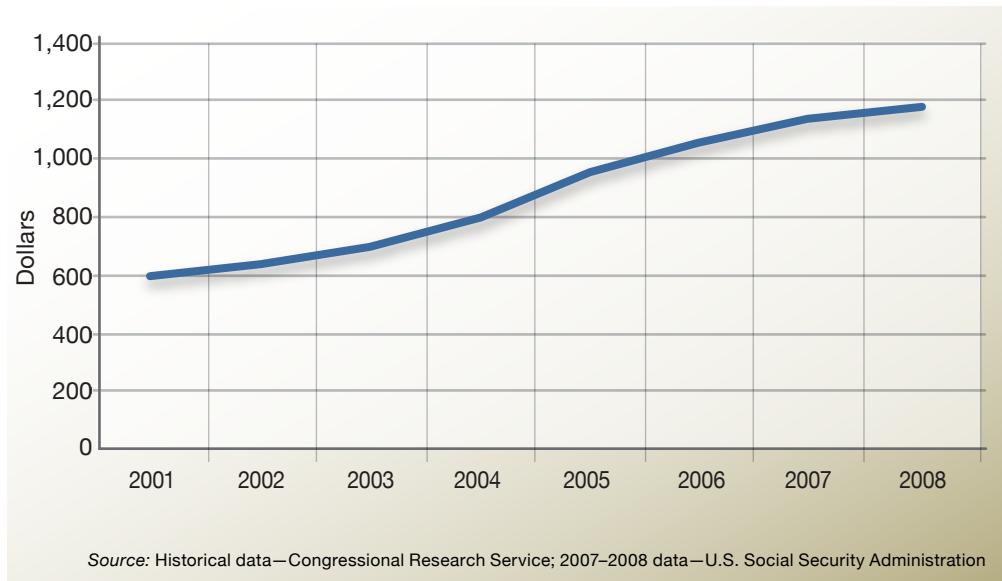


Figure 3-3. Medicare Part B Premiums, Single Rates

premiums for individuals increasing from \$600 in 2001 to a minimum of \$1,157 in 2008, depending on beneficiary income.²⁴

Since 2007, higher income individuals have faced even larger Part B Medicare payments, as the Medicare program began its transition to an income-based premium. While most beneficiaries will continue to pay 25 percent of Part B costs under the new system, by 2009 higher income beneficiaries will be expected to pay 35 percent, 50 percent, 65 percent, or 80 percent of total Part B costs, based on their modified adjusted gross income—a combination of adjusted gross (taxable) income and tax-exempt interest income. Medicare estimates that only 4 to 5 percent of beneficiaries will face higher premiums resulting from the new income brackets, as income levels for most beneficiaries place them within the 25 percent pay category. (Table 3-3 displays 2007 and 2008 premiums for single participants by income bracket.)

Hence, not only are Medicare participants expected to bear a proportionate share of their rising health care costs, but those individuals with higher incomes are expected to pay more than their lower income counterparts. Such income-based

24. In Figure 3-3, the 2007 and 2008 amounts reflect premium levels for participants in the lowest income bracket. In 2007, the lowest brackets were \$80,000 and below modified adjusted gross income for singles, \$160,000 and below for couples. In 2008, \$82,000 and below for singles and \$164,000 and below for couples.

Table 3-3. Medicare Part B Premiums for Singles by Income Bracket

2007		2008	
Modified Adjusted Gross Income	Premium	Modified Adjusted Gross Income	Premium
\$80,000 and below	\$1,122	\$82,000 and below	\$1,157
\$80,001–100,000	1,297	\$82,001–102,000	1,466
\$100,001–150,000	1,493	\$102,001–153,000	1,931
\$150,001–200,000	1,715	\$153,001–205,000	2,396
above \$200,000	1,937	above \$205,000	2,861

premiums are also becoming more common in employer-sponsored health insurance offered by large private sector employers (those with over 5,000 employees). Yet among military retirees, the trend is reversed, as younger retirees with higher incomes pay considerably smaller premiums than lower income, older retirees.

In addition to premium contributions, other out-of-pocket TRICARE costs have also remain fixed or been reduced over the last several years. There is no annual deductible for participants in TRICARE Prime (HMO), while the deductibles for Extra (PPO) and Standard (POS) are \$150 for an individual and \$300 for a family. These rates are substantially lower than those charged in private sector plans, where annual deductibles for single coverage average \$401 in an HMO, \$461 in a PPO, and \$621 in a POS. However, the 66 percent of covered workers enrolled in PPOs do not have to meet the deductible before preventive care is covered. In addition to these deductibles, many workers have separate deductibles for hospitalization.

49

Concerns with the Current System

Maintaining a quality military health care system is essential—both to force readiness and as a highly valued element of compensation. Since the creation of the TRICARE program a decade ago, the health care benefit has continued to improve and expand, along with program costs. The costs of providing care to military retirees, in particular, have increased substantially.

Figure 3-4 shows past and projected military health care expenditures from 1980 to 2025. The chart also shows how the composition of health care spending has changed and projects how health care resources will be spent in the future. While TRICARE has resulted in an improved and expanded military health care benefit, the cost-control aspects of the system have lost much of their effectiveness, and

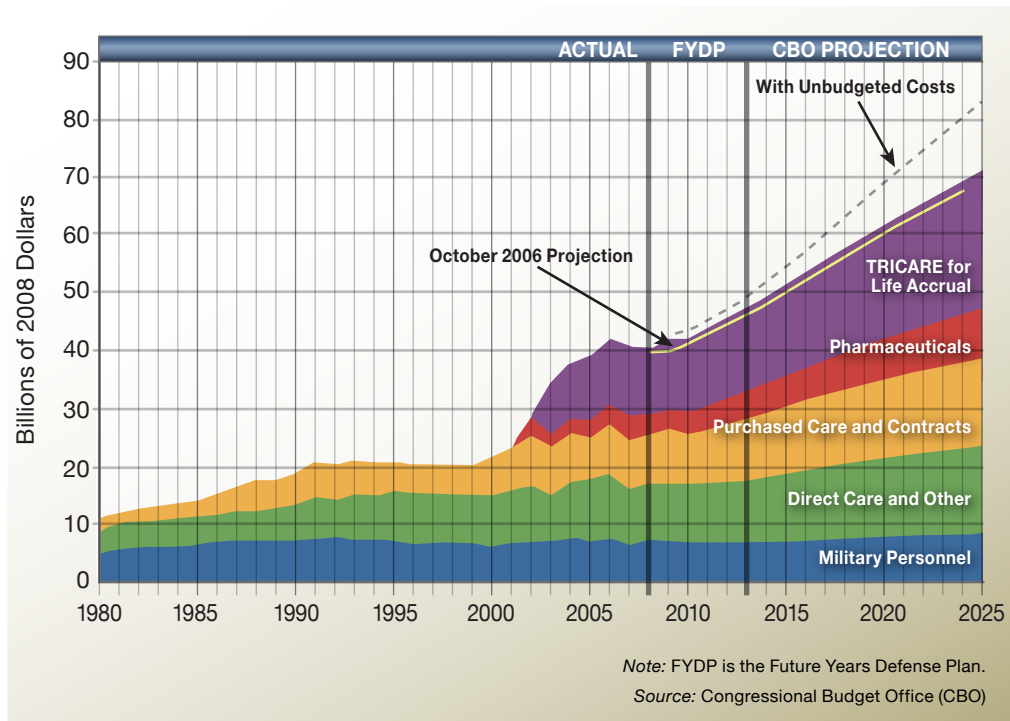


Figure 3-4. Military Medical System Costs

DOD expenditures on civilian sector health care have skyrocketed. Between fiscal years 2001 and 2006, for example, the cost of care provided at military treatment facilities grew by an average of 4.8 percent per year. Over the same period, the cost of DOD-purchased care in the civilian sector rose an average of 18.1 percent per year.

Cost increases are projected to continue for the foreseeable future. Between 2008 and 2015, total military health costs are expected to rise another 60 percent, growing from \$40.6 billion to \$64.4 billion. Yet little of this substantial cost increase results from providing health care to military personnel. As Figure 3-4 shows, health care costs for military personnel are forecasted to remain relatively stable over the 2008–2025 period.

Many factors have contributed to the substantial rise in purchased care costs, including the increased number of mobilized reservists now utilizing military treatment facilities, which has pushed dependents and retirees out of MTFs and into the civilian health care market.

In addition, the number of military retirees using TRICARE continues to grow. In fact, one of the key factors driving the growth in purchased care expenditures has been the decision by many retirees with other health insurance to switch to

TRICARE. Given the substantially lower premium costs charged to younger retirees under TRICARE, it is not surprising that increasing numbers are choosing military health insurance over other insurance options. In fact, between 2002 and 2005, the portion of eligible retirees and dependents who utilized TRICARE grew from 66 percent to 75 percent. In 2002, 72 percent of those retirees had access to civilian employer health insurance.²⁵

With the TRICARE premium for younger military retirees frozen at 1996 levels, and civilian premium rates continuing to increase in response to rising health care costs, the premium gap between TRICARE and civilian plans will continue to grow, making TRICARE even less expensive—and more attractive—relative to civilian health care options.

Also contributing to rising costs is the fact that, as currently structured, the military health care system does little to encourage users to select the most cost-effective options for their health care. For example, although prescription drugs purchased from MTFs or via mail order cost DOD substantially less than drugs purchased at retail pharmacies, the copays for drugs purchased at retail pharmacies are not significantly higher than the copays for the less expensive MTF and mail order options. Hence, with little incentive for beneficiaries to choose the lower-cost outlets, they often choose the retail pharmacy option, resulting in much higher costs to the government. As Figure 3-4 shows, the Congressional Budget Office estimates that the portion of TRICARE dollars spent on pharmaceuticals will steadily increase over the next 15 years.

Previous Reform Efforts

Over the past several years, a number of groups have evaluated the military health benefit and explored options for curbing the program's persistent and substantial cost increases. Recommendations from these panels have often focused on using cost of living adjustments or other indices to increase the TRICARE premium for military retirees under age 65.

- **Defense Advisory Committee on Military Compensation.** In its 2006 report, the DACMC recommended that both premiums and other cost-sharing provisions for military retirees under age 65 be increased to levels more comparable to premiums and cost sharing in typical civilian employer plans. The DACMC proposal would increase the annual TRICARE Prime family premium for retirees under age 65 from \$460 to

25. Defense Advisory Committee on Military Compensation.

approximately \$2,500, a hike that DACMC predicted would substantially reduce the cost growth of the TRICARE program for retirees under age 65. In order to maintain comparability with civilian plan premiums, the committee also recommended that the TRICARE premium be increased annually, consistent with the annual cost-of-living adjustment to the military retirement annuity.

- **Task Force on the Future of Military Health Care.** Created in 2006 in response to congressional concern about the rising costs of military health costs,²⁶ the task force also recommended that the TRICARE premium be increased for military retirees under age 65—although by a smaller amount than advocated by DACMC. Specifically, the task force proposed restoring the cost-sharing relationship that existed when TRICARE was first established (about \$1,100 for a family of four, according to DACMC).²⁷ Like DACMC, the task force recommended that the premium be indexed so that the restored cost-sharing relationship would be maintained in the future.

Other task force recommendations included a small enrollment fee for TRICARE for Life beneficiaries, as well as a proposal that most fees and deductibles be “tiered,” so that those with higher retirement pay would contribute more. While the task force believed that these recommendations might improve retiree health care and increase accountability, it noted that its proposed cost-sharing changes “will at most comprise a small part of the solution to problems of DoD health care cost growth.”²⁸

- **Fiscal Year 2007 President’s Budget Proposal.** Concerned with the rising cost of military health care, in 2005 DOD developed proposals to increase beneficiary cost shares, beginning in 2007. These proposals would have increased TRICARE Prime enrollment fees, increased TRICARE Standard deductibles, instituted an enrollment fee for TRICARE Standard, and adjusted pharmacy copayments. Enrollment fees and deductible increases would have been tiered by retired rank. For example, officer family Prime enrollment fees were to rise from \$460 to \$1,400, while junior enlisted Prime enrollment fees would have risen to only \$650. Standard enrollment fees would have been set at \$560 for officers and \$280 for junior enlisted. In addition, enrollment fees and deductibles would have been indexed based on the rate of increase in the

26. Public Law 109-364 (National Defense Authorization Act for Fiscal Year 2007, section 711).

27. U.S. Department of Defense, December 2007.

28. Ibid.

Federal Employees Health Benefit plans. Retail pharmacy copays were recommended to increase to \$5 and \$15 for generic and brand name drugs (up from the current \$3 and \$9, respectively). Mail order copays for generic drugs would have been eliminated.

Despite the consensus among many of these groups that the TRICARE premium for retirees under age 65 should be increased, efforts to revise the premium have not been successful. Advocates have effectively fended off such proposals, characterizing them as attempts to cut costs by making retirees pay for DOD's inefficiencies.

Potential Program Reforms

As part of its review of the military health care system, the QRMC considered several reform initiatives. In evaluating those proposals, and developing the recommendations described below, the QRMC was guided by a set of principles designed to enhance the equity and cost-effectiveness of the current system:

- TRICARE's first priority is the care of active duty personnel and their families.
- All retiree fees should relate to the value of the plan selected.
- Fees should be fair to all retiree populations.
- Fees should reflect a beneficiary's ability to pay.
- The TRICARE system should be biased toward preventative care rather than treatment.

53

Cost Containment Initiatives

The QRMC evaluated a number of policy changes designed to encourage users of the military health care system to select more cost-efficient options.

High Deductible Health Plan. A relatively new concept that private sector employers are offering to their employees as a way to reduce health care cost growth is a high-deductible health plan (HDHP) combined with a health savings account (HSA). Designed to encourage workers to use their health care more efficiently, this program gives employees a savings account from which to pay higher annual deductibles. Employees who use health care sparingly are allowed to keep any unused dollars in the employer-funded savings account. This money carries over from year to year, and eventually can be used towards retirement.

With the growing popularity of HDHPs among large employers—22 percent of employers with over 5,000 employees now offer HDHP coverage—the QRMC evaluated whether HDHP/HSA plans could be used to manage health care for

active duty dependents and for retirees and their dependents. The QRMC's analysis revealed that government health care costs would indeed decline under this type of coverage, due to lower utilization. Total costs, however, would increase because of the substantial contributions DOD would have to make to participants' HSAs.

In fact, the QRMC found that no matter what HSA contribution level is chosen, HSA-generated cost increases will always exceed health care cost savings. For example, the QRMC estimated that a \$500 HSA contribution would increase total DOD costs by \$154 million (\$94 million for retirees and \$60 million for active duty dependents). Setting the contribution at the much higher level of \$3,000 would increase total costs to \$1.95 billion (\$1.3 billion for retirees and \$646 million for active duty dependents).

“Other Health Insurance” Subsidy. Until recently, many private sector and state government employers offered subsidies to military retirees who used TRICARE rather than their own health care plans. Essentially, these schemes allowed employers to shift onto DOD the costs of providing health care to their military retiree employees. Although Congress put a stop to this practice earlier this year, the QRMC conjectured that an “other health insurance” subsidy may be an innovative way for DOD to encourage individuals with other insurance options to opt out of TRICARE, thereby reducing DOD health care costs.

Yet here again, cost analyses revealed that DOD costs would increase under such an initiative, no matter what subsidy amount was used. Essentially, many active duty dependents and retirees who currently do not use TRICARE would nonetheless claim the subsidy, with no resulting reduction in TRICARE costs. Even a modest \$500 subsidy would cost DOD \$140 million (\$65 million for retirees and \$75 million for active duty dependents).

Buyout for Retirees Under Age 65. The QRMC also evaluated an initiative that would provide lump-sum buyouts to military retirees who agreed to use health insurance other than TRICARE until they reached age 65. For the government to realize any savings under this plan, however, the buyout payment offered to retirees would have to be less than the present value of future cost savings resulting from their nonparticipation in TRICARE. Assuming a government discount rate of 3.25 percent, a new retiree would have to have a personal discount rate above 11 percent in order to make a buyout cost effective. Research has shown that the average enlisted rate exceeds 15 percent while the officer rate is under the 11 percent threshold. Since most retirees will be unable to qualify for other employer-sponsored care which would carry them to age 65 without continuous employment to that age, this would leave those with the smallest retirement incomes at the most risk. Therefore, the QRMC does not feel that there is adequate justification to support this alternative.

TRICARE Premiums for Military Retirees

Over the past decade, health care costs have increased for all segments of the market, including private sector employees, retirees, and the military population. But while civilian employees and retirees, as well as all Medicare recipients, have been forced to share the burden of these increased costs in the form of substantially higher premiums, military retirees under age 65 who are enrolled in TRICARE are still paying the same premium they paid in 1996, despite the fact that their health care costs have increased considerably. As a result, younger military retirees' contributions to their health care costs have dropped from 27 percent in 1996 down to 12 percent today, with the Services—and the U.S. taxpayer—making up the difference.

Older military retirees, in contrast, do not fare as well as their younger counterparts. While TRICARE premiums for military retirees under age 65 have been frozen for the last 12 years, premiums paid by military retirees age 65 and older have increased dramatically, as they are required to maintain Medicare Part B in order to qualify for TRICARE for Life. Those premiums increased by over 85 percent between 2001 and 2007, and will continue to do so—due both to higher health care costs as well as to Medicare's new income-based premiums.

Yet older retirees are less likely than younger retirees to be employed. In fact, the 2003 Survey of Retired Military found that only 31 percent of military retirees age 65 and above were employed in 2002, compared to 84 percent of retirees under age 65.²⁹ And while they do receive Social Security benefits, older retirees' earnings are typically far less than the earnings of younger retirees. Hence, while Medicare and many private sector insurance plans are instituting income-based premiums, TRICARE is moving in the opposite direction, with lower income retirees, over age 65, typically paying substantially higher premiums than higher income retirees under age 65.

The QRMC finds this situation inherently inequitable—both to older retirees, who are faced with significantly higher premiums than younger, higher income retirees, as well as to lower income younger retirees, particularly those unable to work due to disabilities, who are charged the same rates as their peers with lucrative post-service employment. Moreover, absent any reforms, this situation will continue to worsen, with premium rates charged to older military retirees continuing to rise, while younger retirees continue to pay the same flat rate they paid more than a decade ago, unaffected by either health care cost increases or by retiree income levels.

29. U.S. Department of Defense, *2003 Survey of Retired Military: Overview Briefing* (Arlington, Va.: Defense Manpower Data Center, December 2005).

The QRMC believes that TRICARE fees should be fair to all retiree populations and—consistent with trends in Medicare—should cover a larger portion of health care costs and reflect beneficiaries’ ability to pay.

RECOMMENDATION

The QRMC recommends that TRICARE Prime premiums for single retirees under age 65 be set at 40 percent of the Medicare Part B premium, with the family rate set at twice the single rate, regardless of family size. TRICARE Standard/Extra premiums for single retirees should be set at 15 percent of the Part B Premium, with the family rate set at twice the single rate.

The QRMC believes that basing TRICARE premiums for younger retirees on the fees charged to TRICARE-for-Life beneficiaries would inject an element of equity into the health care system by treating all military retirees more consistently. Maintaining higher premiums for TRICARE-for-Life coverage reflects the relatively more generous nature of that program compared to TRICARE Prime, but tying the two premiums together ensures that the rate-setting systems are consistent and based on the same cost-sharing and income-based policies.

Hence, retirees under age 65, like older retirees, will begin to pay premiums that cover a larger portion of their actual health care costs and that are adjusted to reflect health care cost increases. Moreover, like other military and civilian retirees participating in Medicare, their payments will be based in part on their ability to pay. This represents a major departure from the current configuration, in which younger retirees pay substantially lower premiums than older, typically lower income, retirees.

In addition, the new TRICARE Prime premium schedule for younger retirees will reestablish the initial relationship between TRICARE Prime and Medicare Part B premiums. When TRICARE was first introduced, the premium paid by military retirees for TRICARE Prime was 41.6 percent of the single Medicare Part B premium. Figure 3-5 shows how that relationship has eroded over time, as premiums paid by older retirees escalated while those paid by younger retirees remained unchanged. Moreover, by reducing the price gap between TRICARE and civilian sector premiums, the new premium structure will reduce incentives for younger retirees with other insurance opportunities to switch to TRICARE.

Table 3-4 estimates the Part B fees that older retirees would face under Medicare’s income-based system in 2009, when that system is fully phased in. Tables 3-5 and 3-6 show the calculated 2009 TRICARE Prime and Standard/Extra premiums at

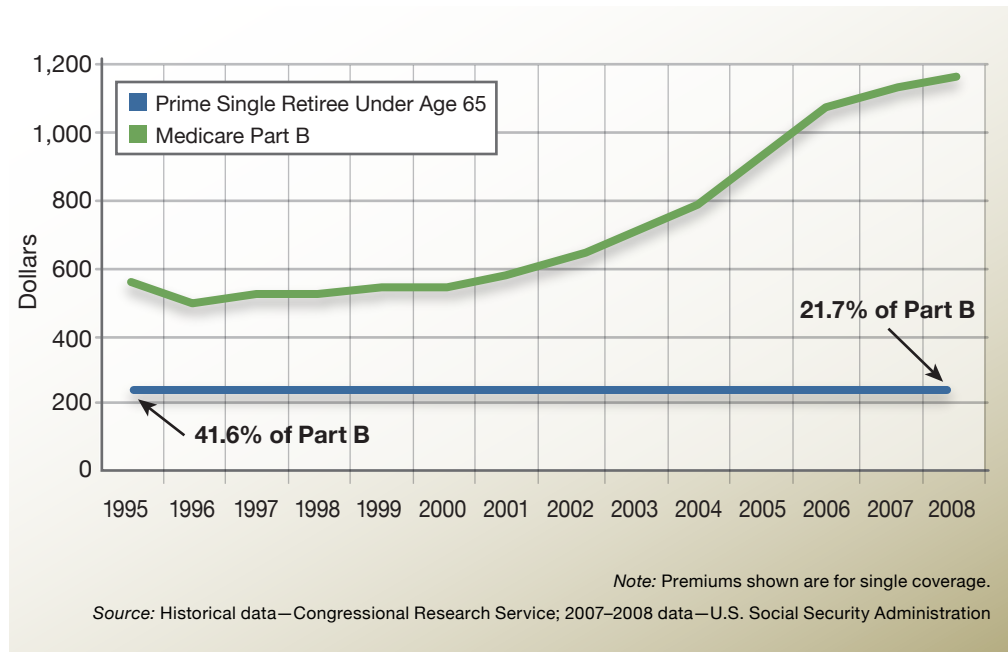


Figure 3-5. TRICARE Prime and Medicare Individual Premiums

Table 3-4. Estimated Medicare Premiums, 2009

Modified Adjusted Gross Income	Monthly Part B	Annual Part B
Individuals: \$82,000 or below Married Couples: \$164,000 or below	\$96.40	\$1,156.80
Individuals: \$82,001–102,000 Married Couples: \$164,001–204,000	135.10	1,621.20
Individuals: \$102,001–153,000 Married Couples: \$204,001–306,000	193.15	2,317.80
Individuals: \$153,001–205,000 Married Couples: \$306,001–410,000	251.35	3,016.20
Individuals: above \$205,000 Married Couples: above \$410,000	309.40	3,712.80

Note: Data based on 2008 modified adjusted gross income brackets and estimated before program cost and income level increases were calculated.

Chapter 3

Table 3-5. Annual TRICARE Prime Premiums Under QRMC Recommendation:
40 Percent of 2009 Medicare Part B Premium

Modified Adjusted Gross Income	Single Premium	Family Premium
Individuals: \$82,000 or below Married Couples: \$164,000 or below	\$462.70	\$925.40
Individuals: \$82,001–102,000 Married Couples: \$164,001–204,000	648.50	1,297.00
Individuals: \$102,001–153,000 Married Couples: \$204,001–306,000	927.10	1,854.20
Individuals: \$153,001–205,000 Married Couples: \$306,001–410,000	1,206.50	2,413.00
Individuals: above \$205,000 Married Couples: above \$410,000	1,485.10	2,970.20

Note: Data based on 2008 modified adjusted gross income brackets and estimated before program cost and income level increases were calculated.

58 >

Table 3-6. Annual TRICARE Standard/Extra Premiums Under QRMC
Recommendation: 15 percent of 2009 Medicare Part B Premium

Modified Adjusted Gross Income	Single Premium	Family Premium
Individuals: \$82,000 or below Married Couples: \$164,000 or below	\$173.50	\$347.00
Individuals: \$82,001–102,000 Married Couples: \$164,001–204,000	243.20	486.40
Individuals: \$102,001–153,000 Married Couples: \$204,001–306,000	347.70	695.40
Individuals: \$153,001–205,000 Married Couples: \$306,001–410,000	452.40	904.80
Individuals: above \$205,000 Married Couples: above \$410,000	556.90	1,113.80

Note: Data based on 2008 modified adjusted gross income brackets and estimated before program cost and income level increases were calculated.

40 and 15 percent of the estimated 2009 Medicare Part B premium. Note, however, that the 40 and 15 percent rates would not be fully phased in until 2012.

In developing this proposal, the QRMC considered recommendations proposed by other groups that would have tied TRICARE premium payments to military retirement pay rather than total income. However, retiree pay is not necessarily a good indicator of a retiree's ability to pay. Because many military retirees have additional income (typically wages from a second career), retirees with lower retirement pay are sometimes financially better off than those with higher retirement pay. Tying premiums to total income better captures a retiree's ability to pay, and also would be consistent with the definition of income used by the Medicare program. There is also a DOD precedent for using family income—the fee structure for child development centers is tied directly to family income, rather than member income.

To lessen the impact of these cost increases on retirees and their families, the QRMC recommends that the new rates be phased in over four years, with retirees paying an additional 25 percent of the increased fee (plus additional program cost growth) each year. This is similar to the transition plan used to implement Medicare's shift to income-based premiums, but would provide a four-year, rather than a three-year, phase-in period.

RECOMMENDATION

The QRMC recommends that TRICARE deductibles also be linked to Medicare rates and that copayments for preventative care be eliminated.

In addition to premium contributions, TRICARE participants face other out-of-pocket costs, including copays and deductibles. Consistent with its recommendation regarding premium contributions, the QRMC recommends that TRICARE deductibles for single retirees be set equal to the Medicare deductible (\$135 per person in 2008). Deductibles for families should be double the single rate. The QRMC recommends that other copayments remain at current levels, but advises DOD to reevaluate the suitability of those payment rates after the transition to the new Medicare-based premium is complete. The QRMC also recommends that the cap on catastrophic costs remain at current levels, but that premium contributions not count towards the cap.

Because the QRMC believes that the TRICARE system should be biased towards prevention, rather than treatment, it recommends that copays for preventative services be eliminated. Preventative care is widely acknowledged to be a cost-effective health

care investment, relying on relatively low-cost strategies to prevent illness or to detect and treat disease at an early stage, thereby reducing costs over the long term. Making preventative care available at no cost will encourage enrollees to seek out such care, improve their health status, and reduce their overall costs of care.

RECOMMENDATION

The QRMCM recommends that military retirees and dependents wishing to participate in TRICARE be required to enroll during a designated open enrollment period.

Currently any retiree wishing to utilize TRICARE can do so at any time, even if they were not previously enrolled in the military health plan. In the civilian sector, in contrast, individuals must enroll in a health care plan during a specified open enrollment period or when they first become eligible for an employer-sponsored plan. The QRMCM believes that, in this regard, participation in TRICARE should be consistent with civilian sector practices. This change would result in improved identification of the patient populations and more premium contributions from participants. It would also encourage more retirees and their dependents to obtain ongoing health coverage and care, rather than just episodic coverage.

Consistent with civilian sector plans, individuals should be allowed to enroll in TRICARE outside of the open enrollment period in the event of specified life changing events, such as marriage or the birth of a child. The QRMCM further recommends that the list of eligible life changing events for enrollment in TRICARE include loss of private insurance. For example, if a military retiree with employer-sponsored insurance is laid off, that individual would be able to enroll in TRICARE, regardless of whether the job loss occurred during an open enrollment period.

Prescription Drugs

Since 2000, the fastest growing component of military health care has been the pharmacy benefit, which has grown from \$1.6 billion in 2000 to \$6.5 billion in 2007, and now accounts for about 16 percent of the Unified Medical Budget.³⁰ TRICARE beneficiaries can fill their prescriptions at military treatment facilities, through the TRICARE mail order pharmacy, in one of the more than 58,000 retail pharmacies that participate in the TRICARE Retail Pharmacy Program, or in non-network retail pharmacies.³¹

30. U.S. Department of Defense, December 2007.

31. Ibid.

RECOMMENDATION

The QRMC recommends that prescription drug fees be set at levels that encourage beneficiaries to choose lower-cost purchasing options.

TRICARE prescription drug program costs could be reduced if more beneficiaries filled their prescriptions at MTFs or through the TRICARE mail order pharmacy. However, under TRICARE's current fee structure, there is little incentive for beneficiaries to choose these less expensive options over higher-cost retail pharmacies, since copays are quite similar for all three points of service.

In order to encourage beneficiaries to use MTF pharmacies and mail order services, the QRMC recommends that prescriptions filled at those outlets be provided to beneficiaries at much lower cost, or even at no cost. By setting mail order fees at one third of the cost of retail pharmacies for Tier 2 (preferred) and Tier 3 (non-preferred) drugs, and providing Tier 1 (generic) drugs at no cost, beneficiaries would be more likely to use the least-cost options, reducing program costs to the government as well as their own out-of-pocket expenditures.

RECOMMENDATION

The QRMC recommends that prescription drug copays under TRICARE be set at no more than two thirds of the average copayments faced by civilians at retail pharmacies. Prescriptions filled at military treatment facilities should continue to be dispensed at no cost.

Table 3-7 presents the new prescription drug fee schedule recommended by the QRMC. In 2007, the average prescription drug copayments for civilian workers were

Table 3-7. Recommended TRICARE Prescription Drug Fees

Tier	Military Treatment Facility	Mail Order 30-Day Supply ^a	In-Network 30-Day Supply
1	\$0	\$0.00	\$7.00
2	0	5.70	17.00
3	0	9.70	29.00

a. Must be purchased in 90-day supply.

\$11 for Tier 1 drugs, \$25 for Tier 2, and \$43 for Tier 3.³² The QRMC believes that fixing copayments at two thirds or less is appropriate, given the burdens of service faced by military personnel and their families.

Program Funding

TRICARE for Life and military retirement are currently funded through accrual accounts. These accounts enable decision makers to gain insight into the costs of these deferred benefits and to make appropriate decisions regarding overall personnel end strengths and the shape of the force. As we have shown, the cost of health care for retirees under age 65 is significant, yet the present funding methodology does not make these costs clear. In addition, by excluding these costs from current budgets, programs that may lower costs associated with these retirees might receive less attention than they would were the costs carried against current personnel budgets.

All significant and separable costs related to military retirees should be explicitly identified in the DOD budget. Today the budget reflects outlays required to deliver health care to retirees under age 65, but this does little to support force management. The current retired population reflects management decisions made in the past. The cost associated with treating these retirees is a fact of life and may be viewed as a cost of doing business. It makes little sense to fund the health care for older retirees using accrual accounting while using a current outlays methodology for retirees under age 65. These concerns were also raised by DACMC, which recommended financing health care for retirees under age 65 through accrual accounting.

RECOMMENDATION

The QRMC recommends financing health care for retirees under age 65 through accrual accounting.

Changing to accrual accounting would shed light on how current manning decisions affect future costs. However, should this recommendation be adopted, it is critical that a one-time adjustment be made to the DOD budget to account for the impact of this change. It is essential that other DOD accounts not be penalized in order to make this transition.

32. Kaiser Family Foundation and Health Research and Educational Trust.

TRICARE Reimbursement

One important aspect of the value of the military health care benefit is access to civilian health care providers outside the MTFs. If access to civilian providers is limited, the value of the health care benefit, and, hence, the overall compensation package, declines.

When a TRICARE-enrolled retiree or dependent receives care from a civilian health care provider, TRICARE reimburses the provider at established rates, similar to the way other health insurance pays providers. However, the rates that are reimbursed under TRICARE are, in general, much lower than those which would be paid by private insurers. Current surveys indicate that, in 2006, Medicare fees were 81 percent of the fees paid by private insurers, and the gap is widening.³³ By law, TRICARE rates are capped at Medicare reimbursement rates with some specific exceptions. In the last two years, Medicare rates have been artificially suppressed based on spending limits for Medicare. This has resulted in reticence by many providers to accept large Medicare populations, but few deny Medicare recipients entirely.

For TRICARE patients, however, the impact of lower reimbursement rates is different. Since the TRICARE population is much smaller, there is less motivation to take on these patients at the low Medicare rates. In fact, among providers who are accepting new patients while turning away TRICARE patients, the Survey of Civilian Physician Acceptance of TRICARE, conducted in fiscal year 2007, found that reimbursement rates were the most commonly cited reason for not accepting TRICARE beneficiaries. Without adequate reimbursement, there is a concern that dependents and retirees will face an ever-shrinking pool of providers willing to treat them. Particularly for the active duty and mobilized reserve populations, limited access to health care providers could have a significant negative impact on recruiting, retention, and readiness.

RECOMMENDATION

The QPMC recommends that TRICARE reimbursement rates be periodically evaluated to guarantee sufficient provider access so that appropriate care is available.

33. Medicare Payment Advisory Commission (MEDPAC), *Report to Congress: Medicare Payment Policy*, (Washington, D.C.: March 2008), Section 2B.

Currently, DOD has the authority to provide exceptions to Medicare rates and establish higher rates in those geographic areas and for those specialties where access to providers becomes and remains a problem. Where necessary, the Department should be more aggressive in exercising this authority. While Congress has acted to avoid reducing Medicare and TRICARE reimbursement rates, freezing rates creates further pressures to reduce the TRICARE patient load. The QRMC urges Congress to take action to prevent increases in the gaps between TRICARE and private sector reimbursement rates.

Health Care Professionals

Essential to the military health care system is a corps of experienced health care professionals capable of providing a full range of general and specialized care to military personnel, retirees, and their dependents. Health care professionals have many attractive and lucrative career opportunities in the private sector, and the Services have long relied on a series of recruitment and retention tools to attract and retain such individuals into military service. Some of the tools used by force managers include scholarship programs, accession bonuses, and special pays. In recent years, however, recruitment and retention of health care professionals have become more challenging, and the Services have struggled to meet their requirements for uniformed medical personnel.

With more civilians and contractors being used to provide health care services, the military has been able to reduce the number of active duty health care professionals necessary to meet Service needs. Between fiscal years 1995 and 2006, for example, the number of authorized active duty physicians dropped by 12.6 percent, authorizations for dentists declined by 18 percent, and nurse authorizations decreased by 15.6 percent.

Yet these lower authorization targets have not enabled the Services to meet their health care professional requirements. In fact, actual inventories of health care

Table 3-8. Inventories and Authorizations of Active Duty Physicians, Dentists, and Nurses, Fiscal Year 2006

	Authorization	Inventory	Fill Rate
Physicians	11,594	11,417	98.4%
Dentists	3,291	2,932	89.1
Nurses	10,284	9,353	90.9

Source: Health Manpower Personnel Data System

professionals have dropped even more sharply than authorized billets. Over the same 1996–2006 time frame, for example, the number of physicians dropped by 13.8 percent, dentists by 20.7 percent, and nurses by 24.3 percent. These declines have resulted in shortages in all three professional areas (Table 3-8).

Concerned with these trends, Congress included language in the National Defense Authorization Act of 2007 charging the QRMCM with “careful examination of compensation issues pertaining to the uniformed medical personnel of the Department of Defense.” This section reviews the current inventory of physicians, dentists, and nurses in the uniformed services, explores the underlying causes for the challenges facing the military in each of these professional groups, and evaluates the effectiveness of existing recruitment and retention tools to meet force needs. Based on these analyses, the QRMCM proposes several recommendations designed to improve the effectiveness and efficiency of current recruitment and retention efforts.

Current Status of Health Care Professionals

As shown above, it is becoming more and more difficult for the uniformed services to fill health professional slots, despite increased reliance on civilian health care resources to meet some medical needs. The extent of the problem varies somewhat across the three professional groups, with the “fill rate” for physicians somewhat higher than fill rates for either dentists or nurses. Yet all three groups are experiencing significant shortages in a range of critical specialties.

- **Physicians.** In aggregate, inventories for military physicians are not significantly below authorized levels, with fiscal year 2006 inventories at 98 percent of authorizations. Several physician specialties, however, are experiencing significant shortfalls, as the following fill rates indicate: general medicine (85 percent), radiology (87 percent), family practice (95 percent), psychiatry (86 percent), anesthesia (92 percent), and gastroenterology (87 percent).³⁴

Participation rates in the military’s Health Professionals Scholarship Program have also been dropping. In fiscal year 2006, the Army was able to award only 84 percent of its available scholarships (down from 100 percent in 2004), while the Navy filled only 66 percent of its scholarships (down from 84 percent in 2004). Only the Air Force was able to fill all of its scholarship slots. Because of the long training period for physicians,

34. U.S. Department of Defense, *Report on Department of Defense Military Medical Recruiting & Retention* (Washington, D.C.: Assistant Secretary of Defense for Health Affairs, June 2007).

the reduced participation in the scholarship programs will not have an immediate impact on physician inventories. However, when these medical students enter military service starting in 2010, their smaller numbers will exacerbate the existing shortages.

- **Dentists.** Maintaining sufficient numbers of dentists to meet requirements has been a long-standing problem for the uniformed services. Despite recent declines in the number of billets for dentists, the fill rate is still only 89 percent. Over three quarters of the shortages are in the area of general dentistry, which has a fill rate of only 82 percent, and is short nearly 300 dentists. As with the physician population, both the Army and Navy are also having problems filling their scholarship slots for dental students, awarding only about two thirds of available scholarships in 2006.
- **Nurses.** Over 10,000 nursing billets are authorized across the force. The Services began having problems filling their nursing billets in fiscal year 2001, when only 96 percent of authorized billets were filled. Since that time, the size of the shortfall has grown; by fiscal year 2006 the fill rate dropped to 91 percent, a shortage of 817 nurses. Recruiting problems have been a large factor in this decline. In 2005, for example, DOD successfully recruited only 738 nurses (76 percent of its goal).

Generally, the nursing shortages are spread fairly evenly among the Army, Navy, and Air Force. Specialties facing the biggest shortages include critical care nurse (85 percent fill rate), general nurse (94 percent), operating room nurse (87 percent), nurse anesthetist (82 percent), and flight nurse (55 percent).

Reasons Underlying Current Challenges

A number of factors are contributing to the current shortages of military health care professionals. Some of these issues affect one occupational area more than the others; while other factors are more generic, influencing all health professions. In aggregate, however, it is clear that the Services are finding it increasingly difficult to meet their recruitment and retention goals. Moreover, many of the recruiting and retention tools that have worked in the past have become less effective.

Increased Competition

Part of the current problems facing military force managers is the high demand for health professionals in the civilian market. The U.S. population is expanding and

aging—both trends that increase the demand for health care services. Many of the challenges facing the Services are similar to those confronting health care providers in the civilian sector who are trying to meet the growing demand for medical services. As of late 2005, for example, the vacancy rate for registered nurses in civilian hospitals was 8.5 percent, fairly consistent with the 8 percent vacancy rate in DOD nursing billets in fiscal year 2006.^{35, 36} Military concerns about physician shortages are also a concern in the civilian sector, with the Association of American Medical Colleges calling for a 30 percent increase in medical school capacity by 2015 to help meet growing demand for health care services.³⁷

With increased civilian sector demand, competition for health professionals has intensified. Today, both physicians and dentists can command much higher salaries in the civilian sector than they can earn in the military. This is especially true for specialists. For example, a 2007 survey of physician compensation found that, on average, family practice doctors earn \$185,740 per year, while specialists such as dermatologists and cardiac and thoracic surgeons earn \$316,473 and \$460,000, respectively. Annual compensation for neurosurgeons—which had a 2006 fill rate of 93 percent—averages \$530,000.³⁸ Dentists can also receive substantial compensation in the civilian sector. In 2005, the average net income among independent private practice owners was \$198,350 for a general practitioner and \$304,020 for a specialist.³⁹

In many instances, military compensation simply cannot compete with civilian compensation levels. Depending on their specialty and the length of their service obligation, military physicians can receive extra Special and Incentive pays amounting to over \$100,000 per year. In fact, special pays have traditionally been the largest single component of cash pay for health professionals. Yet despite this substantial supplementary pay, many experienced specialists can earn more in the civilian sector, making it difficult for the Services to retain such professionals.

35. American Hospital Association, “The State of America’s Hospitals,” *Chartbook*, April 2006.

36. Rich Franco, *Medical Manpower and Personnel Update*, Briefing to Medical Personnel Committee, February 2007.

37. Paul Hogan, *Adequacy of Future Physician Supply*, Conference on Providing the Health Benefit: Issues for the 10th Quadrennial Review of Military Compensation, December 14, 2006.

38. Cejka Search, *2007 American Medical Group Association Physician Compensation Survey*. http://www.cejkasearch.com/compensation/amga_physician_compensation_survey.htm. Accessed May 2, 2008. The data are believed to be representative of large multi-specialty group practices.

39. American Dental Association, *Survey and Economic Research on Dentistry: Frequently Asked Questions*. <http://www.ada.org/ada/prod/survey/faq.asp>. Accessed May 4, 2008.

Military dentists are also eligible for additional pays of up to \$82,000 per year. As with physicians, military dentists who are specialists can receive significantly higher pay than general dentists. But because only a small number of dentists are chosen for specialty training, most military dentists are general dentists, earning substantially less than what they could earn as specialists in the civilian marketplace.⁴⁰ With relatively little additional training, those general dentists can command significantly higher earnings in the civilian sector as cosmetic dentistry specialists. Given the growing availability of such lucrative civilian sector opportunities, retention among general dentists is becoming increasingly difficult. As the Assistant Secretary of Defense for Health Affairs noted in a 2007 report to Congress:

In Fiscal Year (FY) 2005, only 40 percent of dental officers remained on active duty after the first decision point, down from 60 percent in 2001. Most of these officers leave military service due to high dental education debt and the large inequity in pay when compared to civilian dentists.⁴¹

Faced with increased difficulties filling its physician and dentist billets, DOD has requested additional authority to increase several specific Special and Incentive pays for those occupational groups.

68 >

Further exacerbating the disparity between civilian and military compensation has been the fact that many of the special pays available to health professionals were categorically restrained, limiting force managers' ability to design the most effective compensation packages to attract and retain military health professionals. However, the National Defense Authorization Act for 2008 included the QRMC proposal to consolidate existing Special and Incentive pays into several broad categories, providing the Services with more flexibility to design pays to better meet force management needs. This legislative change will enable the Services to increase and tailor special pays so that military compensation paid to health care professionals is more competitive with compensation available to such professionals in the civilian sector.

Work Environment

Some military leaders believe that pay comparability is not as important as other factors, such as the work environment, in retaining health care professionals. In fact, in its 2007 report to Congress on military medical recruiting and retention, the Department recommended that "working conditions, when possible, should be comparable to the civilian sector."⁴²

40. Ibid. The American Dental Association estimates that in 2005 more than 20 percent of dentists were specialists.

41. U.S. Department of Defense, June 2007.

42. Ibid.

In some areas, the work environment for military health professionals may compare unfavorably to conditions enjoyed by their civilian counterparts. Civilian doctors, for example, work with the latest equipment, and may have more control over their working conditions than do military doctors. Civilian medical professionals may also face fewer administrative responsibilities than their military counterparts, with many of those duties performed by support staff in the civilian sector. Administrative tasks that reduce the time health professionals can spend on patient care can be frustrating. For example, medical professionals returning from deployments in the Middle East have complained of paperwork demands that interfered with patient care.

In addition, military health professionals may have fewer or less attractive opportunities for professional development than are available to practitioners in the civilian sector. However, the Services do offer a wide array of such programs, including fellowships, access to professional conferences, and continuing education in order to retain licensure. Further, as commissioned officers, military health professionals have access to all of the professional development programs typically available to officers.⁴³

In the last few years, working conditions for many military health professionals have also been affected by deployment in support of the Global War on Terror. Even those who have not deployed face increased workloads as they fill in for colleagues who are deployed. However, there is no systematic data available on how the war is affecting recruitment and retention of health professionals into the military.

Changing Demographics

Changing demographics of medical and dental schools students—and thus future physicians and dentists—also create challenges for the military. Today, over 60 percent of medical students come from families with incomes in the top 20 percent nationwide. Given their families' financial resources, such students may have limited need for the scholarships that the military offers to medical students in exchange for service commitments. Even those medical and dental students with less family financial support have ready access to low interest private sector loans to help finance their postgraduate education.⁴⁴

In addition, an increasing percentage of medical and dental students are women, who are less likely than men to join the military. In 2007, women made up 48.3 percent of first year medical students.⁴⁵ At dental schools, 44.3 percent of students,

43. Ibid.

44. Ibid.

45. Association of American Medical Colleges. <http://www.aamc.org/data/facts/2007/2007school.htm>. Accessed May 4, 2008.

during the 2006–2007 school year, were female.⁴⁶ The percentage of medical students who are not U.S. citizens is also on the rise. This population is generally ineligible for service, as current law requires that military officers be U.S. citizens or individuals who have been lawfully admitted to the United States for permanent residence. Non-U.S. citizens may also face barriers getting security clearances.⁴⁷

Recruitment and Retention Tools

The Services use several recruitment and retention incentives to attract and retain health care professionals into the military, including scholarship programs, accession bonuses, and special pays.

Financial Assistance for Education

DOD offers a variety of programs to help medical professionals finance their education, including the Armed Forces Health Professionals Scholarship Program (HPSP), the Financial Assistance Program (FAP), and the Health Professions Loan Repayment Program (HPLRP). These programs are the largest source of physician and dentist accessions into the military—approximately 80 percent of physician accessions and 75 percent of dental accessions come from the HPSP and FAP.⁴⁸

70 >

- **Armed Forces Health Professionals Scholarship Program.** In terms of recruiting physicians and dentists, this is the most widely used program, with 2007 spending totaling \$169 million.⁴⁹ The HPSP targets individuals entering medical or dental school, paying tuition, books, fees, and a \$1,300 monthly stipend in exchange for a commitment to military service—typically four years for physicians and dentists. After finishing medical school, physicians participating in the HPSP enter the military, where they begin their residency training. With no residency requirements, graduating dentists enter the service as general dentists.⁵⁰
- **Financial Assistance Program.** The military also offers a Financial Assistance Program for graduate medical and dental education. Under this program, residents receive an annual grant and stipend to supplement

46. American Dental Association.

47. U.S. Department of Defense, June 2007.

48. Approximately 15 percent of HPSP/FAP participants attend the military's own medical school, the Uniformed Services University of the Health Sciences; the rest attend civilian medical schools.

49. Nurse anesthetists are also eligible for the HPSP.

50. As discussed earlier, after three or four years of service, a small portion of military dentists are selected for specialty training; however, most continue as general dentists.

their residency program earnings. All residents receive the same annual stipend amount—about \$45,000 in 2007—regardless of their specialty. Hence, doctors training to become neurosurgeons receive the same stipend as those specializing in pediatrics. FAP is typically a two- or three-year program, with participants obligated to serve one year more than the program length.⁵¹ Fiscal year 2007 funding for the FAP program totaled approximately \$6.5 million.

- **Health Professions Loan Repayment Program.** Health professionals who have finished their schooling are eligible for the HPLRP. Under this program, military physicians and dentists can receive up to \$60,000 per year to repay educational loans, while nurses are eligible for \$29,000 in loan repayment benefits. In 2007, HPLRP costs totaled \$12.8 million.

The costs of producing a military physician or dentist through the HPSP and/or FAP programs vary, depending on a student's choice of specialty, differences in school tuition rates, and other factors. One 2006 study estimated that average 2005 costs to educate military doctors ranged from \$627,000 for family practitioners to \$1.1 million for neurosurgeons.⁵² In terms of military dentists, a 2002 study estimated a four-year HPSP dental scholarship costs the Services an average of \$274,000.⁵³

Despite the substantial financial assistance available to medical and dental students under the HPSP, the program is attracting fewer recruits. In fiscal year 2006, for example, only the Air Force met its HPSP targets. The Army awarded only 84 percent of its physician scholarships, while the Navy filled just 66 percent of its slots. Scholarship slots for dental students were only about two thirds full in both Services. In an effort to improve participation, Congress recently created a \$20,000 accession bonus for students entering the HPSP.

In part, the problems with the HPSP program reflect the changing demographics of health professionals that were discussed earlier, including the growing proportion of female doctors and dentists, the financial independence of many students, and the growing number of noncitizens attending U.S. medical schools.

-
51. Conference on Providing the Health Benefit: Issues for the 10th Quadrennial Review of Military Compensation.
 52. Robert Levy, *Using Cash for Medical Accessions*, Conference on Providing the Health Benefit: Issues for the 10th Quadrennial Review of Military Compensation.
 53. Robert A. Levy, Richard D. Miller, and Pamela Shayne Brannman, *Health Professionals' Retention and Incentive Study (Phases II and III)*, CRM D00004460.A5 (Alexandria, Va.: Center for Naval Analyses, January 2002).

Yet some of the declining interest in the military's scholarship programs may result from weaknesses in the programs themselves. For instance, HPSP students have only limited access to the military's health care system, receiving medical or dental care only for the 45 days per year that they are on active duty. For the remainder of the year they must rely on whatever health care is offered through their schools (which rarely includes coverage for family members). Further, while the costs of financing the education of a medical or dental student are substantial, many students still struggle to make ends meet, particularly in areas where the cost of living is high. Moreover, HPSP does not cover the costs of much of the program-related equipment that students are required to purchase, such as computers.

While these education programs are by far the largest source of physician and dental accessions into the military, it takes several years for scholarship dollars invested in a medical or dental student to produce an active duty physician or dentist. Moreover, the HPSP does not restrict the choice of specialty among participating students; nor does it require students to declare their area of specialization. Because of this, the Services have no way of predicting what the specialty mix will be among each class of matriculating HPSP medical students, nor whether the class will produce the specific types of specialists needed to meet force requirements and address critical shortages.

72 >

Special and Incentive Pays

As discussed earlier, health care professionals can often command significantly higher salaries in the civilian sector than are available to them in the military. To remain competitive with lucrative civilian sector compensation, the Services offer a variety of Special and Incentive pays designed to attract and retain health professionals into military service. These pays have been the largest single component of cash pay for health professionals.

Retention Incentives. Table 3-9 lists the special pays that the Services use to retain health professionals in the military. With the recruiting market for health professionals becoming increasingly challenging, retention tools such as these special pays are critically important to maintaining sufficient inventories of physicians, dentists, and nurses.

As the lists show, pays often vary based on years of service, years of obligation, or area of specialization, but in aggregate can supplement military pay by substantial amounts—for example, by more than \$100,000 annually for some physicians.⁵⁴

54. Rich Franco, *Medical Manpower and Personnel Update*. Note that Special and Incentive pays amounts are not included in the calculation of retirement pay.

Table 3-9. Special and Incentive Retention Pays

Physicians	
Board Certified Pay	An annual entitlement of \$2,500 to 6,000 (paid monthly), based on years of service
Variable Special Pay	An annual entitlement of \$1,200 to 12,000 (paid monthly) based on years of service
Additional Special Pay	An annual bonus of \$15,000 for each year of obligation
Multiyear Special Pay	Annual bonus of \$12,000 to 50,000, based on specialty and years of obligation (up to four years)
Incentive Special Pay	Annual bonus of \$12,000 to 50,000, based on specialty and years of obligation (up to four years)
Dentists	
Board Certified Pay	An annual entitlement of \$2,500 to 6,000 (paid monthly), based on years of service
Variable Special Pay	An annual entitlement of \$3,000 to 12,000 (paid monthly), based on years of service
Additional Special Pay	An annual bonus of \$4,000 to 15,000 based on years of service
Dental Officer Retention Bonus	An annual bonus of \$13,000 to 50,000 based on specialty and years of obligation (up to four years)
Oral Surgeon Incentive Special Pay	An annual bonus of \$25,000 for each year of obligation (up to four years)
Nurses	
NPHCP Board Certification Pay	An annual payment of \$2,000 to 5,000 per year to board certified Non-Physician Health Care Providers (NPHCP)
CRNA Incentive Programs	Incentive pay of \$20,000 to 40,000 per year, based on years of service, for Certified Registered Nurse Anesthetists (CRNA)

Source: Conference on Providing the Health Benefit

Even these large pays, however, do not result in civilian pay comparability for all specialties, which affects retention of health care professionals.

In response to increased competition from the civilian sector, Congress raised the level of some special pays in fiscal year 2007. Likewise, DOD requested authority for fiscal year 2008 to increase the maximum payments for several Special

and Incentive pays, including Incentive Special Pay and Multiyear Special Pay for physicians. In its *Report on Department of Defense Military Medical Recruiting & Retention*, the Department also requested an increase in Dental Officers' Additional Special Pay.⁵⁵

Recruitment Incentives. Special and Incentive pays are also available to recruit health professionals into military service. An accession bonus of \$25,000 is provided to nurses who commit to a four-year service obligation, while nurses who participate in the HPLRP may receive an \$8,000 accession bonus.

Although the vast majority of physicians and dentists recruited into the military come from the military's education assistance programs, the Services also offer accession bonuses to physicians and dentists. In fact, the fiscal year 2007 National Defense Authorization Act increased the maximum accession bonus available to fully trained medical personnel in critically short wartime specialties to \$400,000. Accession bonuses for fully trained dentists were also increased, to \$200,000 for general dentists and \$400,000 for specialists.⁵⁶

74 > With the HPSP and FAP attracting fewer new recruits, and a number of critical physician and dental specialties currently in short supply, accessions of qualified professionals—as opposed to students—offer some advantages over the educational assistance programs. For example, because it takes several years before medical and dental students recruited through HPSP and FAP are available to fill physician and dental billets, these new recruits do not help the Services address their current health professional shortages. Moreover, since medical students participating in HPSP have not yet committed to particular specialties, the Services have no way of knowing whether new HPSP recruits will specialize in those areas where they are experiencing shortages.

In contrast, offering accession bonuses to dentists and medical residents allows the military to attract general dentists and physicians who have committed to residencies in specialties where the military is currently experiencing shortages. In doing so, the lag time before these recruits can begin practicing is much shorter. For example, newly recruited dentists begin providing care immediately, four years earlier than dental students recruited through the HPSP program.

Moreover, accession bonuses may also be less expensive than scholarship programs. A recent study found that the bonuses the military would have to offer

55. U.S. Department of Defense, June 2007.

56. Rich Franco, *Medical Manpower and Personnel Update*.

medical residents to enter military service in a specific specialty where the military was short were typically less than the costs of financing those individuals' medical school and residency program expenses through the HPSP and FAP. The study estimated, for example, that using an accession bonus to recruit a medical resident specializing in anesthesiology would cost \$233,000 less than it would cost to train an anesthesiologist through the HPSP and FAP, even after adjusting for the fact that direct accessions tend to leave military service earlier than those who enter through the HPSP.⁵⁷ Similarly, a 2002 analysis found that the military could attract fully trained general dentists into the military with accession bonuses of \$250,000—which is \$25,000 less than the average cost of a four-year HPSP dental scholarship.⁵⁸

New Flexibility in Special Pays. Traditionally, the levels of Special and Incentive pays have been set in statute. However, the QRMC recommendation included in the 2008 National Defense Authorization Act will change the way that the Services manage special pays. Specifically, the new law consolidates the more than 60 pays that exist today into eight broad categories. One of these categories is the Health Professions Officer Force Management Pay, which will subsume the two dozen pays that the Services now use to manage the recruitment and retention of physicians, dentists, and nurses. Within this broad category, the Services will have the flexibility to boost special pay amounts and to structure the pays in a way that maximizes their effectiveness in promoting recruitment and retention of health care professionals. They will also be able to target resources to critical specialty areas, particularly those that are experiencing shortages.

75

Recommendations

Increased competition from the private sector, changing demographics, and working conditions in the military have all contributed to challenges in recruiting and retention of health care professionals. The QRMC developed a series of recommendations designed to respond to these factors and aid the uniformed services in filling requirements for personnel in these fields.

Health Professionals Scholarship Program

HPSP has long been the most widely used recruitment tool for health professionals, covering the cost of medical or dental school education in exchange for

57. Robert A. Levy, Eric W. Christensen, and Senanu Asamoah, *Raising the Bonus and the Prospects for DOD's Attracting Fully Trained Medical Personnel*, CRM D0013237.A2 (Alexandria, Va.: Center for Naval Analyses, February 2006).

58. Robert A. Levy, Richard D. Miller, and Pamela Shayne Brannman.

a commitment to military service. Yet today, the Services are struggling to fill their HPSP slots. In part, declining interest in the military scholarship program reflects the factors outlined above. But the QRMC also identified a number of problems with the HPSP program itself that may discourage participation. The QRMC believes that the recommendations outlined below will rectify these programmatic issues and make the HPSP more attractive to medical and dental students considering military service.

RECOMMENDATION

The QRMC recommends that HPSP participants be given access to TRICARE Reserve Select, or, if coming directly from active duty, be allowed to retain their active duty TRICARE coverage.

As discussed earlier, HPSP students have only limited access to the military's health care system, receiving medical or dental care only for the 45 days per year that they are on active duty. For the remainder of the year they must rely on whatever health care is offered through their schools (which rarely includes coverage for family members).

76 >

Health care coverage, particularly family coverage, is expensive, and difficult for HPSP students to afford on their monthly stipend. Allowing HPSP students and their families to participate in TRICARE would ensure that they have access to affordable health care while attending medical or dental school, and would increase the value of the HPSP benefit. To that end, the QRMC recommends that HPSP students be allowed to enroll in TRICARE Reserve Select when not on active duty.

Established in fiscal year 2008, TRICARE Reserve Select allows drilling reservists in the Selected Reserve to purchase health coverage that is similar to the coverage provided through TRICARE Standard and TRICARE Extra. Participants pay a premium set at 28 percent of cost, with the federal government covering the remaining 72 percent.⁵⁹ The QRMC recommends that statutory eligibility for TRICARE Reserve Select be expanded to include HPSP students who are not on active duty, as well as their dependents.

The QRMC also recommends that existing military personnel who enter the HPSP be allowed to retain their current TRICARE coverage. As the Services try to expand the pool of potential participants in the HPSP, current military personnel

59. Rod Powers, "What Congress Has in Store for You in 2007," About.com: U.S. Military, December 15, 2006. http://usmilitary.about.com/od/payandbenefits/a/07paychanges_3.htm. Accessed May 15, 2008.

are a promising group. However, asking personnel to give up their generous military health benefit in order to participate could be a significant disincentive.

RECOMMENDATION

The QRMC recommends providing a Basic Allowance for Housing (BAH) to HPSP students.

While the costs of financing the education of a medical or dental student are substantial, many students still struggle to make ends meet, particularly in areas where the cost of living is high. The QRMC believes that, like their active duty counterparts, HPSP students should receive a housing allowance. The actual payment should be a percentage of the O-1 BAH rate that is equal to the percentage of O-1 pay that HPSP participants receive as a stipend (currently 75 percent). These additional payments will make it easier for HPSP students to cover their living expenses and will further enhance the value of the HPSP benefit.

RECOMMENDATION

The QRMC recommends that the HPSP cover the costs of all required equipment at medical and dental schools.

Medical schools frequently require students to purchase program-related equipment, such as computers. The HPSP, however, typically does not cover the costs of such materials. In fact, the only equipment costs currently paid for by the program are microscopes. If students are required to purchase equipment as part of the curriculum, the cost of that equipment should be covered by HPSP, just as the program now covers the cost of books.

RECOMMENDATION

The QRMC recommends that HPSP be expanded to cover the costs of additional training requirements for U.S. citizens who attend foreign medical schools. The Services should offer residency slots to certified foreign medical school graduates.

Many U.S. physicians earn their degrees at foreign medical schools. However, to enter an accredited residency program in the United States, graduates of foreign schools typically must pass a battery of tests in order to be certified by the Educational



Commission for Foreign Medical Graduates (ECFMG).⁶⁰ After they are certified, these physicians still face formidable challenges obtaining residency positions, since many U.S. residency programs do not accept graduates of foreign medical schools.⁶¹

While doctors educated in foreign medical schools must undergo additional testing in order to practice in the United States, once they are fully certified they represent a potentially valuable source of military physicians. To attract more of these doctors into military service, the QRMC recommends that foreign-educated physicians who make a service commitment be eligible for the HPSP while they prepare for and take the various ECFMG tests required for certification. To further support these doctors, DOD could establish an ECFMG preparatory program within the military's own medical school (Uniformed Services University of the Health Sciences) to assist them with their studies.

Because it is difficult for many foreign medical school graduates to obtain positions in accredited U.S. residency programs, the QRMC also recommends that the Services more aggressively promote military residency programs to such graduates, with acceptance contingent upon their achievement of ECFMG certification.

Nurses

Like the civilian sector, the military is finding it increasingly difficult to recruit and retain the nurses necessary to meet force management needs. The QRMC believes that the Services can increase their nursing inventories by targeting previously untapped markets.

RECOMMENDATION

The QRMC recommends that the Services expand their recruiting pool to include registered nurses with associate degrees and create a program for these nurses to complete their Bachelor of Science Nursing (BSN) degrees.

The majority of nurses employed in the United States today do not have four-year BSN degrees. With diploma schools merging with BSN programs, there are fewer of these nurses entering the workforce, but the number of nurses with associate degrees is growing. While these non-BSN nurses are admitted into the reserves, they are not allowed to serve in the active force.

60. Educational Commission for Foreign Medical Graduates. <http://www.ecfm.org/2008ib/ibfaq.html>. Accessed May 16, 2008.

61. studentdoc. <http://www.studentdoc.com/foreign-medical-schools.html>. Accessed May 16, 2008.

Although the military has accepted nurses without BSN degrees in the past, today's nurse corps is reluctant to recruit anything but BSNs into service—despite the substantial nursing shortages facing the military. The QRMC, however, found no evidence that the quality of care and leadership provided by non-BSN nurses is significantly different from that provided by BSN nurses. Hence, the QRMC believes that allowing the Services to tap into this large and growing market could substantially alleviate current nursing shortages without sacrificing quality of care.

When non-BSN nurses previously served in the military, licensed registered nurses with diplomas entered as O-1s (compared to BSNs, who entered as O-2s). In the Navy, registered nurses with associate degrees were allowed to enter as warrant officers. Today nurses with BSN degrees enter as O-1s. The QRMC recommends that the Services recruit registered nurses with associate degrees as warrant officers, so that their pay is better aligned with commissioned officer pay. Because the Air Force does not have warrant officers, the QRMC recommends that it consider establishing a lateral high-grade enlisted program for such recruits, similar to the program used for members of Air Force bands.

RECOMMENDATION

To encourage military nurses without BSN degrees to complete their four-year degrees, the QRMC recommends that the Services create programs that enable nurses to earn their degrees while in the military, and subsequently compete for commissions as O-1s.

79

Many nurses without BSN degrees in the civilian sector eventually complete a four-year BSN degree. The Services should offer similar training opportunities to nurses who enter the military. Such advanced training will provide nurses with additional professional development and the Services with a more highly skilled nurse corps.

RECOMMENDATION

The QRMC recommends that the Services offer nurse training to currently serving officers or enlisted personnel.

Existing military personnel are a valuable potential source of health professionals. These individuals have already shown a commitment to military service, and will bring a level of military experience and expertise to their new positions that citizen recruits do not have. There are already programs in place that provide nurse training to currently serving enlisted personnel. The QRMC recommends that such efforts

be expanded so that current officers or enlisted personnel can attend civilian associate degree or baccalaureate nursing programs. Modeled along the lines of the Funded Legal Education Program, participating members would continue to draw full active duty pays and benefits while enrolled in school.

All Health Professions

In addition to the HPSP and nursing recommendations outlined above, the QRMC recommends several other changes designed to maximize contributions from existing military personnel—both health care personnel and other service members who are available for retraining.

RECOMMENDATION

The QRMC recommends that DOD ask Congress to raise the mandatory retirement age for health professionals from 62 to 68.

80 > Many health professionals—particularly physicians and dentists—do not enter the uniformed service until later in life, after completing long years of required training or tenure in civilian practices. DOD currently has the authority to allow medical officers in grades O-5 to O-7 to continue until age 68 on an exception basis.⁶² But in general, health professionals are subject to mandatory retirement at age 62, unless the secretary of the military department concerned defers the retirement.

Because of their relatively late start, health professionals often cannot remain in the military long enough to maximize their retirement benefits, even though they are fully capable of longer service. In fact, recent modifications to the military retirement benefit allow the retirement annuity to increase to 100 percent of base pay at 40 years of service (compared to the former cap of 75 percent of base pay at 30 years of service).

The QRMC believes that health professionals between the ages of 62 and 68 can still make valuable contributions to the military health care system and should be allowed to remain in service if they would like to do so, without requiring action by the secretary of the military department. This change will expand the pool of qualified professionals available to help the Services address current shortages; it will also provide long-serving professionals with the opportunity to maximize their retirement benefits.

62. 10 U.S. Code, Sections 633, 634, and 635.

RECOMMENDATION

The QRMC recommends that, where appropriate, current programs that train enlisted personnel as physician assistants be expanded to cover training in other medical areas.

As mentioned earlier, existing military personnel are a potentially valuable source of health professionals, with a demonstrated commitment to and understanding of military service. The QRMC recommends that the Services explore whether it is cost effective to expand existing physician assistant training programs to train members in other medical fields as a way to increase the supply of military health care personnel.

RECOMMENDATION

The QRMC recommends that the Services use an auction mechanism to induce health care personnel to volunteer for specific hard-to-fill billets.

Health professionals often have lucrative career opportunities available to them in the civilian sector, with civilian sector positions offering them higher compensation, as well as more flexibility to set the terms of their employment. In contrast, health professionals in the military—like other military personnel—often have limited control over their duty assignment or their deployment status.

As with the rest of the military, the burdens of deployment have fallen on military health professionals. In order to provide health professionals with more control over their assignments and the deployment process, the QRMC recommends that the Services institute a bidding system for duty assignments.

The bidding program could be modeled after the Navy's Assignment Incentive Program (AIP), under which qualified personnel submit bids for certain hard-to-fill billets, bidding the amount of extra pay they would require in order to accept a particular open assignment. The Navy retains complete control over the assignment process, but typically the qualified sailor who submits the lowest bid receives the assignment. AIP has reduced the number of involuntarily filled positions in the Navy, and early reports suggest that the program is cost effective and viewed positively by service members.

Instituting a similar auction mechanism for health professional assignments would allow personnel to volunteer for less popular assignments at compensation levels they

specify. The AIP experience suggests that such a program would substantially reduce the number of involuntary assignments, which should improve personnel satisfaction and retention.

RECOMMENDATION

The QRMC recommends that non-citizen health care professionals who are licensed to practice in the United States be allowed to enlist in the military and apply for expedited citizenship.

Many health care professionals practicing in the United States are not U.S. citizens. During the 1990s, immigrant employment grew by 32 percent in U.S. hospitals. The 2000 census found that immigrants accounted for 13 percent of all U.S. health care providers. Remarkably, foreign-born individuals accounted for 25.2 percent of physicians, 11.5 percent of registered nurses, and 14.4 percent of dentists—skills the Services need and in which they have shortages. The QRMC believes that military service may be an attractive opportunity for some foreign health professionals, particularly if that service grants them access to an expedited citizenship process.

82 >

Under federal law, a noncitizen on active duty in the U.S. military is eligible to apply for citizenship.⁶³ The QRMC recommends that DOD utilize this authority to increase recruitment of health care professionals who are legally in the country under long-term, non-immigrant status. Such recruits would enlist in the reserves and subsequently be placed on active duty for a short training period. Once a reservist has served on active duty for a single day, an application for citizenship can be filed. The citizenship process typically takes about six months to complete, but may require up to a year, depending on processing times at the Department of Homeland Security. Because they are not U.S. citizens—and therefore ineligible to serve as officers—these recruits would enter the military as enlisted personnel (probably as E-5s) and would be placed into inactive reserve status until they became citizens. Once awarded citizenship, they would enter the Medical Corps under the normal commissioning process.

If a health care professional who enters the military under this initiative fails to complete his contract, there is a five-year window under federal law in which his

63. 8 U.S. Code Section 1440 (Naturalization through active-duty service in the Armed Forces during World War I, World War II, Korean hostilities, Vietnam hostilities, or other periods of military hostilities).

citizenship may be revoked. Hence, if circumstances warrant, the Service may consider granting the individual the type of discharge that can result in loss of citizenship.⁶⁴

RECOMMENDATION

The QRMC recommends that DOD use the inter-Service bonus program to encourage surplus health professionals to transfer to a Service where their skills are needed.

Shortages of health care professionals are prevalent throughout the force. However, while aggregate inventories are down, surpluses do exist in some specialty areas or in some of the Services. Hence, it is not unusual for one Service to have a surplus of personnel in a specialty area that is in short supply in another Service. Given the large investment that the military makes to train health professionals, DOD should strive to fully utilize its health care personnel. Hence, if one Service has an excess number of personnel in a particular specialty area, incentives should be available to encourage those personnel to transfer to another Service where their skills are needed.

The QRMC recommends that the Services more aggressively utilize the Inter-Service Transfer Bonus Program to induce surplus health care personnel to transfer to a different Service where their skills are in short supply.

< 83

Conclusion

Accessible and affordable health care is a critical element of force readiness and an important component of the military compensation package. From its modest beginnings more than 200 years ago, the U.S. military health benefit has grown into a comprehensive health care system that provides services to 9.2 million military personnel, retirees, and dependents. The military health benefit is generous compared to civilian sector health plans and is a highly valued element of military compensation—among both service members and retirees. It also accounts for a substantial and growing portion of total DOD compensation costs.

This chapter includes recommendations designed to improve the equity of the military health care benefit and promote more cost-effective choices among program participants. Specifically, the proposed revisions will ensure that the TRICARE premiums paid by younger military retirees better reflect their actual costs to DOD,

64. Ibid.

Chapter 3

as well as their ability to pay—a change consistent with trends in the civilian sector and with the treatment of older military retirees. Changes in copayments and deductibles will encourage increased utilization of cost-effective preventive care and provide incentives for participants to choose low-cost prescription drug providers.

The QRMC also recommends reforms designed to improve recruitment and retention of health care professionals. Increased competition from the private sector, changing demographics, and working conditions in the military have made it more difficult for the Services to attract and retain the corps of doctors, dentists, and nurses that is needed to provide quality health care to service members and their dependents. The recommendations included in this chapter will make existing recruiting and retention tools more attractive to medical and dental students and health care professionals considering military service and will promote recruiting opportunities in previously untapped markets.

Quality of Life Programs

The military compensation package offers a comprehensive set of benefits designed to attract and retain sufficient numbers of high-quality individuals into the all-volunteer force. Compared to private sector compensation, the military compensation package is relatively generous, reflecting the high standards, potential hazards, and other burdens associated with military service.

Quality of life benefits represent a significant portion of service members' compensation, and the military needs to structure, utilize, and evaluate quality of life programs in that context, as *valuable elements of the compensation package*. Despite the substantial investment, it is not clear how much quality of life programs promote key force management goals or whether quality of life dollars are being used as efficiently and effectively as possible, or in ways that maximize member choice. In-kind benefits, for instance, are generally considered less efficient with respect to attracting and retaining personnel than cash benefits, which service members can spend in whatever way they would like. It is also unclear whether programs developed decades ago to support families of a conscript military are as relevant and valuable to the all-volunteer force of the 21st century.

Moreover, while service members and their families may appreciate and often rely upon quality of life benefits, surveys of military personnel suggest that they substantially underestimate the value of those benefits and do not necessarily consider them part of their compensation package. If personnel do not recognize the true value of a compensation benefit—or how it compares to what is available in the private sector—its effectiveness as a recruitment or retention incentive is diminished.

This chapter describes the constellation of quality of life benefits available to military families. It presents a number of recommendations designed to make the system a more effective, efficient, and equitable force management tool, and to provide service members with more choice as to how they spend their quality of life benefits. Some of these recommendations address system-wide issues, while others focus on specific quality of life programs.

Background

The challenges of military life are not limited to military personnel. Over 60 percent of service members have families whose lives are also affected by the frequent moves, deployments, and other sacrifices associated with military service. To help military families manage these challenges, the Services offer an extensive and diverse array of quality of life benefits, ranging from on-base commissaries and child care centers to family counseling and stress management programs. Force managers believe that providing the support necessary to maintain a high quality of life for service members and their families is critical to attracting and maintaining a high caliber force.

Quality of life programs can be traced back to the Revolutionary War, when the American Army appointed private entrepreneurs, known as sutlers, to supplement regular Army rations with various daily necessities, including wine and liquor. Each month the post or regimental sutler was assessed a charge of 10 to 15 cents per man. This money was used to establish a special post fund—now referred to as a Non-Appropriated Fund activity—for the benefit of the troops. In 1825, the Army began selling goods at cost from its commissary department storehouses to officers at some remote outposts. This arrangement was formalized in 1866 when legislation was enacted that allowed all officers and enlisted personnel to make at-cost purchases at all Army posts, creating the first Service-wide commissary system.⁶⁵

In 1895, the Army directed the establishment of an exchange at every post. These exchanges were under the operational control and management of the installation commander. The present exchange system, which evolved out of the former independent exchanges at each Army post, began in 1941 as the Army Exchange Service.

Since that time, the range of quality of life services has expanded greatly to meet the changing needs and demands of military families, with the isolation and substantial size of many military bases still a major rationale for quality of life programs. Even today, when installations are located near civilian communities, it is argued that large on-base populations could generate more demand for such services than local community resources could reasonably accommodate, providing a continued justification for offering services on base.⁶⁶

65. Defense Commissary Agency. <http://www.commissaries.com/history.cfm>. Accessed June 30, 2008.

66. Defense Advisory Committee on Military Compensation.

Today, many quality of life services can be described as morale, welfare, and recreation programs. Typically located on military installations, these services include programs such as commissaries, exchanges, fitness centers, and libraries. DOD also offers an array of community and family support services designed to help families cope with the hardships sometimes associated with military service, as well as with other issues that can confront both military and civilian families. Examples of these programs include marriage and family counseling, child care services, youth/adolescent programs, and financial counseling. Table 4-1 provides a list of programs that are often included under the “quality of life” umbrella.

Table 4-1. Quality of Life Programs Available to Military Personnel and Their Families

Morale, Welfare, and Recreation Programs	Community and Family Support Programs
Alcoholic beverage stores Animal care clinics Arts and crafts centers Athletic facilities and leagues Auto hobby shops Auto/truck rentals Beaches Bowling Cabins, cottages, and cabanas Campgrounds Clubs Commissaries Community centers Discounted tours and tickets Exchanges and shopettes Fitness centers Golf courses Hotels Libraries Marinas Motocross courses Parks with hiking/bike trails Photo hobby shops Recreation gear shops Rentals/equipment Restaurants and cafeterias Rollerblade and skateboard parks Space available flights Stables Swimming pools Temporary lodging facilities Tennis courts Youth centers and activities	Alcohol/drug programs Chaplain services Child care services Crisis referral services Family support centers Financial counseling Housing office services Individual counseling Information and referral services Legal assistance Marriage and family counseling Services for separating and deploying military On-base higher education programs Parent education Premarital assistance Relocation assistance Services for special needs Sexual assault and domestic violence counseling services Single parent programs Spouse/child abuse services Spouse employment services Stress management programs Suicide prevention programs Transition from military assistance Youth/adolescent programs

Chapter 4

In addition to offering convenient access to services that may not be readily available in neighboring civilian communities, quality of life programs may also help foster a sense of community among service members and their families on base.

Cost estimates of quality of life benefits vary, due in part to debate over exactly which services qualify as part of the quality of life system. Another estimating challenge relates to the multiple—and often hard to pinpoint—funding sources for some quality of life programs. Take, for example, commissaries and exchanges. CBO estimated that the costs to DOD of these operations totaled approximately \$600 million in 1995. But when capital costs and foregone taxes were taken into account, total taxpayer costs grew to \$2 billion.⁶⁷

Rather than focus on the entire array of quality of life programs currently available to military personnel and their families, the QRMC chose to focus on a smaller subset of program areas where reforms could substantially impact the military compensation package. The QRMC used three criteria to identify programs for evaluation. The first is that the programs should involve substantial funding. If program expenditures are modest, any policy changes would have only a minimal effect on compensation. Second, there should be comparable services available to military personnel in the civilian sector. If the same benefit can be accessed in the civilian sector, it may be more cost effective for DOD to provide service members with cash compensation and allow them to purchase the service off base. Finally, programs that are valued more by some military members than by others are promising candidates for analysis, as the cost of providing the benefit exceeds the value to many members.

While there are dozens of quality of life programs, in terms of funding, two programs dominate the system—commissaries and child care programs. In 2007, appropriations for commissaries and child care programs totaled \$1.2 billion and \$532 million, respectively. Spending on the next eight biggest programs combined was just \$395 million (Table 4-2).

Support for quality of life programs is strong, both among service members and military leaders. In fact, the 2006 *Status of Forces Survey* of military personnel found that a substantial majority would rather maintain access to existing quality of life benefits than exchange those benefits for cash vouchers. Yet it is not clear whether that support translates into better retention. Indeed, the same survey found no difference between the continuation intentions of service members who use quality of life programs and service members who do not use those services. The only two

67. Congressional Budget Office, *The Costs and Benefits of Retail Activities at Military Bases* (Washington, D.C.: October 1997).

Table 4-2. Appropriated Funds for Largest Quality of Life Programs, Fiscal Year 2007

Program	Funding (\$ in millions)
Commissaries	\$1,186
Child care	532
Physical fitness and aquatic training	138
Library programs	83
Sports and athletics	48
Basic social recreation (center) programs	35
Directed outdoor recreation	33
Automotive crafts skill development	22
Arts and crafts skill development	18
Recreational swimming	18
Total	\$2,113

Note: Appropriated amounts are for Operation and Maintenance.

Source: Department of Defense, *National Defense Budget Estimates for FY 2007*

programs that appeared to result in higher continuation intentions were commissaries and community centers (Figure 4-1). Even in those instances, it is not clear whether utilization actually affects continuation. Instead, it could be that service members who intend to stay in the military are more involved in on-base activities and apt to participate in more quality of life programs.

DOD leaders have long—and vigorously—supported quality of life programs as critically important to recruitment, retention, and readiness of the force. In a 2002 “social compact” DOD reiterated its long-standing commitment to providing families with the assistance they need to manage the burdens of military life and maintain a good quality of life.⁶⁸

Yet as predominantly in-kind benefits, quality of life programs are not as efficient as cash compensation, which can be used to purchase whatever good or service is most preferred by the individual member. As with most in-kind benefits, the value that service members attach to quality of life benefits varies depending on each member’s unique needs, interests, and personal circumstances. A single service member, for example, may have no use for the military’s child care program, while a member

68. Defense Advisory Committee on Military Compensation.

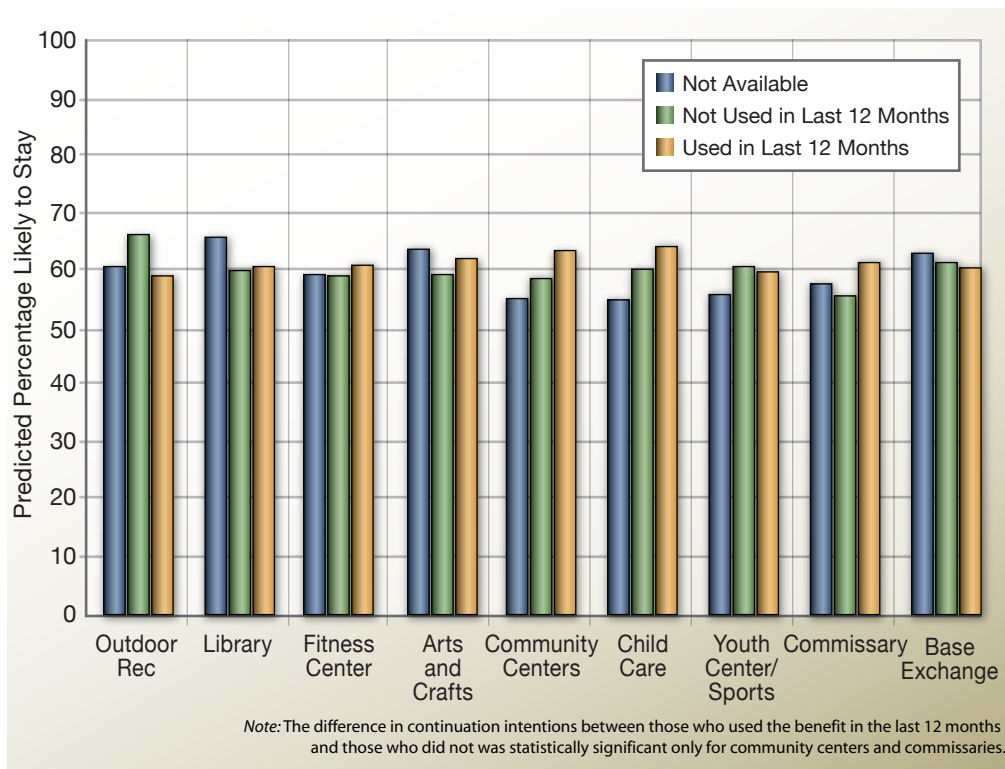


Figure 4-1. Predicted Continuation Intentions by Use of Quality of Life Programs

whose children attend a military child care facility will place a much higher value on the benefit.

Similarly, the installation-based nature of most quality of life benefits means that their value is often greatest for those members living on or near military bases. In fact, utilization of quality of life programs is higher among service members who live on or closest to the installation. A military spouse who lives 30 miles from base may place less value on installation-based commissaries and exchanges than would a spouse living on base. Today, approximately two thirds of active duty military families do not live on military installations.⁶⁹ Moreover, installation-based programs often offer little benefit to reservists, an increasingly critical component of the U.S. military. Reservists and their families often live nowhere near a military base, and are therefore unable to benefit from the array of quality of life programs located at such installations.

69. Cindy Williams, *Transforming the Rewards for Military Service*, MIT Security Studies Program (Cambridge, Mass.: MIT Press, September 2005).

Quality of Life Programs: Critical Element of Military Compensation

Quality of life programs have long played a prominent and central role in the lives of military families, and continue to receive strong support from military leaders. In aggregate, these programs form a strong network of supportive services that help members and their families cope with the challenges, hardships, and unique circumstances of life in the military. However, the QRMC believes that the value of these benefits as force management tools would be enhanced if the Services began to evaluate and manage them as part of the compensation package.

To make its compensation package as effective and competitive as possible, DOD has developed sophisticated analyses that estimate—often with great precision—how various pays and allowances influence recruitment, retention, and readiness. This information allows the Services to better target resources, structure benefits, and market the compensation package to military personnel. Yet no such analysis exists for quality of life benefits. In fact, the large number of quality of life programs, along with their multiple funding sources, make it difficult to estimate the total cost of quality of life services. Nor is consistent and comprehensive utilization data available. Without this information, it is difficult to evaluate the effectiveness of quality of life programs in furthering critical force management goals. More importantly, quality of life programs have not been associated with force management goals in the same way as other elements of compensation.

In order to better manage quality of life resources as an element of compensation, DOD must first develop an accurate and comprehensive estimate of quality of life expenditures government wide. Such cost information will enable DOD to measure the impact of quality of life benefits, and target and structure program resources accordingly. It will also help the Department better educate military personnel about their quality of life benefits package. With such a shift in thinking and approach, quality of life benefits could more effectively contribute to member satisfaction and force management goals.

A critical part of this effort is educating military personnel about the generous quality of life benefits available to service members and their families. While quality of life programs are widely viewed as an integral part of military life, service members do not necessarily consider quality of life services to be part of their compensation package. Nor do they generally grasp the full value of the quality of life benefits they receive—despite the fact that such benefits actually make up a substantial portion of each member's compensation. As detailed in Figure 1-1, the GAO estimates that, on

Table 4-3. Military Personnel Perceptions of DOD Expenditures on Benefits

Paygrade	Estimated Cost to DOD per Dollar Earned				
	Less than 10 cents	10–25 cents	26–40 cents	41–55 cents	More than 55 cents
All	21%	27%	22%	11%	19%
E1–E3	22	26	23	10	19
E4–E6	23	25	21	10	21
E7–E9	19	30	23	11	17
O1–O3	14	31	25	13	17
O4–O6	12	29	29	15	16
W1–W5	24	31	22	11	12

Note: Data weighted to account for survey stratification and nonresponse.

Source: *Status of Forces Survey*, December 2006

average, other noncash benefits, also called installation-based benefits, alone make up 12 percent of average military compensation.

In part, service members' undervaluation of quality of life benefits results from the in-kind nature of the benefits. In contrast to a cash benefit, such as a reenlistment bonus for a specified dollar amount, it is more difficult for members to quantify the worth of the in-kind benefits they receive, such as the savings to their grocery bill from shopping at a commissary rather than a retail supermarket. In fact, survey data indicate that 70 percent of service members underestimate how much their benefits cost the military per dollar earned. As Table 4-3 shows, more than one in five respondents believed that benefits cost less than 10 cents per dollar earned; and nearly half felt that they amounted to no more than 25 cents per dollar earned. Actual DOD costs are in the range of 41 cents per dollar earned.⁷⁰

Service members' perceptions regarding the value of the military child care benefit illustrate this point. Personnel whose children are cared for in child development centers (CDCs) benefit from heavily subsidized care, with a subsidy that can total as much as \$10,000 per child per year. Yet survey data indicate that many families are

70. The 41 cent estimate does not include benefits paid for by other governmental entities, such as the Department of Veterans Affairs. If those benefits were included, the amount per dollar earned would be even higher.

unaware of the full value of this extremely generous benefit. In fact, some families believe that DOD actually makes money from its child care operations.⁷¹

Given the tendency among service members to undervalue the in-kind benefits they receive, it is not surprising that a large portion of the force believes it would be easy to find a civilian job with comparable salary and benefits. Member responses to the 2006 Status of Forces Survey indicated that 45 percent of personnel believed it would be easy to find comparable civilian employment (Table 4-4).⁷² Among junior officers, a startling 60 percent thought it would be easy to do so. Yet analysis conducted by the QRMC indicates that military compensation of both enlisted personnel and officers is significantly higher than compensation paid to comparable civilians. When health, retirement, and tax benefits are included in the calculation, military compensation for both enlisted personnel and officers compares to approximately the 80th percentile of compensation for comparable civilians.⁷³ If other in-kind benefits

Table 4-4. Military Personnel Perceptions on Finding Civilian Employment with Comparable Income and Benefits, and Impact on Continuation Rates

Paygrade	Percentage who responded “easy”	Percentage likely to stay of “easy” responders	Percentage likely to stay of “not easy” responders
All	45	56	67
E1–E3	44	31	44
E4–E6	43	49	62
E7–E9	37	67	70
O1–O3	60	56	65
O4–O6	62	75	77
W1–W5	56	68	70

Note: Data weighted to account for survey stratification and nonresponse.

Source: Status of Forces Survey, December 2006

71. Joy S. Moini, Gail L. Zellman, and Susan M. Gates, *Providing Child Care to Military Families: The Role of the Demand Formula in Defining Need and Informing Policy*, MG-387-OSD (Santa Monica, Calif.: RAND Corporation, 2006). <http://www.rand.org/pubs/monographs/MG387/>. Accessed February 2008.

72. More detailed discussion of these results can be found in Diana S. Lien, PhD, et al., *Perceptions and Influence of Quality of Life and Retirement Benefits*, in a subsequent volume of this report.

73. For more information about this comparative analysis of civilian and military compensation, see *Report of the Tenth Quadrennial Review of Military Compensation*, Volume 1, Chapter 2: The Military Compensation System.

and special and incentive pays were included, military compensation would compare even more favorably.

Accurate or not, such perceptions about how military compensation compares with civilian employment opportunities affect members' continuation plans. As Table 4-4 shows, 56 percent of service members who said it would be easy to find a comparable civilian job indicated that they were likely to remain in the military, compared to 67 percent of personnel who believed finding comparable civilian employment would not be easy. Moreover, the cohorts of personnel who are in their target retention years—first and second term enlisted personnel and junior officers—are the ones with the greatest increased likelihood of separating if they believe that comparable civilian employment is easily attainable. Among the most junior enlisted personnel, perceptions that it would not be easy to find similar pay and benefits result in a 42 percent higher intended continuation rate than for their peers who believed it would be easy to obtain such employment.

If service members neither consider quality of life services part of their compensation package, nor appreciate the true value of those services and how they compare to civilian opportunities, such programs may have less impact on continuation intentions than they would if service members better understood their actual value within the compensation package.

DOD does supply military personnel with some information about the value of their compensation package, and also provides service members with access to personnel specialists to field questions about pay and benefits. Yet despite these efforts, service members are often unaware of the true value of their benefits package, and are frequently frustrated with the Services' attempts to disseminate compensation information. In fact, over half of active duty personnel participating in 40 GAO focus groups convened in 2004/2005 noted how unhelpful DOD personnel resources were in helping service members understand the value and composition of their compensation package.^{74, 75}

Every year, for example, each service member is given a personalized earnings statement that details the amount of his or her cash pay and provides general

74. U.S. Government Accountability Office, *Military Personnel: DOD Needs to Improve the Transparency and Reassess the Reasonableness, Appropriateness, Affordability, and Sustainability of Its Military Compensation System*, GAO-05-798 (Washington, D.C.: July 2005). <http://www.gao.gov/new.items/d05798.pdf>. Accessed June 30, 2008.

75. According to GAO, the 40 focus groups were not designed to "provide statistically representative samples or reliable quantitative estimates." However, the information was collected from a wide range of personnel in different Services and grade levels.

information about the value of other elements of military compensation.⁷⁶ Unfortunately, for many personnel, the earnings statement further confuses, rather than clarifies, their understanding of military compensation. Many of the active duty personnel participating in the GAO focus groups felt that the earnings statement was not believable because they could not comprehend how their total compensation was calculated. In fact, within the focus groups, the earnings statement was sometimes referred to as the “lie sheet.”⁷⁷

Despite these issues, DOD officials have indicated that educating personnel about their compensation package has not been a department-wide priority. Nor has the Department ever undertaken a comprehensive effort to inform service members about the value of military compensation compared to compensation packages typically available in the civilian sector.⁷⁸

RECOMMENDATION

The QRMC recommends that the Services develop a more comprehensive system to educate personnel on an ongoing basis about the variety of quality of life programs available to service members, the value of those programs, and the fact that they represent a substantial component of military compensation.

In order to maximize the impact of quality of life resources on force management goals and member reenlistment decisions, service members and their families need to more fully appreciate the true value of quality of life benefits and better understand how those benefits compare to compensation in the civilian sector. Take, for example, commissaries, which are part of the daily routine of many service members and their families. Studies indicate that, on average, commissary prices are about 30 percent below retail prices, saving the average military family of four approximately \$2,700 per year. Yet while members are well aware of the size of their reenlistment bonus, or their monthly housing allowance, they cannot necessarily quantify the value of their commissary benefit.

The Services need to develop accessible and easy-to-understand ways for service members to quantify what quality of life benefits are worth to them and their families, so that personnel facing reenlistment can more accurately compare their civilian

76. The 2008 Air Force Compensation Fact Sheet, contained in Appendix B, illustrates the information provided to service members regarding their compensation package.

77. U.S. Government Accountability Office, July 2005.

78. Ibid.

and military employment opportunities. Military personnel should appreciate that these programs are a benefit of military compensation, and they should know the value of that benefit. Absent such an understanding, the impact of quality of life resources on retention and other force management goals will not be maximized. Indeed, the Services could potentially improve retention by simply educating service members about the value of their quality of life benefits—the value of the benefits would not have to increase, just service members’ understanding of the value. In fact, a 2004 survey by Watson Wyatt Worldwide found that employers who effectively communicated with their workforce about their benefit package had employees who were three times more likely to be satisfied with that package.⁷⁹

In Volume 1 of this report, the QRMC recommended that the Services embark on a structured program to better educate service members about the total value of their compensation package. Adoption of a more comprehensive measurement of military compensation—Military Annual Compensation—will help in that effort. It is crucial that this educational initiative also provide service members with a better understanding of the many different quality of life benefits that are part of their compensation. Moreover, this educational process should be an ongoing program that begins in basic training and continues throughout the course of a military career.

96 >

Providing service members and potential recruits with more information about the military compensation package allows them to make more informed choices about their military service, particularly since the value of the compensation package is a crucial element in an individual’s decision to join or remain in the military. Unfortunately, anecdotal data suggest that service members are often attracted by higher salary offers in the private sector and do not take into account the substantial in-kind benefits included in the military compensation package.

Promoting quality of life programs among service members and potential recruits may be even more critical in the coming years, as the military—like other employers—seeks to attract more of the Millennial generation into service. Current studies and surveys of this cohort find that they are more interested than previous generations in achieving a satisfying balance between their work responsibilities and personal priorities. As employers seek to recruit and retain these individuals, compensation benefits and work policies that promote a higher quality of life may become an essential and compelling component of employment.

79. Watson Wyatt Worldwide. <http://www.watsonwyatt.com/news/press.asp?ID=143303>. Accessed June 4, 2008.

RECOMMENDATION

The QRMC recommends that the Department of Defense conduct periodic reviews of its quality of life programs to assess their ongoing role and effectiveness as compensation tools.

In its *1st Quadrennial Review of Quality of Life*, DOD looked at potential ways in which the military's quality of life programs could be expanded. These potential expansions, however, were not identified based on their effectiveness as compensation tools. In contrast, the QRMC is recommending an analysis of the recruiting, retention, and readiness impacts of specific quality of life programs to guide decision makers in allocating resources among those programs. While there is a general sense among force managers that personnel and their families appreciate quality of life services and possibly factor these benefits into their continuation decisions, there is no hard data to quantify their positive impact on either retention or recruitment. As mentioned above, DOD does not currently collect data on quality of life expenditures government wide, nor does it systematically measure program utilization by personnel and their families.

DOD needs to develop more sophisticated survey tools to better measure member preferences and satisfaction regarding quality of life benefits.⁸⁰ More accurate data will better enable DOD to periodically and carefully assess these programs in order to ensure that quality of life resources are being used as effectively as possible to support military members and their families and to advance force management goals—particularly in recruiting, retention, and readiness. If quality of life programs are not improving critical outcome measures, DOD should reexamine why they are being offered and consider whether such programs would be more effective or cost efficient if they were converted to cash benefits.

Specifically, quality of life initiatives must be efficiently targeted to ensure that the dollars are invested in the areas of greatest return to the Services. Inefficient targeting may result when dollars are expended on service members who are at little or no risk of separating, absent these benefits, or on areas that do not measurably contribute to recruiting or readiness. Quality of life benefits should be targeted in much the same way as Special and Incentive pays in order to maximize the effect on critical personnel management outcomes.

80. One promising approach that should generate useful data involves choice-based conjoint survey questions, in which respondents are presented with scenarios that force them to make tradeoffs among different options and ultimately reveal their true preferences.

Each current or proposed benefit should be evaluated for its overall cost-effectiveness in achieving the objective for which it has been designed, with concrete outcome measures and expected levels of attainment established for each benefit. In addition, program objectives should not simply be to make life better for recipients; they must relate to recruiting, retention, or readiness. The opportunity costs of quality of life initiatives should also be periodically evaluated to ensure that resources continue to be spent where they have the greatest return to the Services.

It is also critically important that the amount of funding provided to these programs is based on actual needs. Too much funding wastes resources, while too little funding—or an inappropriate distribution of program resources—results in inequitable access to benefits.

As with other aspects of compensation, force managers should have the flexibility to adjust quality of life programs and resources to better address changing force goals and the evolving needs of military families. Since the September 11 attacks, for example, the number of active duty and reserve personnel deployed into combat zones has risen to levels never before experienced in the all-volunteer force. The duration, frequency, and hazardous circumstances of these deployments have placed additional burdens on many service members and their families. Regular evaluation of quality of life programs would enable the Services to assess whether the current structure and allocation of these programs continue to meet the needs of the families facing higher operational tempos, or whether adjustments are necessary to better deal with the changed circumstances of military personnel and their families.

For example, when deployments reduce the number of personnel present at an installation, force managers could reallocate the funding for on-base resources that are normally targeted at members and instead use those resources to target problems faced by family members left behind. For instance, dollars normally spent for extended hours at fitness centers could be shifted to respite care to alleviate stress on custodial parents. Without more comprehensive data and analysis, however, any such adjustments are simply guesswork.

Flexible Spending Accounts

As mentioned above, a large portion of the military compensation package is made up of “in-kind” benefits. In the civilian sector, in contrast, there has been a growing trend toward flexible benefits that give employees more say over the types of benefits and levels of coverage in their compensation package, thus enabling them to tailor their benefit plans to their specific needs and preferences. According to one estimate, 90 percent of Fortune 500 companies, in 2001, offered at least one kind of

flexible benefits plan to their employees. Among small businesses, the use of flexible benefits applied to 25–40 percent of the workforce.⁸¹

Two of the most commonly offered flexible benefit programs are (1) cafeteria plans, which provide employees with a range of benefits and allow them to choose the specific benefit programs in which they want to participate; and (2) flexible spending accounts (FSAs), into which employees place pretax income to cover costs of specific goods or services, such as medical or dependent care. Because they use pretax income, FSAs enable employees to increase their purchasing power. FSAs are also attractive to employers, since they effectively increase employee income at no cost to the employer. In fact, because employers do not have to pay employer taxes on earnings placed in FSAs, their tax payments are also reduced when employees use these accounts.

RECOMMENDATION

The Services should adopt dependent care and health care flexible spending accounts for uniformed service members.

The QRMC believes that offering these types of flexible spending accounts to service members would enable them to increase their purchasing power to buy benefits that meet their particular needs, preferences, and circumstances.

At the beginning of each year, an employee contributing to an FSA must decide how much to set aside in his or her account, typically via payroll deductions. Those funds are then available to cover eligible expenses, but must be used within a specified period or they are forfeited by the employee. Until 2006, the “use-or-lose” period was the plan year in which the payroll deduction occurred, but that period has now been extended to 14.5 months.

The two most frequently used FSAs are medical and dependent care accounts. Medical FSAs can be used to pay for medical expenses not covered by the employee’s health plan, such as employee premiums, copays, uninsured treatments, dental care, and over-the-counter medications. Dependent care FSAs are typically used to cover child care costs, but can be used to cover costs for any dependent needing care while the employee is at work. The Internal Revenue Code caps the amount that employees can place into dependent care FSAs at \$5,000, while employers set the maximum amount that employees are allowed to contribute to medical FSAs.

81. Gary Kushner, of the employee benefits consulting firm Kushner and Co., Kalamazoo, Michigan, quoted in “The Good and Bad of Spending Accounts,” *Business and Legal Reports*, September 18, 2001. <http://hr.blr.com/display.cfm/id/3569>. Accessed July 3, 2008.

Similar accounts are also available to federal employees through Health Care Flexible Spending Accounts (HCFSAs) and Dependent Care Flexible Spending Accounts (DCFSAs). The amount that an employee can place into either of these federal FSAs is capped at \$5,000 per plan period. Like the plans available to private sector employees, dollars placed in HCFSAs and DCFSAs are available for 14.5 months; any funds unspent during that time period are forfeited.

For employees, the main benefit of FSAs is the ability to shelter income from taxation. The magnitude of this benefit depends on the employee's tax rate. That is, those with higher incomes and tax rates receive a greater benefit from sheltering income than do individuals with lower income. Among the uniformed services, for example, the marginal tax rate for senior personnel can be 40 percent or higher, meaning that those members would receive a benefit of \$2,000 from sheltering \$5,000 of income from taxation. In comparison, junior personnel may have tax rates as low as 15 percent, so their benefit from sheltering the same \$5,000 would be only \$750.⁸²

These accounts do carry some risk, however. As mentioned above, employees forfeit any unspent funds at the end of the use period. Hence, such accounts make the most sense for employees who have a good idea of their medical or dependent care expenses for the coming year. If such accounts are made available to military personnel, force managers will have to undertake a well-publicized informational effort to educate service members about the benefits and risks associated with FSAs.

The federal FSAs could easily be applied in the military setting. Like civilian sector employees, military personnel face medical expenses that are not covered under TRICARE, including contacts and eye glasses, orthodontia, and over-the-counter medications. And while DOD subsidizes child care for many military families, those subsidies do not cover all child care costs. Moreover, because of resource constraints in the military child care program, many military parents do not have access to DOD-sponsored child care and must pay 100 percent of their child care costs. In addition, members could use the dependent care accounts to defray costs of services that may not be available, such as elder care and summer day camps. Offering military personnel the option of covering these costs with pre-tax dollars would represent a substantial benefit for many service members and their families.

Moreover, active duty and reserve personnel could be incorporated into the existing federal FSA system operated by the Office of Personnel Management

82. It should be noted that junior personnel frequently qualify for the Earned Income Tax Credit (EITC). The federal tax code prohibits EITC recipients from using dependent care flexible spending accounts, but EITC is usually much more generous.

(OPM). In fact, because DOD civilian personnel can already participate in federal FSAs, the Defense Finance and Accounting Service has experience with the process for taking flex account deposits from employee pay and transferring them to the OPM contractor.

In order for flexible spending accounts to be workable in a military context, the federal rules governing FSAs will have to be modified to acknowledge the unique and often uncertain nature of military service—specifically, those FSA policies regulating forfeiture of unused funds.

As mentioned above, employees forfeit any unspent funds remaining in their FSAs at the end of the 14.5 month plan period. Employees can only change their set-aside amount if they experience a “qualifying event,” such as marriage, birth, divorce, or death. Unlike civilian employees, military personnel often face major changes in their employment status due to force management decisions or operational needs completely out of their control. For instance, a service member may be ordered to a new duty assignment in another city or deployed overseas. Such a change in status could dramatically affect a military family’s circumstances. For example, a military spouse may have to give up his or her job to relocate with a transferred service member or leave a job when a spouse is deployed. When these changes occur, family financial resources might be needed to meet priorities other than health and dependent care; or planned medical procedures may have to be delayed until after a deployment. In such circumstances, the use-or-lose rule governing FSAs could create a financial hardship for military personnel.

In order for service members to be comfortable participating in FSAs, they will need some assurance that they will not lose unused FSA monies when they are deployed or relocated to a new assignment. **To that end, the QRMC recommends that the law governing FSAs be modified to provide deployed or transferred military personnel with the authority to both modify their FSA contribution plan and carry forward unused FSA dollars into the first full year following a transfer or return from deployment.** The QRMC does not believe it would be fair for members to be financially penalized for personnel actions outside of their control.

There is already some precedent in the military compensation system for providing flexibility to service members during war time or when deployed in combat zones. For example, service members are normally allowed to carry forward up to 60 days of unused leave over the course of their career. Personnel serving in combat zones, however, are allowed to accrue up to 90 days’ leave (although they must “spend down” to 60 days after their return). After September 11, all military personnel were allowed to carry forward additional days of leave that could have

been taken after September 11, because so many leaves were cancelled due to the national emergency.

As long as military FSAs include provisions to provide some flexibility to service members facing deployment or a change of station, the QRMC believes that supplementing the in-kind benefits in the military compensation package with a flexible benefit would improve the value of the benefit package—at no additional cost to DOD and with only a small impact on the Treasury due to lost tax revenues.

Dependent Education

Frequent changes of station are one of the realities of military life—not just for service members but for their families as well. For the school-aged children of military personnel, such transfers mean new schools, teachers, and classmates. Given these frequent school changes, maintaining quality education and smooth transitions for their children is a critical priority for military parents and a goal shared by DOD. Nearly 30 percent of the force has school-aged children. If DOD wants those service members to remain in the military, they need to ensure that their children have access to the same quality and choices in education as children of civilian parents.

102 >

The Department of Defense provides schooling for the children of military personnel through three programs. Department of Defense Dependent Schools (DODDS) operate 153 schools serving 71,500 students in 13 foreign countries, while the Department's Domestic Dependent Elementary and Secondary Schools (DDESS) include 68 schools with 27,800 students in seven states, Guam, and Puerto Rico. In addition to providing education directly, the federal government also subsidizes the public school education of many children of military personnel through Impact Aid, a program funded and administered by the U.S. Department of Education (DOE) that provides financial assistance to local school districts for a variety of reasons, including the presence of a large number of military dependents.⁸³ It is estimated that about 40 percent of Impact Aid dollars are allocated to school districts for the education of military dependents.⁸⁴

83. According to the Department of Education, the Impact Aid law “provides assistance to local school districts with concentrations of children residing on Indian lands, military bases, low-rent housing properties, or other Federal properties, and, to a lesser extent, concentrations of children who have parents in the uniformed services or employed on eligible Federal properties who do not live on Federal property.” <http://www.ed.gov/about/offices/list/oese/impactaid/whatisia.html>. Accessed June 3, 2008.

84. National Military Family Association, *Fact Sheet: Impact Aid* (Alexandria, Va.: January 2006).

Most children of military personnel stationed in the United States attend local civilian schools—an arrangement that works well for the vast majority of military families. However, there are a few areas where concerns about the quality of local schools make parents of school-aged children reluctant to accept assignments. Personnel stationed in these locations often send their children to private school—an expensive alternative usually affordable only for officers—or choose to home school them. Both of these alternatives may place financial burdens on members: those sending their children to private school often face sizeable tuition payments, while those who choose home schooling may experience a loss of family income if a military spouse has to give up paid employment in order to educate their children.

Since the Services have no control over the quality and safety of schools surrounding installations, consideration needs to be given to providing military families with more attractive alternatives for educating their children. Absent reform, members with children may begin to refuse assignments to areas with less desirable public schools, making it more difficult for the Services to fill positions in those areas. The military faced a similar problem in the 1970s, when some service members refused assignments to areas with high costs of living because of the inadequacy of the military housing allowance at that time.

The QRMC recommends three initiatives designed to improve the choices available to parents assigned to these areas.

RECOMMENDATION

The QRMC recommends that, in designated parts of the country, DOD, in cooperation with the Department of Education, institute a voucher program in which military parents could choose the school on which to spend the Impact Aid dollars associated with their child.

The QRMC recommends that DOD begin with a pilot program in which federal funds currently provided to public schools for military dependents instead be given to parents in the form of vouchers to be used at the school of their choice. The voucher option would be offered at a limited number of locations considered to have less desirable designated public schools. By providing service members with educational options other than designated public schools, this proposal would potentially make assignment to these locations more palatable to military personnel with school-aged children, and ultimately improve retention and readiness.

States receive Impact Aid based on the number of military dependents attending local public school districts that enroll large numbers of military children. Currently, states receive about \$2,200 for each student living on a military installation who attends an Impact Aid-eligible school and about \$450 for children of military personnel living off base who attend designated schools.⁸⁵ However, because the Impact Aid is provided to local school districts, it does not necessarily have to be spent at the impacted schools.⁸⁶

Under this proposal, military parents stationed at participating locations would be given control of the Impact Aid associated with their child. Those parents satisfied with the local public schools could continue to “spend” their Impact Aid dollars at those facilities. Parents unhappy with designated public schools, in contrast, would be able to use their Impact Aid dollars to subsidize private school tuition or to select a different public school.

Because Impact Aid is funded directly through the Department of Education, this proposal would have to include a mechanism to shift control of Impact Aid dollars from DOE to individual parents. One approach would be to issue vouchers to parents, which they would in turn hand over to the private or public school that their child attends. The recipient schools would then cash in their vouchers with the Department of Education.

Since the voucher amount under this proposal would equal the amount already being spent on each child through the Impact Aid program, it would not increase total federal spending, aside from some administrative costs. However, because the program would lead some military parents to move their children from public to private schools, public schools that receive Impact Aid could experience a loss of students—and fewer Impact Aid dollars.

RECOMMENDATION

The QRMC recommends that parents be allowed to form charter schools at military installations, similar to civilian charter schools currently operating under state laws.

Charter schools are publicly funded schools that are granted autonomy from many traditional public school regulations in exchange for rigorous accountability

85. Military Impacted Schools Association. <http://www.militaryimpactedschoolsassociation.org/>. Accessed January 2008.

86. Richard Buddin, Brian P. Gill, and Ron W. Zimmer, *Impact Aid and the Education of Military Children* (Santa Monica, Calif.: RAND Corporation, 2001).

regarding student achievement and fiscal practices. Today, 40 states and the District of Columbia allow groups of parents, community leaders, businesses, or other local groups to operate charter schools under contracts that typically run for three to five years. As of the 2004/2005 school year, there were over 3,000 charter schools in the United States, with more than 700,000 enrolled students.⁸⁷

Like traditional public schools, charter schools are funded according to student enrollment, although how much funding they receive in comparison to traditional public schools varies by state. Most states do not provide charter schools with capital funds, but charter schools are eligible for some federal grants that can assist with start-up costs.

Charter schools are often referred to as public “schools of choice,” since teachers and students choose to participate. Charters are required to have “fair and open admissions processes” and to undertake outreach and recruitment efforts to all segments of the areas they serve. When the number of applicants exceeds available space, charter schools often use lotteries to award slots; many also maintain waiting lists.

The QRMC recommends that parents at military installations be allowed to form charter schools in the same way that civilians can under state law. Like civilian charter schools, military charter schools should be considered part of the local system and funded in the same manner. Offering a charter school option in areas with less desirable local schools would give parents stationed in those locations another choice in addition to the private school or home schooling options currently pursued by those dissatisfied with the local public schools.

Due to the high turnover rate that military charter schools would expect to see among the children of military personnel, the rules governing waiting lists would have to be slightly different for military charter schools than they are for civilian charter schools. Under current rules, students leaving parent-initiated charter schools are replaced by children on waiting lists. While this rule has worked well in the civilian context, it is easy to see how its application in the military setting could quickly turn a school initiated by military parents into a school made up predominantly of civilian students.

At military charter schools, a large portion of military dependents will leave each year as their parents transfer to other assignments. If civilian children have put their names on a military school’s waiting list, they will receive newly open slots before the children of service members who subsequently transfer into the installation.

87. The information in this chapter regarding charter schools is from US Charter Schools, http://www.uscharterschools.org/pub/uscs_docs/index.htm. Accessed April 23, 2008.

Over time, the number of military dependents at these schools could decline to the point where they make up only a small minority of the student body, thus frustrating the original intent of establishing military charter schools. To avoid such an outcome, rules governing the waiting lists at military charter schools should give the highest priority to the children of military personnel.

RECOMMENDATION

The QRMC recommends that Congress fully fund Impact Aid associated with children of uniformed service members, and transition to a current-year enrollment basis for distribution of the funds.

As mentioned earlier, about 40 percent of Impact Aid dollars are allocated to school districts for the education of military dependents. Impact Aid does not, however, fully compensate schools for the additional costs associated with educating children of service members. Particularly as military populations shift over the coming years as a result of the base realignment and closure decisions, funding needs to be both more timely and robust. To address this issue, the QRMC recommends that Congress provide sufficient appropriations to fully fund Impact Aid associated with military dependents.

Child Care

The Department of Defense operates the largest employer-sponsored child care program in the United States, spending approximately \$530 million annually to provide services to the children of military personnel. It is unclear, however, whether this substantial investment in child care has a significant or cost-effective impact on key force management goals such as recruitment, retention, or readiness. Nor is it clear that the child care benefit—which is available to only a fraction of the force—is being utilized as efficiently and equitably as possible in order to maximize the benefit to personnel.

DOD provides child care to about 175,000 military children, ranging in age from six weeks to 12 years old.⁸⁸ The two main government-sponsored options for care are child development centers and family child care (FCC) programs. After-school care is also available for older children through school-age care (SAC) programs.

88. U.S. Department of Defense, *Report of the 1st Quadrennial Quality of Life Review*, (Washington, D.C.: 2004) http://www.opm.gov/retire/fers_election/feresh/hb.pdf. Accessed July 9, 2007.

The child development centers are the centerpiece of the military's child care program. DOD operates approximately 800 CDCs that provide care to 70,000 military children worldwide. Most CDCs meet rigorous national accreditation standards and are widely recognized for the high-quality care they provide.⁸⁹ Nearly all CDCs are operating at 100 percent capacity and have long waiting lists. Services are provided on a first-come, first-served basis, with priority usually given to single parents and families with both parents serving in the uniformed services (often referred to as dual military families).

FCC programs offer home-based care that is often provided by trained military spouses, usually in on-base military housing. FCC providers must undergo background checks and be licensed. There are currently about 9,000 FCC providers offering care to approximately 50,000 military children on or near military installations. Unlike CDCs, FCC programs sometimes offer evening and weekend coverage, a valuable resource for service members who often work long and irregular hours. The cost of providing family child care is substantially less than child care costs at CDCs and in most civilian facilities (Figure 4-2).

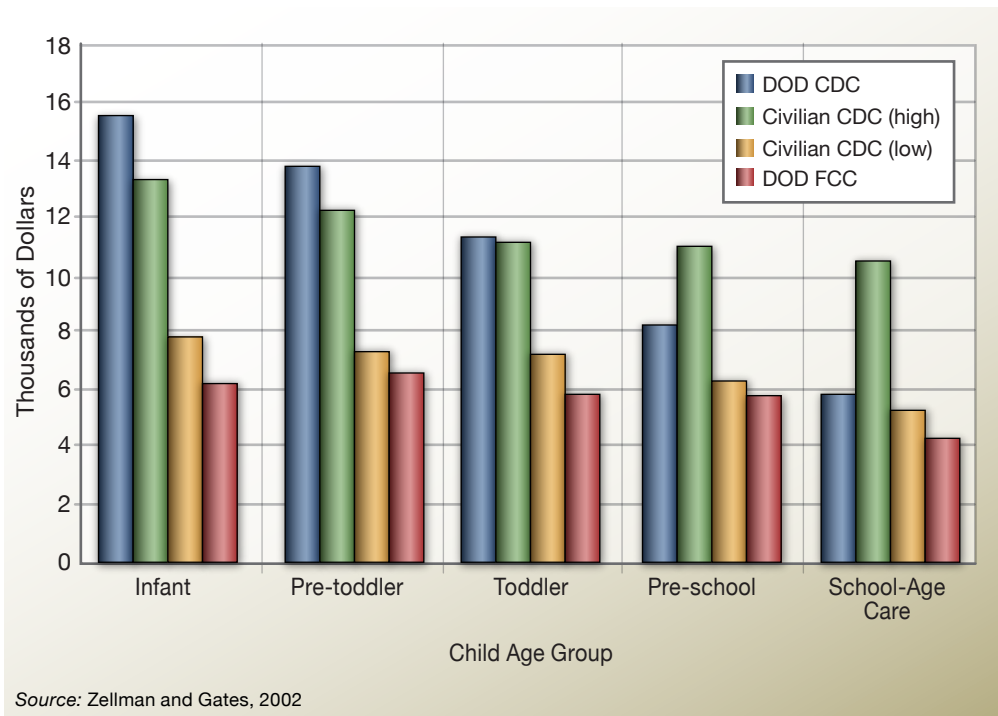


Figure 4-2. Annual Costs of Providing Child Care

89. Fewer than 10 percent of child care centers nationwide meet accreditation standards, compared to 93 percent of CDCs.

The vast majority of military child care dollars are used to subsidize the cost of care in the CDCs. On average, these subsidies cover approximately 55 percent of CDC costs and drive down the amount parents have to pay for CDC care. For some families, the per-child subsidy can exceed \$10,000 annually, depending on family income and age of the child. Payments are based on family income, with those at lower income levels paying less.⁹⁰ Lower income families may pay as little as \$43 per week for child care, with higher income parents paying up to \$126 per week. These rates are low compared to rates typically charged in the private sector.

Family child care, in contrast, typically receives little or no direct financial support from DOD. Only about 20 percent of children attending FCC programs receive subsidies, with the average subsidy totaling just \$1,000. So although FCC operating costs are substantially lower than CDC costs (Figure 4-2), the heavy subsidy provided to CDCs reduces the price differential between the two options.

While CDCs and FCC providers offer quality care to participating children, only a small fraction of the force actually utilizes military child care. At most, 7 percent of personnel with young children use CDCs and 4 percent use family child care (Figure 4-3). Even among military families with children under six, less than 30 percent use DOD-sponsored care (Figure 4-4).

Families living off base are even less likely to use military child care, with utilization dropping the further they live from the installation. This may have less to do with availability and more to do with inconvenience. A *Working Mother Magazine* survey, for example, found that mothers living farther from the workplace are less likely to take advantage of onsite child care, instead preferring facilities closer to home. Assuming the same preferences exists among military parents, the on-base focus of military child care makes it a less attractive option for families living off base. And in fact, the *1st Quadrennial Review of Quality of Life* noted that the current child care system is flawed because it is so base-centric.

90. Fees do not vary by the age of the child, even though the cost of care varies substantially by age. Hence, in order to maintain the same fee for children of all ages, DOD must provide a greater subsidy for younger, more costly children, such as infants. RAND estimates that among average income families at the same income level, the per-child subsidy ranges from \$1,400 to \$11,000, depending on the participating child's age.

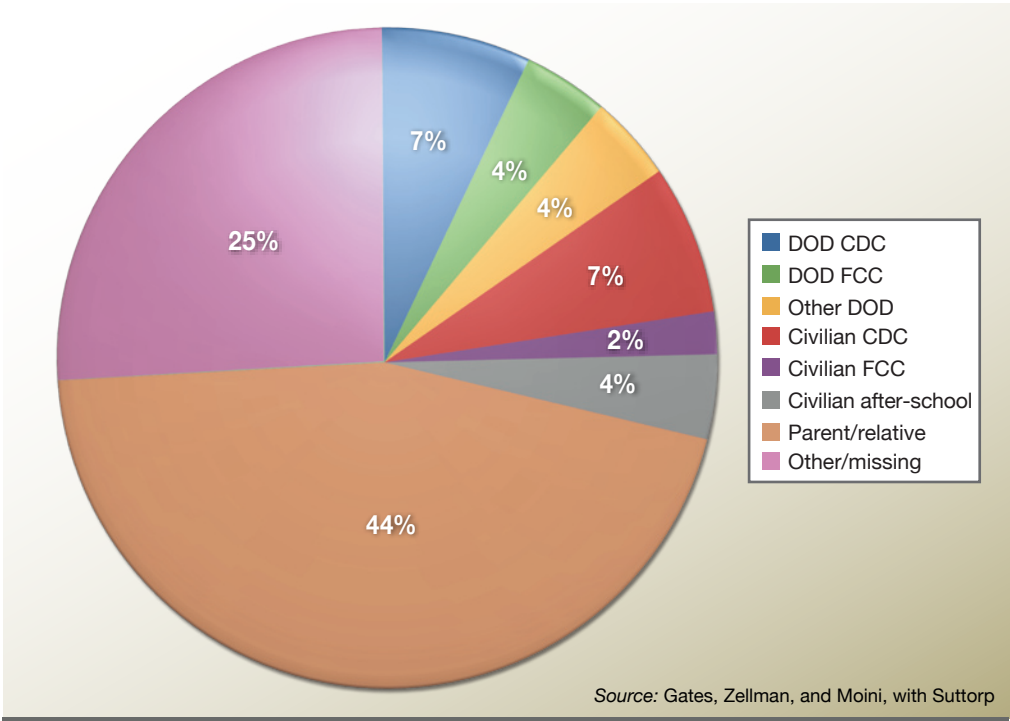


Figure 4-3. Primary Child Care Arrangements for Children Aged 12 and Under

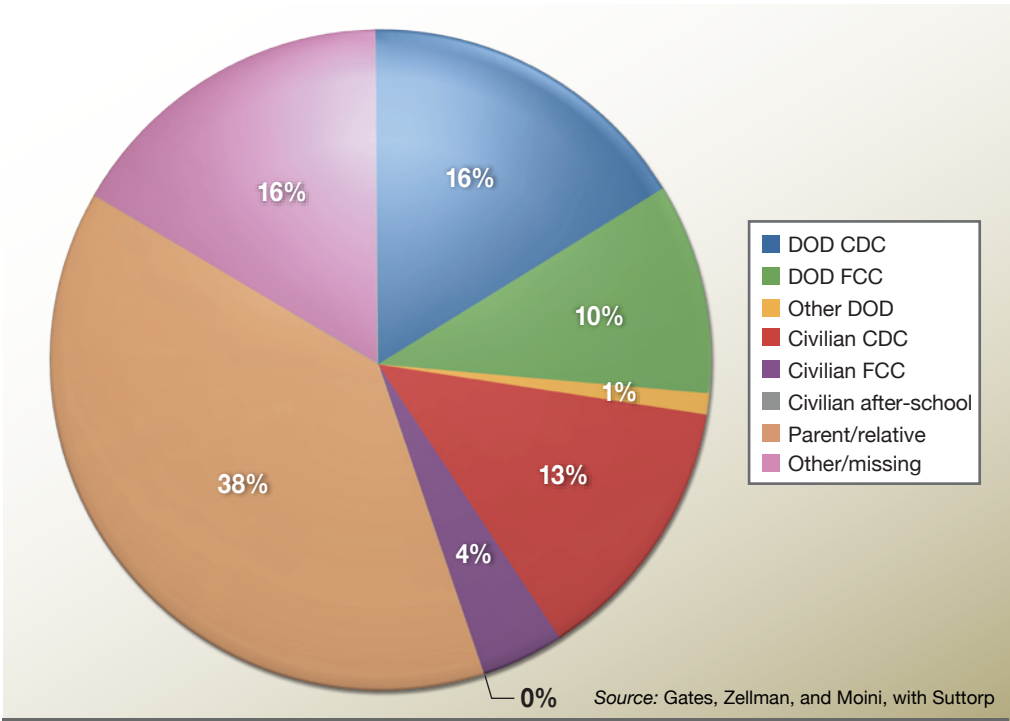
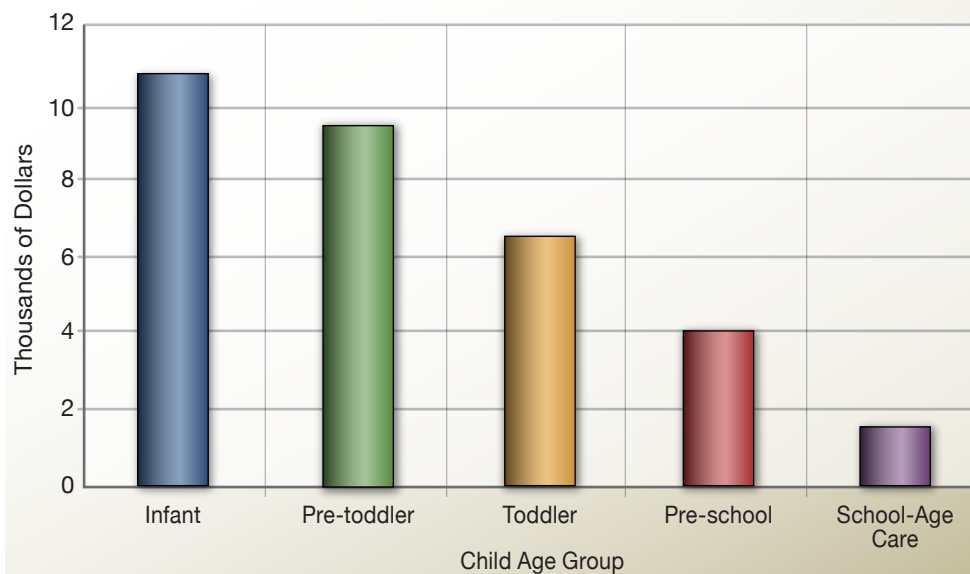


Figure 4-4. Primary Child Care Arrangements for Children Aged Five and Under

Concerns with Current System

Despite the substantial dollars invested in military child care, only about 11 percent of personnel with young children currently participate in the system. While the majority of military parents receive no financial assistance with their child care expenses, those fortunate families whose children attend CDCs receive a benefit that can exceed \$10,000 annually, or one third of their basic pay, depending on their income and the age of the participating child (Figure 4-5). In addition to missing out on a generous subsidy, families that cannot access DOD child care may receive lower quality care, since civilian facilities rarely meet the same accreditation standards as CDCs.

Even among those military families that receive DOD-sponsored child care services, there appears to be little positive impact on retention or readiness. **In fact, parents using CDCs are more likely than other parents to report a propensity to leave the military because of child care issues.** A RAND study of parents with preschool age children found that 71 percent of CDC users expressed a propensity to leave the military due to child care issues, compared with 24 percent of FCC users



Note: CDC subsidies vary based on family income within six income categories. The subsidies shown here are for Category III (family income of \$34,001–\$44,000). Estimates have been revised to reflect 2007 dollars.

Source: Zellman and Gates, 2002

Figure 4-5. Value of Child Development Center Subsidy

and 51 percent of those using formal child care through the civilian sector.⁹¹ Hence, those members receiving the most generous subsidy indicate that they are the most likely to leave military service.

The impact on readiness is also unclear, with service members who utilize military child care programs among the many military personnel who cite child care problems as causing them to miss or be late for work.⁹²

These results may speak to the limitations of DOD's child care system to meet the unique scheduling needs of military personnel. For example, most CDCs are only open during normal duty hours, which may be problematic for military personnel who often must work nights and weekends. In fact, the RAND survey found that between one-quarter and one-half of families using DOD child care would prefer a different option.

Further, the process for allocating military child care resources is not necessarily designed to advance important force management goals. While other compensation benefits are targeted to personnel with critical or hard-to-find skills, the child care benefit is essentially allocated on a "first-come, first-served" basis, with some preference given to dual military and single parents. In other words, there is no system in place to channel this extremely generous benefit to those personnel that the military most wants to retain.

Nor is it clear whether current waiting list policies give priority to personnel most in need of child care services. The families of deployed personnel, for instance, often face significant disruptions to family life, and new studies suggest that child care needs may increase for families with deployed members. For example, spouses who work outside the home might need additional child care help to manage life as single working parents. Yet these families receive no preference for child care slots.

Instead, preference is given to dual military and single parents—two groups who presumably need reliable child care in order to report to work.⁹³ Yet it does not appear that increased access necessarily improves retention or readiness among these groups.

91. Susan M. Gates, Gail L. Zellman, and Joy S. Moini, with Marika Suttorp, *Examining Child Care Need Among Military Families*, TR-279-OSD (Santa Monica, Calif.: RAND Corporation, 2006).

92. In a 2004 RAND child care survey, 51 percent of military mothers and 22 percent of military fathers reported being late for work in the past month due to child care issues, while 37 percent of military mothers and 7 percent of military fathers reported having to miss work because of child care issues. Joy S. Moini, Gail L. Zellman, and Susan M. Gates.

93. Survey data suggest that in some single parent families, the other parent is available to provide child care, suggesting that the need among this group may be less critical than assumed.

According to the 2004 RAND survey, among families with preschoolers, dual military families were 30 percentage points more likely to report a propensity to leave the military due to child care issues—this despite the fact that 42 percent of these families use CDCs.⁹⁴ Here again, these findings may be related to CDC operating hours, which may not meet the needs of dual or single military parents who have no second parent available to provide backup care. For these families, the longer and more flexible hours available from FCC providers may be a better alternative.

Another concern with military child care is the lack of understanding among members regarding the true value of the benefit. While the value of the child care benefit to an individual member can exceed \$10,000 per year, surveys suggest that many personnel are unaware of exactly how generous the benefit is. Indeed, some parents think that DOD makes a profit from its child care system. This extremely generous benefit cannot be an effective retention tool if members do not appreciate its true value, nor understand the much higher cost they would face if trying to secure similar care in the private sector.

A final concern involves the lack of data available regarding the military child care benefit. DOD has developed an extensive body of research on the various components of the military compensation system. Yet despite the substantial resources devoted to military child care, there is little or no analysis available on how the child care benefit impacts recruitment, retention, or readiness. It is difficult to assess program effectiveness or design system improvements without such information.

The QRMC believes that many of the concerns with military child care arise from the fact that DOD does not manage its child care program as an element of the military compensation package; instead, most of the management focus on the program has revolved around improving the quality of care.

This focus on quality can be traced back to the origins of military child care, which were informal and locally-based efforts to provide a few hours of child care to military wives who wanted to participate in volunteer or personal activities. This informal system expanded as more spouses began to work outside the home. In 1989 the Military Child Care Act (MCCA) was enacted in response to concerns about quality and availability of services, as well as allegations of child abuse at some locations. The focus of the MCCA was on assuring high-quality services and expanding access through generous subsidies. The legislation did not consider whether the informal system being codified was the best way to provide what would eventually become a significant service member benefit. Rather, the focus

94. Susan M. Gates, Gail L. Zellman, and Joy S. Moini, with Marika Suttorp.

of the legislation—and of program managers since then—was on developing and expanding a high-quality and safe child care system.

Clearly, it is in everyone's interest that children in child care facilities receive quality care, and the Services have created an impressive system that is often referred to as "the gold standard" in child care. But the focus on quality has meant that opportunities to use child care as an effective compensation tool were seldom, if ever, considered.

This contrasts sharply with the approach to child care benefits in the private sector, where for many private sector employers, the principal reason for providing child care benefits is to recruit and retain their workforce and enhance workplace performance.⁹⁵

The military and private sector employers also differ regarding the *types* of child care benefits they offer to employees. Because they treat child care as an element of compensation, private sector employers closely evaluate the impacts of different child care benefits on current employees and potential future employees. Although some private sector employers operate child care centers or subsidize care in the community, such benefits are the exception, not the rule. In fact, even among large and medium-sized firms, less than 10 percent offer onsite child care.

Instead, private sector employers are much more likely to offer their employees less expensive benefits, such as resource and referral services. Another popular benefit available to many private sector employees is Dependent Care Reimbursement Accounts, which allow employees to set aside pretax income to cover child care costs. In 2006, approximately 30 percent of private sector employers offered such flexible spending accounts to their employees,⁹⁶ allowing them to use pretax income to choose the type of child care that best meets their needs and preferences.

In recent years another trend has emerged, as employers have begun to shift away from the provision of specific goods and services (such as child care centers) and are instead focusing on a different kind of benefit—increased flexibility in the workplace, such as flextime, job sharing, compressed hours, and the ability to work from home. Such changes carry little or no costs to employers, and are highly valued by employees, because they make it easier for them to balance work/life issues and manage child care needs.

95. According to the *2005 National Study of Employers* conducted by the Families and Work Institute, nearly half (47 percent) of employers offer work-life policies, including child care initiatives, to assist with recruitment and retention.

96. U.S. Department of Labor, U.S. Bureau of Labor Statistics 2006. *National Compensation Survey: Employee Benefits in Private Industry in the United States*. March 2007. <http://www.bls.gov/ncs/ebs/sp/ebsm0006.pdf>. Accessed May 2008.

Moreover, these private sector trends are consistent with employee preferences. Surveys find that choice and flexibility are highly valued by employees. In fact, employees often prefer more flexible benefits over more costly benefits that limit choice. This suggests that employees may prefer benefits that could be used at a variety of child care venues, such as vouchers or cash reimbursements, rather than heavily subsidized slots at onsite child care centers.

Recommendations

The child care services available to military personnel provide extremely high-quality care at affordable prices. Yet the system serves only a fraction of all military families who need care. Moreover, despite the considerable per-child cost of CDC care, CDCs do not appear to fully meet the needs of those families whom they do serve. The QRMC recommends three reforms that would improve the effectiveness, equity, and efficiency of the child care benefit, as well as expand services to cover more members. The first proposal would change the policies governing allocation of the child care benefit to better advance Service goals and more effectively meet the needs of military families. The other recommendations are to establish a voucher program for child care services and increase subsidies to FCC. In addition, the QRMC urges DOD to consider the potential benefits of using more private sector providers to deliver child care services to military families.

Many of these proposed reforms may require legislative changes to the MCCA, since that law requires that DOD match every dollar paid by parents with a dollar of appropriated funds. Other than the Navy, each of the Services is currently operating its child care systems extremely close to the MCCA limitations.⁹⁷

RECOMMENDATION

The QRMC recommends that the Services prioritize allocation of child care slots based on force management needs.

Military child care is an extremely generous benefit that the Services currently allocate on essentially a “first come, first served” basis, with little regard to how this valuable compensation resource could be leveraged to advance force management priorities or meet the needs of military personnel. To have the maximum impact on force management needs and readiness, the child care benefit should be targeted to

97. Gail L. Zellman and Susan M. Gates, *Examining the Cost of Military Child Care*, MR-1415-OSD (Santa Monica, Calif.: RAND Corporation, 2002). Based on data from 1998.

those personnel most valued by the Services, and to those members most in need of child care assistance in order to meet their service obligations.

In peacetime, when few members are deployed, the Services should prioritize child care slots based on Service needs and objectives. For example, priority could be given to personnel serving in skill areas with high temporary duty time (e.g., military airlift crews), or to service members in occupational areas that are highly valued by the Service or that are experiencing critical shortages. While the QRMC leaves the specific peacetime allocation scheme up to each Service's discretion, it urges managers to better utilize this valuable benefit to advance force priorities.

During wartime, first priority for military child care slots should be given to families of deployed service members. A 2006 survey of spouses of active duty service members found that deployments created substantial child care issues for a significant minority of military spouses.⁹⁸ As Figure 4-6 illustrates, nearly one quarter of junior enlisted members' spouses reported that increased child care needs were a large problem during deployments.

Figure 4-7 shows the slightly smaller—but still sizeable—percentage of spouses who experienced significant problems finding child care during deployment when it was not previously needed.

RECOMMENDATION

The QRMC recommends that DOD implement a voucher program to help service members pay for child care costs.

Because a child care voucher initiative could be structured a number of different ways, the QRMC recommends that DOD implement a pilot program to evaluate different program designs that could supplement or replace the current in-kind child care benefits with vouchers that personnel could apply towards the cost of child care. Depending on its structure, a voucher program would offer a number of improvements to the current system. For example, vouchers could be used to provide some level of financial assistance to the many military families who currently receive no child care benefit, as well as to those parents using FCC programs, but receiving no subsidy. It would also be easier for service members to assess the value of vouchers compared to the current system, where subsidy amounts are not always clearly articulated.

98. U.S. Department of Defense, *Financial Issues and Employment: Experiences of Military Spouses. Results from the 2006 Survey of Active Duty Spouses* (Arlington, Va.: Defense Manpower Data Center, August 2007).

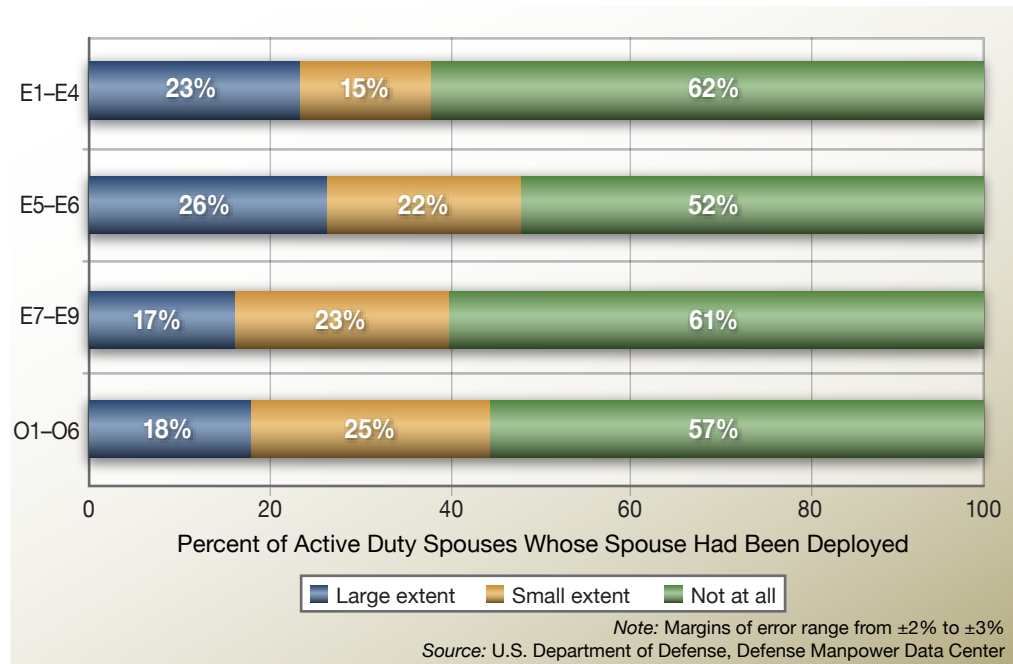


Figure 4-6. Extent of Problems Resulting from Increased Need for Child Care During Deployment

116 >

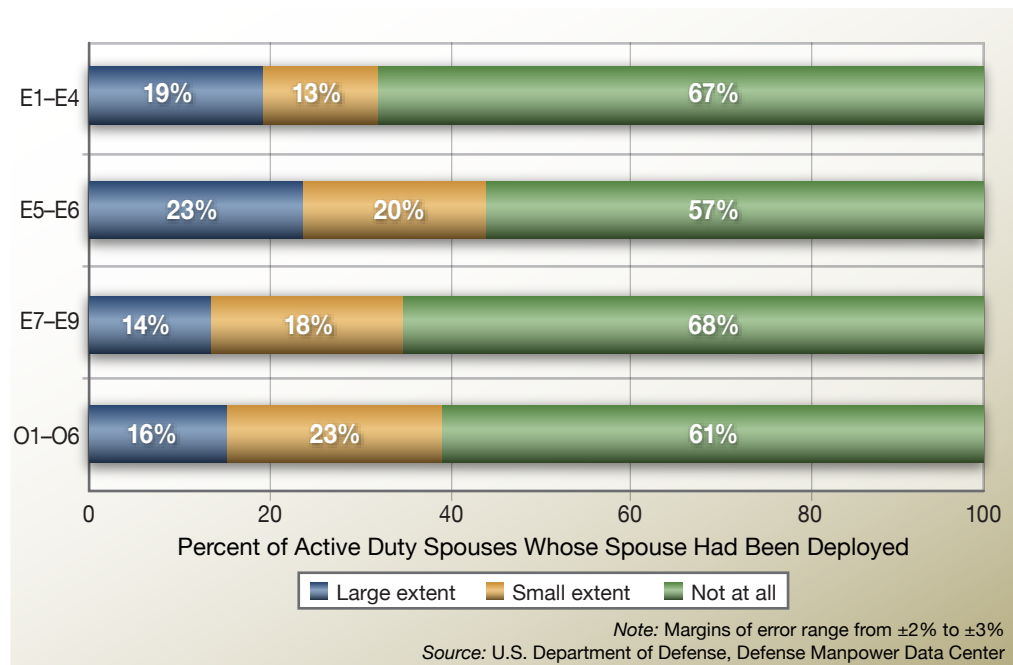


Figure 4-7. Extent of Problems Finding Child Care During Deployment, When Not Previously Needed

Vouchers would also support greater employee choice. Although the current system offers high-quality care, it is not the best fit for all military families, due to limited operating hours, distance from home, or other reasons. In fact, survey results found that between one-quarter and one-half of families using DOD care would prefer a different option. Yet under the current system, families may nonetheless opt to use military care because of the generous subsidy it provides. However, if vouchers were available, military personnel could purchase the type of child care that best meets their needs. Such flexibility would be particularly valuable to service members living far from base, for whom installation-based care is less convenient.

A voucher system could be designed any number of ways and at various price points. One approach would be to give all military parents with young children the same flat voucher amount. Because so few families currently receive a child care subsidy, setting the voucher equal to the current per-child CDC subsidy would be extremely expensive, increasing annual costs by nearly \$1 billion. Providing a smaller voucher of about \$2,000 to all eligible children would be cost-neutral relative to the current child care program. But while this lower amount would provide a substantial new child care benefit to many families who currently receive no assistance, it would reduce the benefit provided to most families currently using CDCs.

Alternatively, DOD could vary the amount or availability of vouchers to meet a variety of force needs and operational goals, based on factors such as family income, child's age, family type, local civilian child care costs, occupational specialty, or deployment status. For instance, providing greater subsidies to lower income personnel with younger children—similar to the current system—would make child care more affordable to the youngest, lowest-ranked members. If DOD instead wished to use the vouchers as a more targeted retention incentive, it could provide larger vouchers to personnel in critical occupational specialties. Readiness could be enhanced by targeting vouchers to families with deployed members, or by providing supplemental vouchers to personnel on weekend or overnight duty.

While a voucher system offers many advantages, it has its limitations. Most significantly, providing service members with unregulated child care vouchers would not guarantee that the child care they purchase will be high quality. On the other hand, a voucher program would give DOD the means to promote higher quality by limiting the use of vouchers to providers who meet specific quality standards established by DOD. While requiring participating providers to meet national accreditation may be an unrealistic goal, DOD could establish standards that would improve private sector child care quality above current levels.

The Services would also have to consider the likely impact of a voucher program on CDCs and FCC providers. Vouchers could be used in conjunction with CDCs and FCC programs, but depending on how the program was designed, it could create incentives for parents to shift from CDC to less costly FCC or civilian care. For example, if the current CDC subsidies were eliminated as part of the shift to vouchers, CDC costs would increase, and many parents would likely turn to less expensive family-based child care or other lower cost civilian options. Such a change would force CDCs to compete for voucher dollars on a level playing field and become more efficient. FCC providers, meanwhile, would be able to charge higher amounts, enabling them to make more money, and, hence, become a more attractive option for spousal employment.

If, on the other hand, DOD wanted to maintain CDCs as the leading type of care offered to military families, it could structure a voucher system that made CDC care affordable relative to other child care options. For example, it could provide larger vouchers to parents using CDC care.

RECOMMENDATION

The QRMC recommends that DOD increase investment in family child care.

118 >

Like a voucher program, increased financial support to FCC programs would enhance the effectiveness and efficiency of the child care benefit, as well as expand families' access to services. To fund such an effort, DOD could request additional appropriations or reallocate resources currently assigned to CDCs.

As mentioned above, FCC costs are substantially less than CDC care. Moreover, FCC providers have the flexibility to offer overnight and weekend hours, a valuable service to military personnel that is not available at CDCs. Hence, if DOD channeled more resources to lower cost family child care, it could potentially serve more families, and in settings that offer more flexibility in terms of operating hours.

DOD should offer targeted subsidies to FCC operators to encourage them to provide the sort of child care services that would most effectively and efficiently improve retention and readiness. For example, DOD could encourage more FCC providers to offer extended hours by providing subsidies to providers who offer such flexible schedules. DOD could also provide subsidies to FCC programs offering infant care, since FCC infant care costs approximately \$7,000 less per year than CDC infant care. The Department could also offer higher subsidies to FCC programs that provide care to dual military and single parent families—two groups who presumably would appreciate the more flexible hours.

Such subsidies, however, may not be enough to persuade substantial numbers of military parents to use family child care. Many parents view CDCs as safer and more stable sources of care, primarily because CDC care is not dependent upon a single individual. DOD would have to provide some additional support to FCC programs in order to convince parents that their child care needs would be met at those facilities.

One of the main parental concerns with family child care is the lack of back-up care when a provider is ill or unavailable. Although all FCC providers are required to have back-up plans in place, parents are skeptical about their feasibility. They note that in most instances the designated back-up provider is another FCC provider who is already caring for a group of children at his or her own home, and would therefore not have the capacity to take in another provider's children as well. If DOD wishes to increase utilization of family child care, it will have to ensure that reliable and realistic back-up care will be available. One promising strategy would be to set aside a small number of slots at local CDCs as back-up family child care.

Even though an increased investment in FCC offers many advantages—particularly the ability to leverage the lower cost care to expand service to more families—the system would still be predominantly installation-based, and, as such, would not improve access or convenience to many personnel who live off base and who prefer child care options closer to home.

Greater Utilization of Private Sector Resources

DOD should also consider whether greater utilization of private sector providers offers any advantages over the current child care network, which is dominated by DOD-sponsored facilities.

There are some instances when it makes sense for employers to provide a benefit in kind; such as when an employer can provide the benefit at a lower cost than the employee would have to pay on his own, or when the benefit would be unavailable unless offered by the employer. Neither of these conditions, however, appears to apply in the case of military child care. There is no indication that DOD operates its child care program more efficiently than private sector child care providers. In fact, the cost of CDC care—particularly for children under age six—is higher than the cost of family child care or child care provided by private contractors.

While military families may need coverage at times when civilian child care is difficult to find, CDCs are no more likely to offer extended hours than are civilian providers. Some may also argue that there are not enough high-quality providers in

the private sector to serve all military families. This may be true. Yet it is also true that there are not enough high-quality slots available in the military child care system to serve military families either.

It may make sense, therefore, for DOD to consider relying more on the private sector to supply child care benefits to military personnel. Greater private sector involvement could be introduced in a number of ways, including privatization or purchasing child care slots from private sector providers.

There would be several potential benefits to this approach. First, it would enable DOD to offer community-based care to personnel who do not live on or near the installation and would prefer child care facilities closer to home. Second, if private sector care is more efficient, more care could be provided for the same amount of money. Moving away from in-kind benefits also has the added benefit of making the value of the benefit clearer to service members. By establishing quality standards for all participating civilian child care operations, DOD also could improve the quality of care provided to both military dependents and other children living in communities surrounding military bases.

Commissaries

DOD operates approximately 280 commissaries worldwide. Each year these facilities sell over \$5 billion in groceries and household supplies to military personnel, retirees, and their families. Commissaries are the most costly quality of life benefit offered to military personnel, with DOD spending approximately \$1.2 billion each year to support the system.

Prices charged at commissaries are capped at cost plus a 5 percent surcharge (which must be invested in capital improvements). DOD estimates that commissaries save service members roughly 30 percent on their grocery and household supply purchases, compared to what those items would cost at regular retail stores. For the average military family of four, this translates into annual savings of approximately \$2,700. Actual savings, however, vary based on a service member's purchasing patterns. For example, a first-term enlistee with no dependents spends significantly less money on commissary purchases than does a midcareer service member who is married with children. Because of this difference in spending patterns, the first-term enlistee will realize a smaller "benefit" from access to the commissary.

In addition to cost savings, commissaries offer convenience, particularly to service members who live or work on base. Some proponents also assert that commissaries help promote the sense of community and camaraderie found on military installations.

Although a substantial investment, the \$1.2 billion appropriation is not the only cost associated with commissaries; they also generate significant opportunity costs. For example, commissaries are located on military installations, often in prime locations convenient to both housing and work areas. On urban military installations, where land is in short supply, this opportunity cost is very high. Absent the commissary, that land could be put to other uses. Commissaries also impact other military systems, including power, communications, and water and sewer.

Commissaries are perhaps the most visible of all the quality of life benefits provided to military personnel. To many, they are an integral part of everyday life at military installations, with a history almost as old as the U.S. military itself. Yet the commissary system is also a component of military compensation. As such, DOD should evaluate whether commissaries improve recruiting and retention, and whether they do so in an efficient, rational, and cost-effective manner.

A 2006 member survey suggests that, in terms of retention outcomes, commissaries are one of the more effective quality of life programs (Figure 4-1). According to that survey, commissaries were one of only two quality of life benefits for which increased utilization was linked to higher continuation intentions. Yet active duty personnel participating in 40 GAO focus groups convened in 2005 reported that commissaries (and exchanges) had “outlived their usefulness because the savings are relatively minor and are not as convenient for those members living off base.”^{99, 100}

121

One alternative would be to leverage the substantial purchasing power of the military population in communities surrounding military installations. For example, at Naval Station Pascagoula, there is no commissary, but the Navy has negotiated with two local grocery chains to provide price breaks for military families. Well received by military personnel and their families, this initiative has enabled the Navy to provide members with access to lower priced goods, without incurring the capital and operating costs associated with commissaries.¹⁰¹ It could be used as a model for similar initiatives in locations where large retail stores are readily accessible in the local community. In addition, if DOD negotiated such price breaks with a national chain, they could potentially be available to the many reservist families who do not live near an installation and therefore have no access to commissaries.

99. U.S. Government Accountability Office, July 2005.

100. As noted earlier, the focus groups convened for the GAO study were not designed to “provide statistically representative samples or reliable quantitative estimates.” However, the information collected is from a wide range of personnel in different Services and grade levels.

101. Carla Tighe Murray, “Transforming In-kind Compensation and Benefits,” In *Filling the Ranks: Transforming the U.S. Military Personnel System*, Edited by Cindy Williams (Cambridge, Mass.: The MIT Press, 2004).

Another alternative would be to consider whether the value personnel derive from commissaries would be provided more efficiently as cash compensation. It could be possible to design a cash benefit that would, on average, provide personnel with compensation comparable to what they now receive from commissaries. For example, the \$1.2 billion subsidy could be directly provided to members receiving the Basic Allowance for Subsistence. Alternatively, members could be given vouchers for use at retail grocery stores, offering a more efficient method for delivering cost savings to personnel.

The difficulty with either of these approaches is setting the appropriate amount for the cash benefit or voucher. As mentioned earlier, commissary-generated savings vary depending on member utilization. A direct compensation scheme might try to capture that variation, although this would result in personnel receiving different pay based solely on personal choice rather than paying for performance.

While an analysis of the commissary system's effectiveness as military compensation is important, also important is the central role that commissaries play in military life. Many service members would view attempts to reduce commissary activities as DOD abandoning its commitment to quality of life. Any effort to invest commissary resources in a more efficient or cost-effective manner would have to take into account the impact such a change would have on force morale and military family satisfaction.

RECOMMENDATION

The QRMC recommends that DOD seek to develop relationships with national and regional grocery chains to provide discounts to service members.

Limited to installations in the continental United States where off-base alternatives are available, this proposal would offer several advantages to both members and DOD. Specifically, it would provide more convenient shopping to the two thirds of members who live off base, and would be available to reservists and retirees who do not live in proximity to an installation. With gas prices at record high levels, off-base members and retirees should welcome local shopping options closer to home. Among personnel assigned to areas where there are no bases nearby, such as recruiters and ROTC staff, this initiative would provide an added benefit and eliminate a source of dissatisfaction. In addition, installations would experience reduced traffic flow.

Overseas Cost-of-Living Allowance

To help offset the additional costs of food, lodging, and related incidental expenses incurred by personnel and their dependents assigned to permanent duty outside the United States, service members are provided with an array of overseas station allowances. There are three main components to this compensation: a housing allowance, a cost of living allowance (COLA), and a temporary lodging allowance.¹⁰² As part of its review of military compensation, the QRMC was asked to assess the COLA rate-setting process.

The overseas COLA is intended to ensure that military personnel assigned to duty locations outside the continental United States are not financially disadvantaged by such an assignment. To that end, the COLA provides additional compensation to offset higher costs of food, transportation, recreation, and similar expenditures, as well as fluctuations in monetary exchange rates.

The COLA rate-setting process uses a “market basket” approach, with the allowance based on the differential between the cost of a typical basket of goods and services purchased at an overseas location and the cost of the same items in the continental United States. The locations at which the purchases are made are determined through a survey that identifies where people shop. An index is created for all locations, with the U.S. index set at 100. If a basket index for a particular overseas location exceeds 100, that market basket costs more in the overseas location than in the United States, and a COLA payment may be made. This is the same methodology that the Department of State and most U.S.-based multinational corporations use to address higher costs of living in overseas locations.

COLA rates vary not only by location, but also by pay grade and number of dependents. While the COLA *index* is based on the price of a market basket at a particular location, the COLA *payment* also considers what portion of a member’s pay typically must be spent to purchase market basket items—referred to as

102. Overseas station allowances for Army personnel were created by the Act of July 2, 1942 (Army Appropriation Act, 1943), which authorized the expenditure of appropriated funds for the “actual and necessary expenses or per diem in lieu thereof as may be determined and approved by the Secretary of War, of military and civilian personnel in and under the Military Establishment on special duty in foreign countries.” The Second Supplemental National Defense Appropriation Act granted the same authority to the Navy. These are authorized by law as “a per diem, considering all elements of the cost of living to members...and their dependents, including the cost of quarters, subsistence, and other necessary incidental expenses, to...a member who is on duty outside of the United States or in Hawaii or Alaska, whether or not he is in a travel status.” 37 U.S. Code, Section 405(a).

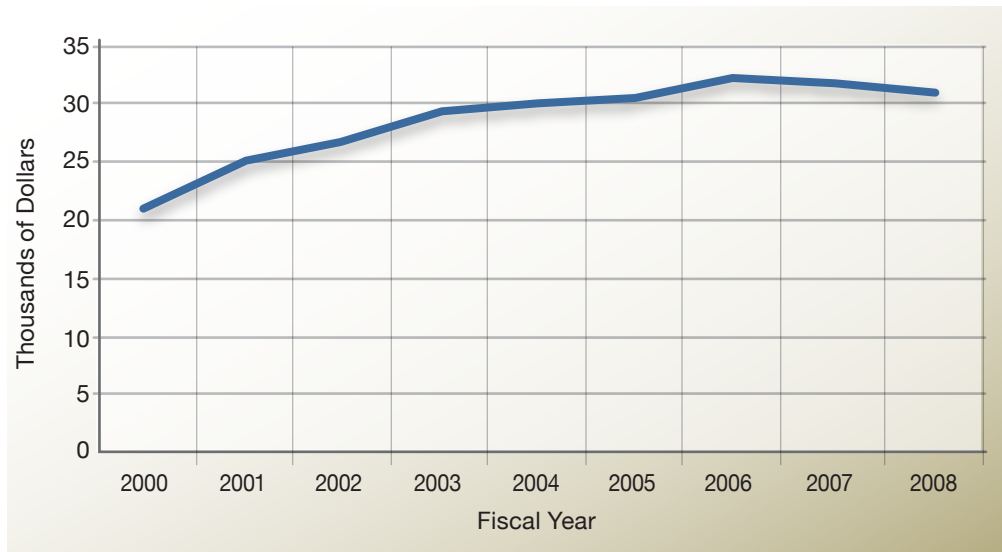


Figure 4-8. Spendable Income for an E-6 with Three Dependents

124

“spendable income.” Understandably, spendable income is higher for personnel with more dependents and changes over time as income grows. Figure 4-8, for example, shows changes in spendable income for an E-6 with three dependents and 12 years of service.

This concept of spendable income is a recent change in how the COLA index is applied and reflects an improvement to the system. Calculating spendable income is an important component of the overseas COLA process, as it is the portion of the member’s income to which the cost of living adjustment applies. Members allocate a portion of household income to items not considered living expenses—such as housing, taxes, life insurance, gifts, and savings. The remainder is spendable income, which is expected to rise with total household income and with household size. Spendable income is calculated using data from the Consumer Expenditure Survey, which includes both military and civilian households—with the number of military respondents being relatively small. As the purchasing choices of civilian households may not be representative of military families, these data could bias the spendable income calculation. **Thus, the Department should periodically examine the spendable income calculation to ensure that it is as accurate as possible.**

Calculating the Allowance

To determine the COLA, DOD performs a painstaking process of constructing the market basket; determining member spending patterns; pricing the basket both

in the continental United States and at overseas locations; calculating the indices; and computing the COLAs for each location, grade, and dependency status. The specific steps are as follows:

- **Determine market basket items and weights.** The market basket consists of items that are representative of the types of goods and services purchased by households in the United States. The specific items included in the basket—and the proportion of income spent on those items—are drawn from the Bureau of Labor Statistics Consumer Expenditure Survey for military members.
- **Determine spending patterns.** In order to determine spending patterns, DOD conducts a Living Pattern Survey at least once every three years at each location to identify where members shop. The survey identifies the proportion of spending done at on-base commissaries and exchanges, at off-base establishments, and through mail order or the Internet.
- **Determine prices.** DOD uses a number of sources to determine prices. Personnel stationed overseas are tasked with pricing market-basket items at on-base stores and the establishments identified in the Living Pattern Survey. On-base and off-base prices in the United States are obtained from Runzheimer, International.
- **Calculate indices.** The indices for the United States and overseas locations are calculated by weighting the market basket prices of each item at each establishment by the proportion of spending on each item and the proportion spent at each location.
- **Compute the COLA.** Finally, the locality index is applied to the spendable income of members by grade and dependency status to develop preliminary COLA factors. The resulting figures must then be adjusted for fluctuations in the exchange rate and for purchases that are unique to a location.

Factors Affecting the COLA Rates

The process of calculating the COLA is designed to provide members serving overseas with the same standard of living they would have if they were living in the United States. If prices in the continental United States were static and prices overseas rose (or fell), the COLA would rise (or fall) proportionally to the change in prices.

In practice, however, a variety of factors can produce unexpected results in the final COLA rates. First, product availability creates differences in U.S. and overseas spending. That is, some items normally purchased in the United States may not be widely available at some overseas locations, driving down the proportion spent on

those items overseas. Conversely, other goods and services at some overseas locations may be more widely available, and, hence, members at those locations may increase their spending on such items. Given that most people will look for less expensive alternatives and accordingly adjust their spending patterns, COLA rates will generally over-compensate for the shift in market basket pricing. Another factor affecting spending patterns is relative price differentials at on- and off-base establishments, which can cause personnel to adjust their shopping habits. These changes in spending patterns may mask some of the extent of price changes.

DOD continuously updates overseas COLA amounts to reflect fluctuations in currency exchange rates. If rates become more (or less) favorable toward the dollar, prices in the overseas local economy will fall (or rise) relative to U.S. prices. Thus, currency fluctuations can affect the prices of goods and services in the local economy; COLA adjustments help to protect the purchasing power of the dollar as these fluctuations occur. Currency exchange rates are examined twice a month to determine their direct effect on the price of items purchased in the local economy and whether COLA amounts should be adjusted in response. In times when the value of the dollar falls significantly relative to local currencies, as has been the case in recent years, it is particularly important that the process for adjusting the COLA in response to currency fluctuations works well.

COLA adjustments also stem from changes in overseas prices relative to prices in the United States. If the price of the market basket of goods in the continental United States rises faster than the price of the goods at an overseas location, the COLA rate will decline despite any increases in prices at the overseas site. To illustrate this point, Figure 4-9 shows the change in the Consumer Price Index for Germany, Japan, and the United States since 2000. While Japan's CPI has remained relatively flat, the CPI has risen by 14 percent in Germany and by 24 percent in the United States. Thus, to maintain relative spending power between members assigned to installations in the United States and these two countries, COLAs for both Japan and Germany would have to decline since, in both locations, the ratio of overseas prices to U.S. prices has declined.

The report of the 9th QRMC included several recommendations designed to improve the COLA rate-setting system—most of which were adopted. Having examined each aspect of the rate-setting process, the 10th QRMC finds that the current methodology is sound and mirrors best practices in the private sector. Further, COLA rate changes clearly reflect economic trends. There are two small program changes, however, that the QRMC believes would provide additional improvements to the overall COLA process.

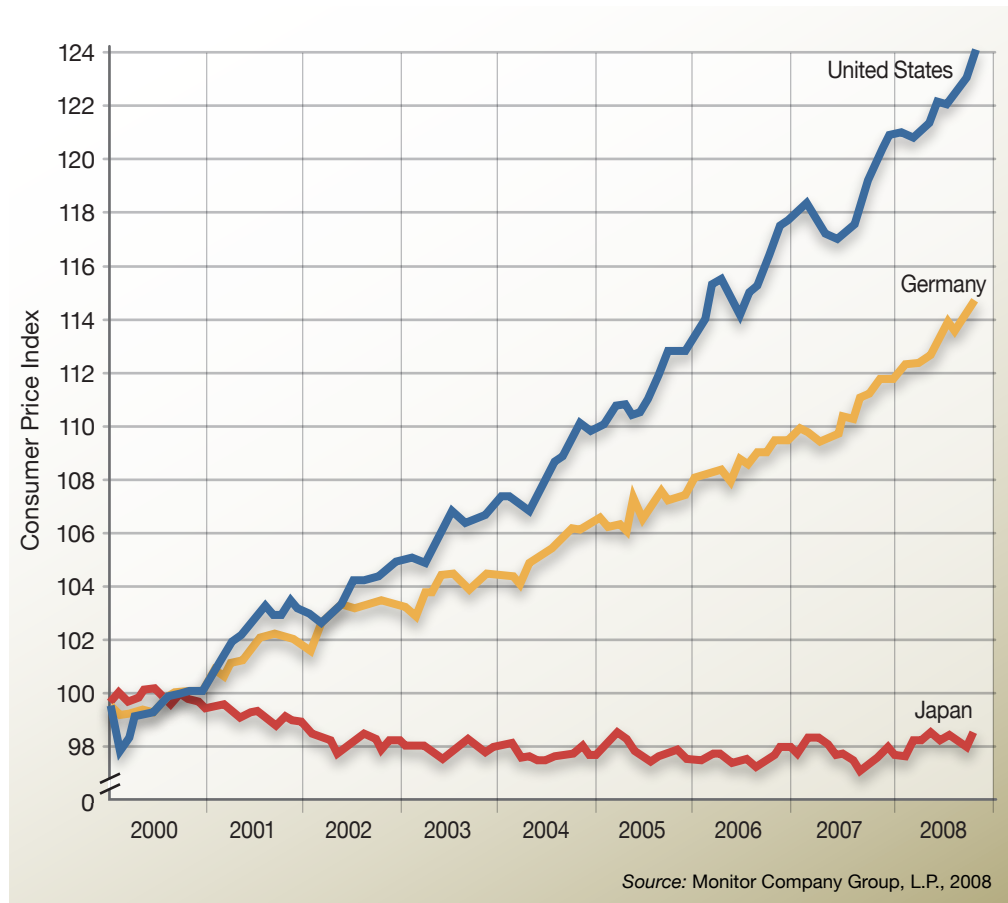


Figure 4-9. Change in Consumer Price Index in United States, Germany, and Japan

RECOMMENDATION

The QRMC recommends that rates for the overseas cost-of-living allowance be based on the size of the commissaries and exchanges located at each overseas site to prevent shifts in shopping patterns alone from causing changes in COLA rates.

This recommendation stems from the fact that members at overseas locations face a different shopping choice than members in the United States. Prices at U.S. commissaries and exchanges reflect the same pricing trends as other establishments in the United States. In other words, because on-base prices move in the same direction as off-base ones, members assigned in the United States are less likely to change where they shop due to price changes.

Overseas, however, that same linkage between on- and off-base prices may not exist. Prices on and off base will generally not move in tandem, causing members to periodically alter their shopping patterns. For example, a decrease in the dollar/euro exchange rate will result in higher off-base prices to members, who will respond by buying more in commissaries and exchanges. To the extent that their behavior is reflected in the Living Pattern Survey, and because on-base prices are lower, this behavior results in a lower COLA index and, in turn, a smaller COLA payment. As the COLA declines, members are driven to shop more on base, further driving down the COLA.

A similar dynamic was created when the military established the Variable Housing Allowance (VHA), a payment designed to reflect variation in housing costs in different geographic locations. VHA rates were based on members' reported rental expenditures. Thus, when rents rose and members sought lower quality housing to stay within their housing allowance, VHA rates declined, driving members to even lower cost housing. This "death spiral" was eliminated in 1998 when VHA and the Basic Allowance for Quarters were replaced with the current Basic Allowance for Housing, a program in which payment rates reflect local rents, not member spending. The QRMC believes that a similar change to the COLA process is in order.

128 >

The QRMC recommends following the same methodology that is used to set the U.S. COLA, establishing higher on-base spending proportions for locations with very large commissaries and lower proportions for those with very small or no facilities. In addition to achieving consistency across COLA programs, this change would halt the see-saw effect of realigning shopping location shares to the lowest-price alternatives. As members select lower-priced establishments, the shopping-pattern survey will always cause COLA rates to reflect lower market basket prices. This penalizes members by paying them less for making more financially astute choices. By adjusting the on- and off-base shopping shares, members would no longer be adversely affected by these choices.

RECOMMENDATION

The QRMC recommends that DOD and the Services develop a clearer explanation of how COLA rates are established and educate personnel on this benefit before they arrive at a new overseas duty station. In addition, DOD should publish frequent updates of the change in the cost of the U.S. market basket, so that members have appropriate expectations regarding changes in the cost of living allowance.

A significant issue with the current COLA system appears to be a lack of understanding of the purpose of the allowance. The allowance is intended to compensate members for differences in the cost of living between the continental United States and overseas locations where members might be stationed. It is not intended to compensate for the hardships of overseas tours, nor to serve as an incentive to accept overseas assignments (except to remove any disincentive that higher overseas prices might create); other special pays and allowances serve these purposes.

Further, it appears that members do not have a clear understanding of how the allowance is formed and how it changes over time—particularly those changes that cause a decline in the allowance. When the allowance declines, it can be disconcerting to members at the overseas location who may be observing rising local prices. What is often misunderstood is that these rising prices are compared to price changes in the United States and that it is the relative changes in price between the two locations that determine whether the COLA increases or decreases.

To improve understanding of the overseas cost of living allowance, the QRMC recommends that the Department invest in a professionally prepared, tested presentation of the allowance—its purpose, how it works, and how changes occur over time. This presentation should be both web-based and available as a PowerPoint briefing. It should be integrated with a command information program at overseas commands to ensure that the information is widely available through command-sponsored channels to affected members and their families. In addition, due to the unseen role that relative prices in the United States have on the overseas COLA, DOD should publish quarterly changes in the U.S. cost of living at a website that is accessible to all or most members. This will allow members to better anticipate changes in the overseas allowance.

Conclusion

Quality of life benefits play a crucial and prominent role in helping military families deal with the burdens and hardships sometimes associated with military life. While service members appreciate the many quality of life programs available to them and their families, they do not necessarily consider these resources as part of their compensation. Nor do they grasp the true value of the benefits, or how well their quality of life package compares to private sector compensation.

Chapter 4

If DOD is to more aggressively use quality of life benefits to advance force management goals, it must first educate service members about the value of these in-kind benefits and their contribution to the military compensation package. It must also develop a better understanding of the utilization of quality of life benefits among military personnel, as well as their impact on critical force objectives such as recruiting, retention, and readiness.

When evaluating the effectiveness of quality of life benefits and considering program reforms, DOD must also bear in mind that service members' needs and preferences vary. This suggests that providing personnel with a range of options—rather than a “one-size-fits-all” system—will better meet the diverse needs of the force. Many private sector employers have already come to this conclusion, and have restructured compensation plans and workplace policies to provide employees with greater flexibility and choice. Employing similar strategies in a targeted way in the military compensation system will provide service members with the flexibility and choice to tailor elements of their compensation package to meet their own needs and preferences.

Military quality of life programs have a long and successful history of providing essential support to military personnel and their families. The proposals outlined in this chapter will build upon these accomplishments by allowing force managers to use quality of life benefits as a compensation tool, maximizing their potential impact on retention, readiness, and other force management priorities.

Summary

In Volume 1 of this report, the QRMC identified two themes that dominated its deliberations and served as critical drivers of system improvement: flexibility for the uniformed services and choice for the member. Force managers need *flexibility* to adjust resources to address emerging issues or shifting priorities. They also need to be able to make targeted adjustments to address specific problem areas. By offering *greater choice to the service member*—in assignment selection, frequency and duration of deployment, and benefits—when those choices are consistent with operational requirements, member satisfaction is increased. Member satisfaction ultimately impacts reenlistment decisions, and potentially even enlistment decisions as reflected in youth perceptions of military life. This concluding chapter evaluates how well the QRMC recommendations in the area of deferred and noncash compensation advance these important principles.

- The **military retirement benefit** is a major component of military compensation. But the system as it exists today, with its 20-year vesting point, is often criticized as inequitable, inflexible, and inefficient. Few members earn the benefit, it leads to very rigid career patterns, and it is less efficient than cash compensation. The QRMC proposal, with early vesting and a mix of both deferred and cash components, mitigates these concerns. The proposal offers greater *flexibility* to force managers to use elements of the retirement benefit to shape the force in response to changing requirements, and *greater choice* to the member to plan a career that meets individual needs and preferences.

The elements of the QRMC proposal that enhance flexibility and choice are its earlier vesting at 10 years of service, a portable defined contribution plan that also vests at 10 years, gate pays payable at specified years-of-service milestones, and separation pay provided to members when they end their service. Gate pays and separation pay are designed to vary, so that force managers can set the criteria for receipt of these pays to shape career lengths in different specialties or for the force in general, and to adjust these levers as Service requirements shift in response to national security missions. Thus, career lengths can vary according to specialty, with “youth and vigor” careers designed to be shorter, compared to some professional and technical careers where longer careers are advantageous.

These diverse career lengths will also provide managers with more *flexibility* to vary assignment length to match force needs.

From the perspective of the member, the 10-year vesting point creates many *more choices for career lengths*. By reforming the “20-years-or-nothing” system with one that vests earlier and includes variable gate and separation pays, service members have more options regarding how long they might serve, which could increase reenlistment rates early in a career. Knowing that a member could serve between 10 and 20 years and still receive retirement benefits may be an incentive to many service members to reenlist a second or third time, even if they are not interested in serving a full career in uniform. The Services would benefit because they would have a greater return from their training investment in the member, and the service members benefit because they have greater *choice* in tailoring their service careers.

Better aligning the active and reserve retirement systems also enhances *member choice* and can serve as incentive for members to stay in uniform after an active duty career, or even for a member to move between active and reserve status multiple times during the course of a career. Furthermore, since most service members value cash compensation more than future compensation—or deferred benefits—the cash elements of the system are more highly valued and can serve as attractive recruiting and retention incentives. Relying on a more efficient mix of current and deferred compensation enables the uniformed services to deliver a more cost-effective retirement benefit that provides enhanced value to both members and the military at no additional cost.

- The **military health care program** provides benefits to active duty, reserve, retired, and dependent populations. It is highly valued by members and their families and is critical to force readiness. A number of the QRMC recommendations serve to infuse greater equity into the program and promote more cost-effective choices among program participants. Recommendations to better align premiums and deductibles with costs and to link these payments to retirees’ ability to pay establish a more equitable system, as well as help ensure that benefits to the members are sustained into the future, even as national health care costs continue to rise. This ultimately sustains the value of the benefit as an element of compensation, which is important to force managers in the context of recruiting and retention.

Changes in copayments and deductibles also encourage increased utilization of cost-effective care. It provides incentives for participants to *choose* low-cost prescription drug providers, for example, and to seek preventative care, which improves healthfulness and in turn lowers health care costs—both to the individual and to the health care provider. It enables members to consider health care *choices* in a new light. Ensuring that TRICARE reimbursement rates are in line with private insurer rates serves to ensure adequate *member choice* in health care providers—both general care physicians as well as specialists. If access to health care is limited, it could have a negative impact on recruiting, retention, and readiness—affecting both the member and the uniformed services.

- **Health care professionals** are the core of the military health benefit—those individuals who provide care to members, retirees, and families. The QRMC recommends a wide range of options to provide force managers with additional tools and *flexibility* to more effectively recruit and retain health professionals during a period of intense competition with the private sector. Recommended changes to the Health Professionals Scholarship Program—to help offset the high costs of medical school—are designed to make the program more attractive to medical and dental students considering uniformed service.

133

Likewise, recommendations for recruiting and retaining nurses are designed to enable the Services to target new markets as a source of personnel to expand nursing inventories. A final set of recommendations is designed to maximize contributions from existing personnel—longer careers, additional training, creative use of bonuses, and other mechanisms—and enable force managers to tap into existing military personnel as a source of health professionals. Making existing recruiting and retention tools more attractive to health care professionals enhances force manager flexibility in this challenging career market.

- Many of the recommendations to enhance **quality of life programs** also expand *member choice*. Flexible spending accounts, voucher programs for dependent education and child care services, and commissary alternatives are several examples of how quality of life benefits can be modified to provide members with more choice. Recommendations to better educate personnel about the value of quality of life benefits compared to civilian compensation opportunities would help individuals make more informed

career *choices* regarding enlistment and reenlistment. Some of these changes could also provide the Services with more *flexibility* to leverage and adapt quality of life resources in ways that better meet the diverse and evolving needs of military families in the 21st century.

While service members and their families appreciate and often rely on quality of life benefits, the in-kind nature of these benefits makes them less efficient than cash benefits and less valuable to some members. Offering flexible spending accounts to cover health and dependent care costs would give service members the *choice* of using a portion of their pretax income to cover health or dependent care costs. The QRMC's dependent care proposals would also enhance *choice* for members by providing—initially via pilot programs—school vouchers and charter school authority to military parents unhappy with local school options. Similarly, recommended changes to the military child care benefit would broaden accessibility and provider options to serve more families more effectively. Exploring partnerships with retail grocery chains could provide additional and more convenient shopping options for military personnel, particularly those not living on or near a military installation. These proposed changes would also give force managers the *flexibility* to vary and adjust quality of life resources to meet diverse needs, preferences, and circumstances.

It is also essential for both service members and force managers to change their thinking about quality of life benefits. These programs are valuable elements of compensation. However, their impact on critical force objectives such as recruiting, retention, and readiness will be diminished if members do not appreciate their true value and if managers do not consider them as part of their compensation “tool kit.” To address these concerns, the QRMC recommends that DOD implement an educational initiative to improve member understanding regarding the value of quality of life benefits, and also urge force managers to utilize and evaluate quality of life benefits as elements of compensation.

Collectively, the recommendations offered here would serve to improve system responsiveness, ensure fair and equitable compensation, and enhance recruiting and retention—all goals that will sustain and strengthen the all-volunteer force.

Appendix A

Federal and State Police and Firefighter Retirement Programs

Federal		Age to Retire	YOS	Formula	COLA	Other Info	Health Care
System							
Federal (FERS) Special Category		50 any	20 25	1.7% x HI-3 x 20 YOS + 1% x additional YOS x HI-3	CPI-begins at retirement	• Pay .5% more • TSP-government matching (max 5%) • Special Retirement Supplement paid until 62 • Mandatory separation @ 57 w/ 20 YOS in covered service	Health care enrollment continues at same premiums as when you were an employee
State							
CALPERS - State & Local Safety		50	5	benefit determined by age and classification best-3% x HI-1 x YOS (capped at 90% of HI-1)	CPI-Max 2%	• Defined Benefit plan 5-9% of earnings	>20 State will contribute fully to premiums <20 will be prorated based on YOS
Connecticut State Retirement-Hazardous Duty		any	20	50% (for 20 years) x average salary + 2% x >20 x average salary	CPI - 2.5%-6% (based on formula)		
State of Delaware/State Police Pension Plan		any 62 age + YOS	20 10 = 75	2.5% x HI-3 x 20 YOS + 3.5% x HI-3 x YOS >20	Done by legislation-last increase 6/2005 for 2% or \$25 per month	• Member contributes 7% of monthly compensation • Vested after 10 yrs	< 10 YOS-participate in group plan with 0 from employer 10-15 YOS-50% paid by employer 15-20 YOS-75% paid by employer > 20 YOS-100% paid
Florida Retirement System		55 52 any any	6 (HiRisk) 25 25 (HiRisk) 30	3% x age/or YOS x HI 5 (all Hi Risk)	3% annually	• Vested after 6 years • Employee noncontributory; employer pays all contributions • Benefits are back loaded - accumulate slowly at first then then at a faster rate the longer you stay	Health Insurance subsidy paid at \$5 x YOS
Michigan Dept of State Police		any 50	25 10	60% x HI-2 2% x YOS x HI-2	2% annually-\$500 max	401 available	95% employer paid (for retirees and dependents)
New Jersey State Police and Firemen		any any	20 25	50% x Final 65% x Final + 1% x Final x >25 (max 70%)	After 2 yrs, received annually @ 60% of the % change between the average CPI for the calendar yr you retired and the average CPI for 1 yr preceding yr of retirement	• Vesting @ 10 YOS • SPRS (state police) contrib 7.5% • PFRS (police & fireman) contrib 8.5% • Supplemental Annuity available • Mandatory retirement @ 55	w/25 YOS no cost for life (for retiree and dependents) (Cost vary with contract in effect when retiree attains 25 YOS)

Police and Firefighter Retirement Programs

State (continued)	System	Age to Retire	YOS	Formula	COLA	Other Info	Health Care
Ohio State Highway Patrol		any	15-20	1.5% x Hi-3 x YOS (payable @55)	3% annually	• Max 79.25% or 34 YOS	Retiree-covered; spouse-\$80 per month, children (1 or more) \$25 per month
		any	20-25	2.5% x Hi-3 x 20 YOS + 2.25% x > 20-25 YOS (payable at 52)			
		any	>25	2.5% x Hi-3 x 20 YOS + 2.25% x 5 YOS + 2% x >25 YOS (payable @48 w/ 25 YOS or 52 w/ <25 YOS)			
Pennsylvania State Police		any any	20 >25	50% x Hi (w/ 20-25 YOS) 75% x Hi	Legislation required/contains varying formulas and restrictions	• <20 YOS standard benefit-2% x Final Average Salary x YOS • Vest @ 5 YOS	Fully paid if retire at least age 50; or 20 YOS
Texas/law enforcement officers, custodial officer, and parole officer or caseworker		50 55 any	20 10 20	2.8% x YOS x Hi-3 2.3% x YOS x Hi-3 <50 - reduced benefits		• Member contributes 6%, state contributes 6.45% 5% interest annually • Additional supplement w/ >20 YOS • Deferred compensation 401K available	Full coverage for retiree and half cost for dependents
Washington/ Law Enforcement Officers & Firefighters (LEOFF plan 2)		50 53	20 5	YOS x 2% x Hi-5	Up to 3% annually	• Retire before 50 w/ 20 YOS reduce 3% per year under age 53 • Employee contribution set by legislation	Health benefits differ by employer. Extremes from no coverage to partial.
Washington State Patrol (WSPRS plan 2)		any 55	25 no min	YOS x 2% x Hi-5	Up to 3% annually	• If you leave before 55 you must be 5 yrs vested to receive reduced benefit • Mandatory retirement @ 60 • Employee contrib set by legislation	If member of PEBB(Public Employee Benefits Board) you may have health coverage after retirement

CITIES		Age to Retire	YOS	Formula	COLA	Other Info	Health Care
System							
Chicago		50 50	10 20	Reduced 52% x Hi-4 (best is 29 YOS@ 50 @75%)	3% annually beginning @55	- Employee contributes 9% + city contributes 9.57% - Deferred plan option available	Health plan available—retiree pays a portion
Dallas Police and Fire Pension (group B)		5 @ 50—at least 5 YOS/unreduced pension at >50 5 @ 45—at least 5 YOS/actuarially reduced pension 20&out-20 YOS using age-based %		Hi-3 x YOS x 3% 20 & Out 2% @ <45 2.25% @ 46 2.5% @ 47 2.75% @ 48 2.75% @ 49	- Annually 4% of monthly pension—not compounded from year to year - Benefit supplement @55 w20 YOS additional 3% of monthly pension (minimum \$75 per month)	- Member contributes 8.5%; city contributions are 27.5% of total leave payroll 401K and 457 plans also available - Max 32 YOS	Health benefits offered w/fee.
Detroit		any	25	2.5% x YOS x Hi-5 (w/ 25 YOS 62.5% x Hi-5) + 2.1% x 25-35 YOS x Hi-5	2.25% annually (compounded)	35 YOS max 5% employee contribution - to receive retirement vest @ 8 yrs and be at least 40 yrs old	City pays health benefits—collective bargaining @ time of retirement
Houston		55	10	2.25% x 20 YOS + 2% X YOS>20 x Hi-3 (max 80%)	2.4%-8% annually		Receive stipend of \$150 per month for health care
Los Angeles (Tier 4)		any	20	2% x Hi-1 x 20 YOS 3% x Hi-1 x each year >20	Annual capped at 3%	- Max 90% @ 33 YOS - Employee pays 8% (contribution stops at 30 years when you acquire max retirement % of 70% based on YOS)	Health benefit is subsidized—as of 7/1/06 max amt 782.44—formula is YOS x 4% x 782.44 Spouse is also subsidized using different max.amt.
Philadelphia		50	5	2.2% x first 20 YOS + 2% >20 YOS x Hi-2	Dependent on fund assets—may be distributed in lump sum bonus, monthly pension increase, ad-hoc COLA, or continuous COLA	- Vested 10 YOS 457b Plan (deferred compensation) available	
Phoenix Police Department		any	20	With 20 YOS, 50% x Hi-3 yrs >20 + 2% x Hi-3 yrs >25 + 2.5% x Hi-3 (Max 80%)	Max 4% of benefit (must be over 55)	- Member contributes 7.65%, employer contributes % as determined by actuarial valuation - Secondary option 457 plan—city contributes 1.18% of monthly gross	Health benefits continue with partial employer contribution
San Antonio		any	20	45% x Hi-3 (+4.5% 21–27 YOS, +3% 28–30 YOS, +.5% >30YOS)	75% of CPI	13th and 14th check (when system funds allow) - Vesting @ 20 YOS	

Appendix B

Air Force Compensation Fact Sheet

JANUARY 2008

In accordance with AFI 36-2618, paragraph 4.1.7, and noted in AFPAM36-2241, paragraph 9.8.7, supervisors are required to provide career counseling to subordinates on the benefits, entitlements, and opportunities available in an Air Force career. Counseling occurs in conjunction with performance feedback or when an individual comes up for review under the Selective Reenlistment Program. Provide a copy of the fact sheet to each individual after counseling. The fact sheet also contains valuable web links associated with each topic providing additional valuable information.

Part I: Compensation for Military Service

1. **Military Pay Raises:** The FY00 NDAA directed that pay raises for 2000 through 2006 will automatically be one-half percent above the private-sector wage increases as measured by the Employment Cost Index (ECI). Pay raises beginning in 2007 are to be equal to the increase in the ECI. Pay raises may exceed these automatic levels if authorized and funded by Congress. In January 2007, the military pay raise was 2.2% (ECI).
http://www.defenselink.mil/militarypay/pay/bp/05_annualraise.html
2. **Annual Leave:** IAW AFI 36-3003, Military Leave Program, annual leave is accrued at a rate of 2.5 days of leave for each month of active duty service for a total of 30 days of leave each fiscal year. Members who are unable to use leave due to military necessity may accumulate a maximum of 60 days by the end of a fiscal year. In the event service members are unable to use their excess accrued leave prior to 30 September due to mission requirements, approval may be requested to carryover the excess leave days (Special Leave Accrual).
3. **Federal Tax Advantage:** While all pays are taxable, most allowances are tax-exempt. The primary allowances for most individuals are Basic Allowance for Subsistence (BAS), Basic Allowance for Housing (BAH) or Overseas Housing Allowance (OHA), and Family Separation Allowance

139

(FSA). Tax savings can be significant as BAS and BAH averages over 30% of a member's total regular cash pay. In addition to being tax-exempt from Federal and State taxes, these allowances are also excluded from Social Security taxes.

http://www.defenselink.mil/militarypay/pay/tax/01_allowances.html

Regular Military Compensation Calculator:

<http://www.defenselink.mil/militarypay/pay/calc/index.html>

4. Housing Allowances:

- a. **Basic Allowance for Housing (BAH):** The intent of BAH is to provide uniformed service members accurate and equitable housing compensation based on housing costs in local civilian housing markets, and is payable when Government quarters are not provided. BAH is paid incident to assignments to a Permanent Duty Station (PDS) in the United States and is based not on actual expense, but on median rental costs, utilities, and renter's insurance. BAH rate calculations do not include mortgage costs. Members residing in family-type Government quarters are not entitled to BAH. Many AF installations are privatizing their quarters, meaning that private contractors are taking over previously AF-owned and operated family housing. Members in these privatized quarters are entitled to BAH and the rental agreement requires a rent amount equal to the BAH entitlement paid via allotment. The Leave and Earning Statement (LES) displays the BAH rate below the heading ENTITLEMENTS, listed as BAH. The PAY DATA portion of the LES shows the BAH type and BAH dependents, as well as other housing-related data.
- b. **BAH Differential (BAH-DIFF):** This is the housing allowance amount for a member who is assigned to single-type quarters and who is authorized a basic allowance for housing solely by reason of the member's payment of child support. A member is not authorized BAH-DIFF if the child support payment is less than the member's applicable pay grade BAH-DIFF amount. BAH-DIFF is published annually and is determined by increasing the previous year's table by the percentage growth of the military pay raise.
- c. **BAH-Partial:** Members without dependents who are not authorized to receive full BAH or OHA, and are residing in Government single-type quarters, are entitled to partial BAH if they meet certain conditions.

d. **Overseas Housing Allowance (OHA)** is a cost reimbursement-based allowance to help defray housing costs incident to assignments to a PDS outside the United States. Members are reimbursed actual rental costs not to exceed the maximum OHA rate for each locality and grade. There are two types of allowances paid under OHA: Move-In Housing Allowance (MIHA) and monthly OHA including a utility/recurring maintenance allowance. The location MIHA (for those who qualify) is based on the average “move-in” costs for members. The monthly OHA is the rent, up to the rental allowance at a PDS, plus the utility/recurring maintenance allowance.

e. **Family Separation for Housing (FSH):** The purpose of FSH is to pay a member for added housing expenses resulting from enforced separation from dependents. It is not payable under any condition to a member permanently assigned to a duty station in Hawaii or to any duty station under permissive orders. FSH is payable to each member with dependents who is on permanent duty outside the United States or in Alaska who meets all of the required conditions. For additional guidance, consult Joint Federal Travel Regulation (JFTR) Vol 1, Chapter 10.

Listed Housing Allowances: <https://secureapp2.hqda.pentagon.mil/perdiem/>

5. **Station Allowances:** Members may be authorized certain station allowances for themselves and their command-sponsored dependents when assigned OCONUS. They include Cost of Living Allowance and Temporary Living Allowance.

<https://secureapp2.hqda.pentagon.mil/perdiem/>

6. **CONUS COLA:** The FY95 NDAA approved the CONUS Cost-of-living Allowance (CONUS COLA), to provide compensation for variations in non-housing costs in the continental United States. Members and authorized dependents may be entitled to CONUS COLA when assigned or residing in a high-cost area. CONUS COLA should not be confused with BAH, which considers median rental costs, rental insurance and utilities. CONUS COLA varies by pay grade, years of service (YOS), and whether or not the member has dependents. A list of current CONUS COLA locations is available at the following web site.

<https://secureapp2.hqda.pentagon.mil/perdiem/ccform.html>

7. **Basic Allowance for Subsistence (BAS):** BAS is a non-taxable allowance used to offset the cost of the service member's meals. Members assigned to single-type Government quarters at their permanent duty station are required to eat in the government dining facilities, receive BAS, and are charged the discounted meal rate that is deducted from their pay. These members are allowed to claim missed meals when a Government meal is not reasonably available for consumption. Regular 2008 BAS rates for enlisted members is \$294.43 and for officers is \$202.76.

<http://www.defenselink.mil/militarypay/pay/bas/index.html>

8. **Family Subsistence Supplemental Allowance (FSSA):** The FSSA program increases the BAS of a service member to remove the member's household from eligibility under the United States Department of Agriculture (USDA) Food Stamp Program. The FSSA is a monthly entitlement paid in whole dollars, equal to the amount required to bring the member's household income to 130 percent of the Federal poverty line but not to exceed \$500 for large families or households. All active duty members may apply for FSSA. Please note that this link contains a RESTRICTED site, meaning this site has information pertinent to military personnel only. Only sites with a URL ending in ".mil" will be allowed access.

<https://www.dmdc.osd.mil/fssa>

9. **Family Separation Allowance (FSA):** The purpose of FSA is to compensate qualified members serving inside or outside the United States for added expenses incurred because of an enforced family separation. FSA has three different categories: FSA-R, FSA-S, and FSA-T. Members are eligible for FSA-R if transportation of dependents, including dependents acquired after effective date of orders, is not authorized at Government expense and the dependents do not live in the vicinity of the member's permanent duty station. FSA-S applies to members serving on ships away from the homeport continuously for more than 30 days. A member is eligible for FSA-T if the member is on TDY away from the permanent station continuously for more than 30 days and the member's dependents are not residing at or near the TDY station. This includes members required to perform a period of the TDY before reporting to their initial station of assignment. The FY05 NDAA made permanent the increase in Family Separation Allowance at a rate of \$250 per month.

http://www.dod.mil/comptroller/fmr/07a/07a_27.pdf

- 10. Hardship Duty Pay (HDP):** HDP is payable to members entitled to basic pay, at a monthly rate not to exceed \$300, while the member is performing duty designated by the Secretary of Defense as hardship duty. The Secretary of Defense has established that HDP shall be paid to members for performing a designated mission, when assigned to a designated location and/or, when serving a designated involuntary extension of duty. Current rates and locations are maintained in the DoD FMR Vol. 7a, Chapter 17.

http://www.dod.mil/comptroller/fmr/07a/07A_17.pdf

- 11. Combat Zone Tax Exclusion (CTZE):** Presidential Executive Order determines combat zones and the applicable dates. Earnings received while performing duties in, or in direct support of areas designated as a combat zone are excluded from taxable income. This exclusion is unlimited for enlisted members and warrant officers and is limited to \$6,867.00 per month, in 2007, for officers.

http://www.defenselink.mil/militarypay/pay/tax/10_combatzone_05.html and http://www.dod.mil/comptroller/fmr/07a/07A_44.pdf

- 12. Imminent Danger Pay (IDP)/Hostile Fire Pay (HFP):** Both are covered under 37 U.S.C. Section 310 and are used synonymously; they are commonly referred to as IDP. IDP is a “threat based” pay, meaning it is payable for any month the member performs duty in an IDP area (designated by USD P&R). These are areas where members are subject to threat of physical harm due to civil insurrection, civil war, terrorism, etc. HFP is an “event based” pay, meaning if the member is exposed to an actual occurrence of hostile fire or an explosion of hostile mine, the member is entitled to HFP for the month in which the hostile fire happened, and up to 3 months afterwards while hospitalized. The FY05 NDAA made permanent the rate of IDP/HFP at \$225 per month. Designated areas are listed in DoD FMR, Vol 7a, Ch 10.

http://www.dtic.mil/comptroller/fmr/07a/07A_10.pdf

- 13. Savings Deposit Program (SDP):** Military members may be authorized to participate in the SDP during assignments and deployments to specified locations. The program provides an interest rate of 10% and allows service members to contribute any portion of their unallotted current pay and allowances up to a maximum amount of \$10,000. Interest paid on the amounts deposited into the SDP is taxable. Eligibility requirements to participate in SDP are outlined in DOD FMR Vol 7a, Chapter 51.

http://www.dod.mil/comptroller/fmr/07a/07A_51.pdf

- 14. Travel Entitlements:** Members may be eligible for a wide variety of travel entitlements for themselves and their authorized dependents when ordered to perform official travel for TDY and/or PCS. Members should seek counseling from their MPF, FSO, and TMO. The following are some of the many entitlements available:

Transportation, Per Diem, and Reimbursable Expenses

Temporary Lodging Expense and Household Goods Shipments

Temporary and Non-Temporary Storage of Household Goods

Privately-Owned Vehicle (POV) Shipment and Storage

Reimbursement for Rental Car when POV Arrives Late

Dislocation Allowance

Partial Reimbursement of Pet Quarantine Fees

Evacuation/Safe Haven Entitlements

Part II: Retirement Pay and Post-Service Benefits

144 >

- 15. Retirement Pay:** One of the most attractive incentives of a military career is the retirement system that provides a monthly retirement income for those who serve a minimum of twenty years. Your retirement represents a considerable value over your life expectancy. While many civilian employees must contribute to their retirement, yours is provided at no cost to you. Currently, there are three retirement plans in effect based upon your Date of Initial Entry to Uniformed Service (DIEUS): Final Pay, High-3, and Choice of High-3 or Redux with \$30K Career Status Bonus. A description of each, to include which one applies to you, follows in the table below. Useful information can be found at the following Web site:

<http://www.defenselink.mil/militarypay/retirement/index.html>

- 16. Thrift Savings Plan (TSP):** The TSP provides military members a 401(k)-like savings plan, which allows members to contribute pre-tax dollars, thereby reducing current taxes, and to accumulate long-term, tax-deferred savings and earnings, which can supplement future retirement income. Participation is painless through payroll deduction, and account management is easy via worldwide web interface. The open seasons are eliminated and members can accomplish any action at any time. The Internal Revenue Code places an annual limit on elective deferrals, e.g., tax-deferred employee

Air Force Compensation Fact Sheet

Plan	Eligible (as determined by DIEUS) (Note 1)	Retired Pay Formula (Notes 2, 3 & 4)	Cost-of-Living Adjustment (COLA) (Note 5)
Final Basic Pay	Entered service prior to 8 Sep 80	2.5% times the years of service times final basic pay	Full inflation protection; COLA based on Consumer Price Index (CPI)
High-3 (Note 6)	Entered service on or after 8 Sep 80 and before 1 Aug 86	2.5% times the years of service times the average of the highest 36 months of basic pay	Full inflation protection; COLA based on Consumer Price Index (CPI)
High-3 Choice -----OR----- Redux/CSB Choice: Instead of retiring under High-3, members may choose to receive a \$30,000 (Note 7) "Career Status Bonus" at 15 years of service in exchange for agreeing to serve to at least 20 years of service and then retiring under the less generous Redux plan.	Entered service on or after 1 Aug 86	High-3: 2.5% times the years of service times the average of the highest 36 months of basic pay -----OR----- *Redux/CSB option: 2.5% times the years of service, minus one percentage point from the product for each year less than 30 years, times the average of the highest 36 months of basic pay. At age 62, retired pay is recalculated without deducting the one percentage point for each year less than 30, which allows it to catch up to what it would have been without the Redux penalty.	High-3: Full inflation protection; COLA based on Consumer Price Index (CPI) -----OR----- *Redux/CSB option: Partial inflation protection; COLA based on Consumer Price Index (CPI) minus 1 percent. At age 62, retired pay is adjusted to reflect full COLA since retirement. Partial COLA then resumes after age 62.

Note 1: Date initially entered uniformed service (DIEUS) refers to the fixed date the member was first enlisted, appointed, or inducted. This includes cadets at the Service Academies, students enrolled in a reserve component as part of the Services' senior ROTC programs or ROTC financial assistance programs, students in the Uniformed Services University of the Health Sciences, participants in the Armed Forces Health Professions Scholarship program, officer candidates attending Officer Training School, and members in the Delayed Entry Program.

Note 2: The maximum multiplier is 75 percent times basic pay.

Note 3: Members should be aware that the Uniformed Services Former Spouses Protection Act allows state courts to consider military retired pay as divisible property in divorce settlements. The law does not direct state courts to divide retired; it simply permits them to do so.

Note 4: Retired pay stops upon the death of the retiree unless he or she was enrolled in the Survivor Benefit Plan. See "Survivor Benefit Plan (SBP)" on page 3 for additional information on this program.

Note 5: COLA is applied annually to retired pay.

Note 6: High-3 is a reference to the average of the high three years or, more specifically, the high 36 months of basic pay as used in the formula.

Note 7: Effective 28 Dec 01, members may elect one of 5 options to receive the \$30K CSB: one lump sum payment of \$30k; two annual payments of \$15K; three annual payments of \$10K; four annual payments of \$7.5K; or five annual payments of \$6K.

contributions to the TSP. For 2008, the elective deferral limit is \$15,500. The TSP, in conjunction with the military pension and Social Security retirement benefits, can provide for a great retirement. Useful information can be found at the following web site: <http://www.tsp.gov/>.

17. Death and Survivor Benefits:

- a. **Servicemember's Group Life Insurance (SGLI):** If you elect to participate in SGLI and subsequently die on active duty, your survivors will be eligible for life insurance payments. Starting 1 Sep 05, you may buy life insurance coverage in \$50,000 increments up to \$400,000 at a very low cost. Additionally, **family member coverage** of up to \$100,000 for the member's spouse (spouse coverage is limited to no more than the member's current coverage) and \$10,000 per child became effective 1 Nov 01, and was automatic for all members participating in SGLI. The spouse coverage premium is an additional monthly premium of \$6-\$54 for maximum coverage based the spouse's age; coverage for children is free. You have the option to reduce or decline spouse coverage and the associated premium.

<http://www.insurance.va.gov/sgliSite/SGLI/SGLI.htm>

- b. **Dependency and Indemnity Compensation (DIC):** Surviving dependents may also be eligible to receive monthly DIC payments (nontaxable) in the amount of \$1033 for the surviving spouse and an additional \$257 for each surviving child. DIC is adjusted annually for inflation.

<http://www.vba.va.gov/bln/21/Rates/comp03b.htm>

- c. **Death Gratuity:** The death gratuity is a lump sum payment for beneficiaries of a member who dies on active duty, active duty for training, or inactive duty for training, or full-time National Guard duty. Its purpose is to help the survivors in their readjustment and to aid them in meeting immediate expenses incurred. Currently, the death gratuity is \$100,000, and payment is normally made within 24 hours of a member's death.
- d. **Survivor Benefit Plan (SBP):** Your regular pay stops when you die. However, if you die on active duty with 20 or more years of service, or in the line of duty with less than 20 years of service, your surviving spouse and children are automatically protected by SBP—at no cost to you. The surviving spouse will get an annuity equal to the difference between the DIC payment and the maximum SBP payment that would

be paid if you had been retired on the date of your death. The SBP survivor annuity is adjusted each year by the same percentage increase given to military retired pay. For AD deaths in the line of duty, the annuity is 55% of what retired pay would have been if retired for total disability. For a retiree the annuity is 55% of the elected retired base pay amount. Survivors of members who retired on or after 28 Oct 04 who participated at the maximum level are not subject to any offset at age 62 when Social Security starts. For those surviving spouses age 62 and older already drawing the SBP annuity, reduction will be eliminated by 5% a year. By Apr 2008, the full 55% will be paid to all annuitants.

<http://www.defenselink.mil/militarypay/survivor/index.html>

- e. **Other substantial benefits:** Surviving dependents may be eligible to receive additional benefits upon the death of a member. They include mortuary entitlements to reimburse the costs of burial, housing for 365 days, active duty transitional health and dental care for 3 years, commissary and exchange privileges, and various Veteran's Affairs and Social Security benefits.

18. **Federal Long Term Care Insurance Program (FLTCIP):** Members may be eligible to obtain coverage from the FLTCIP at premiums estimated to be 15–20% less than standard premiums for comparable coverage. The FLTCIP was designed specifically for members of the Federal Family. It is sponsored by the Federal Government and backed by two of the country's top insurance companies. The Federal Program is designed to help protect enrollees against the high costs of long-term care. Personal access to registered nurse care coordinators, and home care provisions are just a few of the reasons why the Federal Program may be the smart choice for you. Members may be eligible to obtain coverage from the FLTCIP at premiums estimated to be 15–20% less than standard premiums for comparable coverage.

<http://www.ltcfeds.com/>

Part III: Supporting Benefits

19. **Base Exchange:** “We Go Where You Go” is the motto of AAFES. For more than 105 years, the exchange service has remained true to its commitment to value, service, and support for the military customer and their families worldwide. Independent price surveys indicate that AAFES’ customers save an average of 11% over the competition. AAFES helps in two principal ways. First is its guarantee to “meet or beat” any retailer’s price on the same item (under \$5, no questions asked, or over \$5, within 30 days of the retailers advertisement). Second, profits are used to support the Services’ morale, welfare, and recreation programs. AAFES now offers 24/7 conveniences through its new website:

<http://www.aafes.com/>

20. **Base Services:** Installation services programs provide conveniently located, low-cost, professionally managed activities and entertainment. Programs include the golf course, child development center, skills development center, auto skills, aero club, community centers, swimming pool, enlisted club, intramural sports, bowling center, library, chapel, youth center, outdoor recreation, and discounts on special events/off-base recreation areas through Information, Ticket and Tours and the base fitness center in conjunction with the SG-run health and wellness center.

21. **Career Broadening Opportunities:** Assignments, Special Duty Assignments, Retraining, Overseas Duty, etc.

Assignment Information

22. **Child Care/Youth Programs:** CDCs offer care on a space-available basis for children 0-5 years of age. Air Force-licensed family child care is available at most installations. AF centers are certified by the Department of Defense and accredited by the National Association for the Education of Young Children. Fees are based on total family income. Before and after school programs are also offered as part of our youth programs. Youth centers are affiliated with the Boys & Girls Clubs of America and offer a variety of character and leadership development, education and career development, health and life skills, arts, and sports, fitness and recreation programs. Extended duty child care is offered for members required to work late or who have regular child care arrangements temporarily not available.

- 23. Commissary:** The Defense Commissary Agency's vision statement is: "The Commissary Benefit—Cornerstone of Military Quality of Life. It is our goal to provide this premier quality of life benefit to our military efficiently and effectively." Items are sold at cost plus a 5% surcharge, which covers the construction of new commissaries and modernization of existing stores. Customers save an average of 30% (approximately \$2,400 per year for a family of four), compared to commercial prices. Military members and retirees consistently indicate commissaries are one of the most important benefits.

<http://www.commissaries.com/>

- 24. Commissioning Opportunities:** The Airmen Education and Commission Program is an excellent way for enlisted members to earn a college degree and commission by attending Officer Training School or Reserve Officer Training Corps (ROTC). Participants attend college full time (for 1-3 years), receive up to \$15K for tuition annually, and continue to receive pay and benefits. Additionally, ROTC implemented a 1-year Professional Officer Corps Program that allows enlisted personnel, within one year of completing a bachelor's degree, to separate from the Air Force and attend ROTC to earn a commission.

25. Education:

- a. Montgomery GI Bill (MGIB):** Individuals entering the Air Force after 1 Jul 85 are automatically enrolled in the MGIB, unless they disenroll in basic training. The MGIB requires a \$100 a month nontaxable pay reduction for the first full 12 months of active duty. Benefits are currently \$1104 a month for 36 months (adjusted annually based on the consumer price index). Members who elected to participate in the Montgomery GI Bill upon entering active duty (after 30 June 1985) and agreed to payroll deduction of \$100 a month for a total of 12 months, can receive a benefit of \$39,744 with yearly increases as determined by the consumer price index or other Congressional action. Find out how to increase your monthly benefit by looking at the "Buy Up" program at

<http://www.gibill.va.gov/>

- b. Tuition Assistance:** The Air Force currently pays 100% of tuition up to \$250 per credit hour (\$4,500 annually) in off-duty courses with accredited schools. The Air Force provides free CLEP/DANTES

testing that could result in receiving college credit versus having to enroll in certain classes.

- c. **Scholarships:** Many scholarships are available for both military members and their families. Eagle Grants are also available for CCAF graduates who are pursuing a bachelor's degree. Grants range from \$250 to \$500 and may be used in conjunction with tuition assistance:

http://www.afas.org/Education/body_grant.cfm

Military spouses' organizations also offer scholarship opportunities:

<http://www.afas.org/index.cfm#>

- 26. **Airman and Family Readiness Center (A&FRC):** The Air Force realizes there is a direct relationship between a member's ability to successfully accomplish the mission and the quality of life of their family. Because of this relationship, many programs are offered through the base A&FRC to promote a positive family and community environment. The A&FRC offers a transition assistance program for those separating/retiring from the Air Force, an extensive relocation assistance program that includes a smooth move program to prepare those who will PCS, and a base newcomer's tour. The family services program offers a loan locker, which includes pots, pans, cribs, and other household items available for checkout to relocating members and their families. The volunteer resource office maintains a list of agencies accepting volunteers and a list of those wishing to volunteer. The family life program offers classes in parenting, couples communication, stress management, and a host of other family-related courses. The family readiness program prepares families for the stress of deployments, NEOs, and repatriations. Emergency financial assistance is available through the Air Force Aid office, and the Personal Financial Management Program offers information, education, and personal financial counseling on the full range of financial issues. A&FRCs are the first stop on base for information and referral services for all individual and family issues. In addition to these traditional A&FRC programs, the Air Force has a comprehensive community web site at <http://www.afcrossroads.com/>. Crossroads provides our military members and their families access to a wide range of resources from information on 300+ DOD installations to a spouse forum, secure and monitored teen forum, and spouse employment web-site with exclusive access to jobs for our AF Family members.

Family Support

27. **IDEA Program:** Air Force members may participate in the Innovative Development Through Employee Awareness (IDEA) Program and be eligible to receive monetary recognition. AF members may receive up to \$10,000 for each approved idea that results in validated tangible savings, and \$200 for approved ideas resulting in intangible benefits. The AF IDEA Program encourages creative thinking and rewards individuals whose ideas improve the efficiency, economy, and effectiveness of AF, DOD, and federal government operations. Click on <http://intraweb/ds/DSHM/manpower%20guide/IL.htm> and submit your idea today. Attention: To access the web site personnel will need to copy and paste URL into their web browser. Personnel will need to be on a .mil computer system.
28. **Legal Assistance:** The base Legal Assistance Office assists members with preparing wills, powers of attorney, and notarial acts, and provides advice on domestic relations problems, contracts, civil law matters, and income tax assistance.
29. **Promotion Opportunity:** The primary objective of our promotion system is to provide individuals rank commensurate with the responsibility and leadership requirements of the positions they hold. Our system is impartial, visible, and provides equal selection opportunity to all eligible. Airmen are promoted (fully qualified) through senior airman after meeting minimum eligibility requirements with approximately 15% of airman first class advanced to SrA six months prior to the fully qualified phase point through the SrA Below-the-Zone program. SrA through TSgt compete for promotion under the Weighted Airmen Promotion System (WAPS) in their control air force specialty (CAFSC), held as of the cycle promotion eligibility cutoff date (PECD), and require a primary air force specialty (PAFSC) skill level commensurate with the higher grade. In addition to WAPS consideration, commanders at all levels can nominate SrA through TSgts for advancement under the Stripes for Exceptional Performers (STEP) program. Lastly, promotion to SMSgt and CMSgt consists of a two-phase process. Phase one is similar to WAPS consideration with a slight variance in weighted factors. Phase two consists of a central evaluation board process to evaluate an individuals potential to serve in the higher grade. The Air Force uses the combined total score of phase one and two to select individuals for promotion.

Enlisted Promotions

- 30. Space Available Travel:** Active duty members are eligible for travel aboard military aircraft worldwide while family members are eligible for space available travel outside the CONUS:

<http://www.military.com/Travel/TravelPrivileges/0,13396,,00.html>

There is a trial process in place allowing dependent travel inside the CONUS until further notice.

- 31. VA Home Loans:** AF members may be eligible for home loans through the Veterans Administration.

<http://www.homeloans.va.gov/>

- 32. Vocational Training Opportunity:** AF members have training opportunities for both formal training associated with AFSC and various classes related to personal enhancement (PME, computer classes, management training, etc.).

- 33. Programs for Documented Personal Difficulties:** Emergency leave with priority on military aircraft, humanitarian reassignment, permissive reassignment, Exceptional Family Member Program (EFMP), Air Force Aid Society:

<http://www.afas.org>

152 >

PART IV: Intangible Benefits of an Air Force Career

Honor serving your country

Proud military heritage and tradition

Job security

Member of a profession highly respected by the American public

A different and unique way of life; opportunities for personal growth and development

Continuous improvement in quality of life initiatives

Opportunities for leadership early in your career with resources and guidance

Interaction with working professionals around the world and the Air Force family

Fair, impartial treatment for all; equal opportunities for jobs, promotions, and recognition

PART V: Where to Get Your Questions Answered

AF Personnel Contact Center

Toll Free: 1(800) 616-3775, COMM: (210) 565-5000, DSN: 665-5000

AF Crossroads

<http://www.afcrossroads.com/>

Virtual MPF

<http://ask.afpc.randolph.af.mil/>

Supporting Research Papers

Military Retirement

Assessing Compensation Reform in Support of the 10th Quadrennial Review of Military Compensation: Theory, Estimation, and Policy Analysis

Beth Asch, James Hosek, Michael Mattock, and Christina Panis

Military Retirement System Demonstration Test

Paul F. Hogan, Patrick C. Mackin, PhD, John Blayne, Kristofer J. Fenlason, PhD, Daniel Houser, PhD, Burt S. Barnow, PhD, and Thomas E. MacCurdy, PhD

Comments and Concerns on Restructuring Military Retirement: Collateral Issues

Tom Tower

Thinking about Military Retirement: An Analysis for the 10th QRMC

John T. Warner, PhD

Health Care

Conference on Providing the Health Benefit: Issues for the 10th Quadrennial Review of Military Compensation

Transcript, December 14, 2006

Controlling TRICARE Cost Growth: An Evaluation of Three Policies

Lawrence Goldberg, PhD, Karen Tyson, PhD, Phil Lurie, PhD, Dennis Kimko, PhD, Lark Lewis, and Stanley A. Horowitz

Improving the Recruitment and Retention of Military Medical Professionals

Karen W. Tyson, PhD and Stanley A. Horowitz

Quality of Life Programs

Commissary as Compensation: Policy Implications

1LT Mark Adams, 1LT David del Cuadro-Zimmerman, 1LT Theodore Steliga, and Dean Dudley, PhD

Marriage and the Military

Paul F. Hogan and Rita Furst Seifert

Supporting Research Papers

An Analysis of the Overseas Cost of Living Allowance

Paul F. Hogan and Patrick C. Mackin

Perceptions and Influence of Quality of Life and Retirement Benefits

Diana S. Lien, PhD, Michael J. Moskowitz, Michael L. Hansen, PhD, and
Henry S. Griffis, PhD

Survey, Content, Practices, Results, and Trends Related to Private-Sector Flexible
Benefit and Quality-of-Life Programs

Kenneth Pearlman, PhD

Voucher Programs for the Department of Defense

Neil M. Singer, PhD, Gregory A. Davis, PhD, and Stanley A. Horowitz

Flexible Benefits for Military Personnel

Neil M. Singer, PhD, Karen W. Tyson, PhD, and Stanley A. Horowitz

Options for Improving the Military Child Care System

Gail L. Zellman, PhD, Susan M. Gates, PhD, Michelle Cho, and
Rebecca Shaw

References

American Dental Association. *Survey and Economic Research on Dentistry: Frequently Asked Questions*. <http://www.ada.org/ada/prod/survey/faq.asp>. Accessed May 4, 2008.

American Hospital Association. "The State of America's Hospitals." *Chartbook*. April 2006.

Association of American Medical Colleges. <http://www.aamc.org/data/facts/2007/2007school.htm>. Accessed May 4, 2008.

Buddin, Richard, Brian P. Gill, and Ron W. Zimmer. *Impact Aid and the Education of Military Children*. Santa Monica, Calif.: RAND Corporation. 2001.

Cejka Search. *American Medical Group Association Physician Compensation Survey*. http://www.cejkasearch.com/compensation/amga_physician_compensation_survey.htm. Accessed May 2, 2008.

Commission on the National Guard and Reserves. *Transforming the National Guard and Reserves into a 21st-Century Operational Force*. Arlington, Va.: January 31, 2008.

Conference on Providing the Health Benefit: Issues for the 10th Quadrennial Review of Military Compensation. December 14, 2006.

Congressional Budget Office. *The Costs and Benefits of Retail Activities at Military Bases*. Washington, D.C.: October 1997.

_____. *Military Compensation: Balancing Cash and Noncash Benefits*. Washington, D.C.: January 2004.

_____. *Evaluating Military Compensation*. Washington, D.C.: June 2007.

_____. *The Long-Term Implications of Current Defense Plans: Detailed Updates for Fiscal Year 2008*. March 2008. <http://www.cbo.gov/ftpdoc.cfm?index=9043>. Accessed June 30, 2008.

Congressional Research Service. *CRS Report for Congress, Medicare: Part B Premiums*. September 14, 2004. www.law.umaryland.edu/marshall/crsreports/crsdocuments/r132582.pdf. Accessed June 30, 2008.

References

Defense Advisory Committee on Military Compensation. *The Military Compensation System: Completing the Transition to an All-Volunteer Force*. Washington, D.C.: April 2006.

Defense Commissary Agency. <http://www.commissaries.com/history.cfm>. Accessed June 30, 2008.

Educational Commission for Foreign Medical Graduates. <http://www.ecfmg.org/2008ib/ibfaq.html>. Accessed May 16, 2008.

8 U.S. Code, Section 1440.

Executive Order No. 13,269. July 3, 2002. (67 Federal Register 45,287. July 8, 2002.)

Families and Work Institute. *2005 National Study of Employers*. New York, N.Y.: October 13, 2005.

Franco, Rich. *Medical Manpower and Personnel Update*. Briefing to the Medical Personnel Committee. February 2007.

Gates, Susan M., Gail L. Zellman, and Joy S. Moini, with Marika Suttorp. *Examining Child Care Need Among Military Families*. TR-279-OSD. Santa Monica, Calif.: RAND Corporation. 2006.

"The Good and Bad of Spending Accounts." *Business and Legal Reports*. September 18, 2001. <http://hr.blr.com/display.cfm/id/3569>. Accessed July 3, 2008.

Hogan, Paul. *Adequacy of Future Physician Supply*. Conference on Providing the Health Benefit: Issues for the 10th Quadrennial Review of Military Compensation. December 14, 2006.

Kaiser Family Foundation and Health Research and Educational Trust. *Employer Health Benefits: 2007 Annual Survey*. September 2007.

Levy, Robert. *Using Cash for Medical Accessions*. Conference on Providing the Health Benefit: Issues for the 10th Quadrennial Review of Military Compensation. December 14, 2006.

Levy, Robert A., Eric W. Christensen, and Senanu Asamoah. *Raising the Bonus and the Prospects for DOD's Attracting Fully Trained Medical Personnel*. CRM D0013237.A2. Alexandria, Va.: Center for Naval Analyses. February 2006.

Levy, Robert A., Richard D. Miller, and Pamela Shayne Brannman. *Health Professionals' Retention and Incentive Study (Phases II and III)*. CRM D00004460.A5. Alexandria, Va.: Center for Naval Analyses. January 2002.

- Library of Congress, Federal Research Division. *A Summary of Major Military Retirement Reform Proposals, 1976–2006*. Washington, D.C.: November 2007. http://www.loc.gov/rr/frd/pdf-files/CNGR_Summary-Military-Retirement.pdf. Accessed June 20, 2008.
- Library of Congress, Thomas. <http://thomas.loc.gov/cgi-bin/bdquery/z?d110:h.r.04986>. Accessed June 25, 2008.
- Medicare Payment Advisory Commission (MEDPAC). *Report to the Congress: Medicare Payment Policy*. Washington, D.C.: March 2008.
- Military Impacted Schools Association. www.militaryimpactedschoolsassociation.org/. Accessed January 2008.
- Moini, Joy S., Gail L. Zellman, and Susan M. Gates. *Providing Child Care to Military Families: The Role of the Demand Formula in Defining Need and Informing Policy*. MG-387-OSD. Santa Monica, Calif.: RAND Corporation. 2006. <http://www.rand.org/pubs/monographs/MG387>. Accessed February 2008.
- Monitor Company Group, L.P. *Findings from Initial Review of COLA Adjustment Process*. May 8, 2008.
- Murray, Carla Tighe. “Transforming In-Kind Compensation and Benefits.” In *Filling the Ranks: Transforming the U.S. Military Personnel System*. Edited by Cindy Williams. Cambridge, Mass.: The MIT Press. 2004.
- National Military Family Association. *Fact Sheet: Impact Aid*. Alexandria, Va.: January 2006.
- National Research Council, U.S. Naval Studies Board, Committee on Shore Installation Readiness and Management. *Recapitalizing the Navy: A Strategy for Managing the Infrastructure*. Washington, D.C.: The National Academies Press. 1998.
- Powers, Rod. “What Congress Has in Store for You in 2007.” About.com: U.S. Military. http://usmilitary.about.com/od/payandbenefits/a/07paychanges_3.htm. Accessed May 15, 2008.
- Public Law 109-364. (National Defense Authorization Act for Fiscal Year 2007).
- Social Security Administration. <http://www.socialsecurity.gov/mediinfo.htm>. Accessed June 2008.
- Studentdoc. <http://www.studentdoc.com/foreign-medical-schools.html>. Accessed May 16, 2008.

References

US Charter Schools. http://www.uscharterschools.org/pub/uscs_docs/index.htm. Accessed April 23, 2008.

10 U.S. Code, Sections 633, 634, and 635.

37 U.S. Code, Section 405.

_____. Section 1008(b)

U.S. Department of Defense. *Report of the 1st Quadrennial Quality of Life Review*. Washington, D.C.: 2004. http://www.opm.gov/retire/fers_election/fersh/hb.pdf. Accessed July 9, 2007.

_____. *Military Compensation Background Papers*, Sixth Edition. Washington, D.C.: April 2005.

_____. *2003 Survey of Retired Military: Overview Briefing*. Arlington, Va.: Defense Manpower Data Center. December 2005.

_____. *Status of Forces Survey of Active Duty Members*. Arlington, Va.: Defense Manpower Data Center. December 2006.

_____. *Financial Issues and Employment: Experiences of Military Spouses. Results from the 2006 Survey of Active Duty Spouses*. Arlington, Va.: Defense Manpower Data Center. August 2007.

_____. *Task Force on the Future of Military Health Care: Final Report*. December 2007.

U.S. Department of Defense, Assistant Secretary of Defense for Health Affairs. *Report on Department of Defense Military Medical Recruiting & Retention*. Washington, D.C.: June 2007.

U.S. Department of Defense, Office of the Actuary. *Valuation of the Military Retirement System*. Washington, D.C.: September 30, 2003.

U.S. Department of Defense, Office of the Under Secretary of Defense (Comptroller). *National Defense Budget Estimates for FY 2007*. March 2006. <http://www.dod.mil/comptroller/defbudget/fy2007/index.htm>. Accessed June 30, 2008.

U.S. Department of Defense, Office of the Under Secretary of Defense (Personnel and Readiness). *Report of the Ninth Quadrennial Review of Military Compensation*. Washington, D.C.: 2002.

U.S. Department of Education, Office of Elementary and Secondary Education. <http://www.ed.gov/about/offices/list/oese/impactaid/whatisia.html>. Accessed June 3, 2008.

U.S. Government Accountability Office. *Military Personnel: DOD Needs to Improve the Transparency and Reassess the Reasonableness, Appropriateness, Affordability, and Sustainability of Its Military Compensation System*. GAO-05-798. Washington, D.C.: July 2005. <http://www.gao.gov/new.items/d05798.pdf>. Accessed June 30, 2008.

_____. *Military Personnel: DOD Needs to Establish a Strategy and Improve Transparency Over Reserve and National Guard Compensation to Manage Significant Growth in Cost*. “Appendix I: Updated Active Duty Compensation Costs.” GAO-07-828. Washington, D.C.: June 20, 2007.

U.S. Department of Labor, Bureau of Labor Statistics 2006. *National Compensation Survey: Employee Benefits in Private Industry in the United States*. Washington, D.C.: March 2007. <http://www.bls.gov/ncs/ebs/sp/ebsm0006.pdf>. Accessed May 2008.

Warner, John T. and Saul Pleeter. “The Personal Discount Rate: Evidence from Military Downsizing Programs.” *The American Economic Review*. Vol. 91, No. 1, 2001.

Watson Wyatt Worldwide. <http://www.watsonwyatt.com/new/press.asp?ID=143303>. Accessed June 4, 2008.

Williams, Cindy. *Transforming the Rewards for Military Service*. MIT Security Studies Program. Cambridge, Mass.: MIT Press. September 2005.

Zellman, Gail L. and Susan M. Gates. *Examining the Cost of Military Child Care*. MR-1415-OSD. Santa Monica, Calif.: RAND Corporation. 2002.

Glossary

10th QRM	Tenth Quadrennial Review of Military Compensation
AAFES	Army and Air Force Exchange Service
ABP	annual basic pay
AD	active duty
AF	Air Force
AFI	Air Force Instruction
AFPAM	Air Force pamphlet
A&FRC	Airman & Family Readiness Center
AIP	Assignment Incentive Program
BAH	Basic Allowance for Housing
BAH-DIFF	Basic Allowance for Housing Differential
BAS	Basic Allowance for Subsistence
BSN	Bachelor of Science Nursing
CAFSC	Control Air Force Specialty Code
CBO	Congressional Budget Office
CCAF	Community College of the Air Force
CDC	child development center
CHAMPUS	Civilian Health and Medical Program of the Uniformed Services
CLEP/DANTES	College Level Examination Program/Defense Activity for Non-traditional Education Support
COLA	cost of living allowance; cost of living adjustment
CONUS	continental United States
CPI	Consumer Price Index
CRNA	Certified Registered Nurse Anesthetist

Glossary

CSB	Career Status Bonus
CZTE	Combat Zone Tax Exclusion
DACMC	Defense Advisory Committee on Military Compensation
DCFSA	Dependent Care Flexible Spending Account
DDESS	domestic dependent elementary and secondary school
DIC	Dependency and Indemnity Compensation
DIEUS	date of initial entry to uniformed service
DOD	Department of Defense
DODDS	Department of Defense Dependent School
DOE	Department of Education
ECFMG	Educational Commission for Foreign Medical Graduates
ECI	Employment Cost Index
EFMP	Exceptional Family Member Program
EITC	Earned Income Tax Credit
FAP	financial assistance program
FCC	family child care
FERS	Federal Employees Retirement System
FLTCIP	Federal Long Term Care Insurance Program
FMR	Financial Management Regulation
FSA	flexible spending account
FSH	Family Separation for Housing
FSO	Financial Service Office
FSSA	Family Subsistence Supplemental Allowance
FY	fiscal year
FYDP	Future Years Defense Plan
GAO	Government Accountability Office
HCFSA	Health Care Flexible Spending Account

HDHP	high deductible health plan
HDP	Hardship Duty Pay
HFP	Hostile Fire Pay
HMO	health maintenance organization
HPLRP	Health Professions Loan Repayment Program
HPSP	Health Professionals Scholarship Program
HSA	health savings account
IAW	in accordance with
IDEA	Innovative Development Through Employee Awareness
IDP	Imminent Danger Pay
JFTR	Joint Federal Travel Regulation
LES	leave and earning statement
MBP	monthly basic pay
MCCA	Military Child Care Act
MGIB	Montgomery GI Bill
MIHA	Move-In Housing Allowance
MPF	military personnel flight
MTF	military treatment facility
NDAA	National Defense Authorization Act
NPHCP	non-physician health care provider
OCONUS	outside the continental United States
OHA	Overseas Housing Allowance
OPM	Office of Personnel Management
PAFSC	Primary Air Force Specialty Code
PCS	permanent change of station
PDS	permanent duty station
PECD	promotion eligibility cutoff date

Glossary

PME	professional military education
POS	point-of-sale
POV	privately owned vehicle
PPO	preferred provider organization
QRMC	Quadrennial Review of Military Compensation
ROTC	Reserve Officer Training Corps
SAC	school-age care
SBP	Survivor Benefit Plan
SDP	Savings Deposit Program
SGLI	Servicemember's Group Life Insurance
STEP	Stripes for Exceptional Performers
TDY	temporary duty
TMO	Transportation Management Office
TSP	Thrift Savings Plan
URL	universal resource locator
USDA	U.S. Department of Agriculture
USD (P&R)	Under Secretary of Defense for Personnel and Readiness
VHA	Variable Housing Allowance
WAPS	Weighted Airmen Promotion System
YOS	years of service



DEPARTMENT OF DEFENSE

Office of the Under Secretary of Defense
for Personnel and Readiness
Washington, D.C.