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Military compensation should help the services successfully compete with other employers for the personnel they require. Study groups and commissions have repeatedly pointed out that the base pay and allowances system is an inefficient way to support this objective and have recommended that it be replaced by a salary system. Findings/Conclusions: Measuring regular military compensation is complicated, and even those individuals being compensated cannot easily determine their pay. The base pay and allowances system is also inequitable. The regular military compensation is greater for married members than for single members of the same grade and length of service. The base pay and allowances system conceals the cost of military personnel through the provision of goods rather than cash and particularly through tax advantage. A salary system would increase members' awareness of their pay; remove inequities in pay; and make the cost of military personnel easier to identify. Suggested methods of converting to a salary system include: (1) developing salaries based on the pay of a designated segment of civilian employees, or (2) developing salaries based on current levels of regular military compensation. Recommendations: The Congress should replace the military base pay and allowances system with a salary system. (Author/SC)

02873

REPORT

REPORT TO THE CONGRESS



*BY THE COMPTROLLER GENERAL
OF THE UNITED STATES*

Military Compensation Should Be Changed To Salary System

Department of Defense

The purpose of military compensation is to assist the services in successfully competing with other employers for the military personnel they require. The base pay and allowances system is an inefficient means of supporting this objective and should be replaced by a salary system.



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20546

B-163770

To the President of the Senate and the
Speaker of the House of Representatives

This report discusses the need for a change in the structure of the military compensation system to efficiently support the attraction and retention programs of the Armed Forces.

We made our review pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

Advance comments from the Department of Defense, which were requested by March 1, 1977, were not received in time to be considered in preparing this final report. However, the Department stated in its comments that it would await the recommendations of the President's Commission on Military Compensation before taking a position on changes to the form of military pay. We did consider the Department of Defense position on the salary recommendation of the Defense Manpower Commission in the report.

Copies of this report are being sent to the Director, Office of Management and Budget, and to the Secretaries of Defense; Commerce; Transportation; and Health, Education, and Welfare.

Leues A. Strick
Comptroller General
of the United States

D I G E S T

The Congress should replace the military base pay and allowances system with a salary system. (See pp. 31 to 34.)

Military compensation should help the services successfully compete with other employers for the personnel they require. Study groups and commissions have repeatedly pointed out that the base pay and allowances system is an inefficient way to support this objective and have recommended that it be replaced by a salary system. (See pp. 1 to 3.)

BENEFITS OF A SALARY SYSTEM

Regular military compensation, the military equivalent of a civilian salary, has four parts. (See p. 5.)

- Basic pay, which all members receive in taxable cash.
- The nontaxable value of housing provided by the Government or a nontaxable cash allowance for quarters when Government housing is not provided.
- The nontaxable value of meals provided by the Government or a nontaxable cash allowance for subsistence when meals are not provided.
- Tax advantage, which is the additional cash income a serviceman would need in order to leave him with the same take-home pay he now has if all his regular military compensation were subject to Federal income taxes.

Measuring regular military compensation is complicated, and even those individuals being compensated cannot easily determine their pay; regular military compensation was underestimated

by 40 percent of enlisted personnel and 20 percent of officers. Clearly, compensation which is not recognized does not help to attract and retain personnel and is an inefficient use of compensation resources. (See pp. 5 to 7.)

The base pay and allowances system is also inequitable. The regular military compensation is greater for married members than for single members of the same grade and length of service, even if their duties, qualifications, and performance are equivalent. (See pp. 7 and 8.)

The base pay and allowances system conceals the cost of military personnel through the provision of goods, rather than cash, and particularly through tax advantage, which is not reflected in the Defense budget but is a cost to the Government reflected in reduced Federal income tax revenue. (See p. 7.)

A salary system would

- increase members' awareness of their pay,
- remove inequities in pay, and
- make the cost of military personnel easier to identify and evaluate.

METHODS OF CONVERTING TO A SALARY SYSTEM

Two methods of determining military salary levels have been considered in previous studies.

- Developing salaries based on the pay of a designated segment of civilian employees. (See pp. 16 to 18.)
- Developing salaries based on current levels of regular military compensation. (See pp. 18 to 20.)

Determining pay levels by a pay standard would assure both managers and members that military pay was set and maintained on a par with pay

of other employees. Confidence in the system's stability and fairness would then develop. This concept has been studied frequently in the past 10 years, with no change. (See pp. 17, 18, 33, and 34.)

The second method could probably be put into practice more quickly. Also, since pay levels would remain essentially the same as at present, attraction and retention of personnel should not be adversely affected. An examination of the effects of such conversion, which GAO considers only an initial step, should show what additional changes in military pay would be desirable and should place both the Congress and the Department of Defense in a good position to evaluate the military compensation system. (See p. 34.)

A study group within Defense has developed preliminary estimates of conversion costs for four alternatives using the regular military compensation method. Estimates range from \$700 million to \$1.18 billion. (See pp. 24 to 26.)

OTHER ISSUES TO BE CONSIDERED

When converting to a salary system, the following issues should also be carefully considered.

- How other elements of compensation, which are now computed based on the value of an element of the regular military compensation, should be computed under a salary system. (See pp. 27 and 28.)
- The method of adjusting military salaries in the future. (See pp. 28 and 29.)
- The effect of salary limitations on flag and general officer pay. (See pp. 29 and 30.)

Advance comments from the Department of Defense, which were requested by March 1, 1977, have not been received. However, in its response to the salary recommendation of the Defense Manpower Commission, the

Department of Defense stated that the advantages of a salary system are outweighed by the disadvantages. GAO has evaluated the disadvantages cited and disagrees with the Department's position. (See pp. 31 to 32.)

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ABBREVIATIONS

BAQ	basic allowance for quarters
BAS	basic allowance for subsistence
DOD	Department of Defense
FICA	Federal Insurance Contributions Act
GAO	General Accounting Office
CMB	Office of Management and Budget
RMC	regular military compensation

CHAPTER 1

INTRODUCTION

The military compensation system of the United States differs from most civilian compensation systems in the extent to which it undertakes to satisfy personal living requirements with goods, services, and facilities and in the way in which it compensates according to marital and dependency status as well as to grade and length of service.

Military compensation includes three components; regular military compensation (RMC), bonuses and special pays, and supplemental benefits. RMC includes a cash basic pay based on the member's grade and length of service and such items as housing and meals or cash allowances when these items are not provided by the Government. Bonuses and special pays are employed to supplement base pay and allowances where needed to attract, retain, and motivate military personnel to specific duties and occupations. Supplemental benefits include retirement, medical care, social security, and death gratuity. The staff of the Third Quadrennial Review of Military Compensation estimated personnel compensation for fiscal year 1976 as follows:

	<u>Amount</u>
	(billions)
RMC:	\$21.5
Basic pay	\$15.5
Quarters	2.9
Subsistence	1.9
Tax advantage	1.2
Bonuses and special pays	1.2
Supplemental benefits	<u>7.6</u>
Total	<u>a/\$30.3</u>

a/Some compensation costs were excluded from these estimates, such as commissary and exchange benefits.

LONG RECOGNIZED NEED: CONVERSION TO A SALARY SYSTEM

In 1947 the Secretary of Defense appointed the Advisory Commission on Service Pay (the Hook Commission) to review the adequacy of military compensation and the soundness of military pay structures. The Secretary's letter of invitation to prospective Commission members stated:

"The number and caliber of men who have left the Services in the past year, and the continuing number of such separations, indicate the possibility that the Services are not in a position to compete on an equal basis with industry and the professions because of the disparity in the income offered. If this is true, it portends the most serious long-range consequences, for it is plain, I think, that the strength and adequacy of our military establishment depends on the quality of the men which it can attract."

In its report in 1948, the Hook Commission held that during peacetime the Government had to compete with private industry and the Government's civilian branches for qualified personnel. Consequently, the Commission concluded that, in order to attract and retain qualified personnel:

"The pay structure should offer initial compensation and progressive increases that compare with what a serviceman could expect in other professions and occupations requiring similar abilities."

This philosophy of military pay was embodied in the Career Compensation Act of 1949 (the act of Oct. 12, 1949, 63 Stat. 802).

The Hook Commission further held that,

"In the future * * * it is to be hoped that compensation for the Uniformed Forces will consist of a single payment without distinction between compensation for responsibility and work performed and reimbursement for subsistence and quarters. Basic compensation will then be on the same footing as compensation in private industry and in civil government."

On the basis of this recommendation, the President recommended that a "gross pay" (salary) system for the military be instituted. However, no legislation was submitted and no such restructuring of the military pay system occurred.

Under 37 U.S.C. 1008(b) as added by section 2 of Public Law 89-132 of August 21, 1965 (79 Stat. 545, 546), the President is required to direct a quadrennial review of the principles and concepts of the military compensation system. In 1967 the First Quadrennial Review of Military Compensation pointed out that changes in the military compensation structure were needed to insure the maximum effectiveness of compensation expenditures. Problems cited were that military personnel

lacked confidence in the pay structure because it was complex and confusing; it did not reward members equitably; and pay could not be easily compared with, or adjusted in relation to, trends in civilian earnings. As a result, the First Quadrennial Review recommended a salary system for career military members. However, legislation embodying this recommendation was not submitted to the Congress.

In February 1970 the President's Commission on an All-Volunteer Armed Force (the Gates Commission) stated that sizable increases in military pay for the early years of service were required to sustain an all-volunteer service. The Commission further stated that a salary system was necessary to insure the efficiency of compensation in supporting attraction and retention of volunteers. Based, in part, on the recommendations of the Gates Commission, Public Law 92-129 (the act of Sept. 28, 1971, 85 Stat. 348), which included sizable increases in entry level pay, was enacted in 1971. However, the pay and allowances structure was retained.

The Defense Manpower Commission, created under Public Law 93-155 of November 16, 1973 (87 Stat. 605), was a temporary Commission charged with conducting a comprehensive study of defense manpower matters. In its final report issued in April 1976, the Commission pointed out that the pay and allowances structure was inequitable, lacked visibility, and was inefficient and recommended conversion to a salary system.

An indication of the interest of the Congress in restructuring the military pay system was expressed by the Senate Appropriations Committee in its report on Department of Defense appropriations for fiscal year 1976 (S. Rept. 94-446).

"* * * The inherent complexity of the present military pay system defies logical analysis or perception of total compensation, let alone its comparability with any other sector. The majority of military members are, themselves, not aware of the true value of their pay * * *. The permanent solution is to revise the outmoded and confusing structure of the military pay system."

In December 1976 the Third Quadrennial Review of Military Compensation published the results of its review. Its draft final report recommended against converting to a salary system.

SCOPE OF REVIEW

We identified and evaluated what we believed were the key questions in examining the issue of a military salary system.

- Would it be beneficial to change to a salary system?
- What has been the experience of other countries with military salary systems?
- What are the methods and costs of converting to a salary system?
- What related issues need to be examined in order to convert to a salary system?

We reviewed the legislative history of military compensation and earlier military pay studies and consulted compensation authorities. We examined the military compensation systems and experiences of other countries with volunteer forces that have converted to salary systems.

Our review was performed at the Department of Defense, the finance centers of the military services, the Defense Ministries of Canada and the United Kingdom, and the Embassy of Australia.

CHAPTER 2

BENEFITS OF A SALARY SYSTEM

The basic objective of military compensation is to assist in attracting, retaining, and motivating qualified service members. Military compensation would be more visible and equitable under a salary system, and thus it would be more effective in achieving the objective of military compensation.

VISIBILITY OF PAY

The services must compete with other employers for the quantity and quality of personnel necessary to satisfy military manpower requirements. For many military members and prospective members, compensation is an important consideration in deciding for or against a military enlistment or career. In this context, comparisons of military pay with pay offered by other employers are influential.

To make reasonably accurate pay comparisons, the individual must be able to compute military pay. The base pay and allowances system makes this a difficult task. RMC, the military equivalent of a civilian salary, consists of four components.

- Basic pay, which is received in taxable cash by all members.
- The nontaxable values of housing provided by the Government or a cash basic allowance for quarters (BAQ) when Government housing is not provided.
- The nontaxable values of meals provided by the Government or a cash basic allowance for subsistence (BAS) when meals are not provided.
- Tax advantage, which is the amount of additional cash income a serviceman would need in order to leave him with the same take-home pay he now has if all his regular military compensation were subject to Federal income taxes.

The difficulty in computing RMC is largely due to (1) the valuation of Government-provided housing and subsistence and (2) the estimation of tax advantage.

The valuation of Government-provided housing may be difficult because there is a wide range in the quality of quarters to which members may be assigned during their careers. For example, a single member on sea duty is assigned a bunk on a ship; on a land-based tour, he may be assigned a nicely furnished efficiency apartment in one of the new bachelor residence halls. Therefore the individual may have difficulty in deciding what quality of quarters to use as a basis for attaching a cash value thereto. He may then have difficulty in assigning a value to the quarters; the estimate could be based on (1) the cost of quarters to the Government, (2) the cost of obtaining similar quarters on the civilian economy, or (3) the amount of cash he would receive if he were drawing BAQ. These amounts will probably differ according to which approach is used.

Similar difficulties are encountered in valuing Government-provided subsistence.

The estimation of tax advantage is a complicated task. The value of tax advantage depends on the individual's particular circumstances, including whether he receives cash allowances or Government-provided housing and subsistence, family size, income tax bracket, tax deductions, tax return methods, and any other factors influencing the individual's tax liability. Consequently, accurate estimation of tax advantage requires going through a set of Federal income tax calculations.

The result is that even those individuals being compensated by the system cannot easily determine their pay. In our recent report, "Need to Improve Military Members' Perceptions of Their Compensation" (FPCD-75-172, Oct. 10, 1975), we pointed out that lack of visibility of pay among military members was widespread. RMC was underestimated by 40 percent of enlisted personnel and 20 percent of officers. Clearly that portion of compensation which is not recognized by those being compensated provides no incentive in terms of attraction, retention, and motivation. It consequently represents an inefficient use of compensation resources.

The report also pointed out that members who underestimated their pay were more likely to indicate they would leave the service. A potential effect is that personnel needed to satisfy military manpower requirements may opt for other careers based on erroneous assessments of relative financial rewards. This, in turn, could result in

unnecessary increases in military pay in an effort to aid attraction and retention programs.

We believe that reexpressing military pay as a fully taxable salary would insure that members fully recognize their RMC and thus reduce the potential for unnecessary compensation expenditures.

The base pay and allowances system, through its provision of items, rather than cash, and particularly through tax advantage, conceals the cost of military manpower. Tax advantage is not reflected in the Department of Defense (DOD) budget, but it is a cost to the Government reflected in reduced Federal income tax revenue.

On the other hand, gross salary costs for DOD's civilian personnel are reflected in the DOD budget. A potential adverse effect is that, in considering, for example, the advisability and cost effectiveness of military, civilian manpower substitutions, military personnel may appear to be less costly than civilians although this may not, in fact, be the case.

We believe that the total cost of military manpower should be reflected in the DOD budget. A military salary system would aid in achieving this result.

EQUITY

The base pay and allowance system is inequitable. It compensates married and single members of the same grade and length of service differently, regardless of whether their duties, qualifications, and performance are equivalent.

Married members receive higher cash quarters allowances or are assigned to larger Government quarters than single members of the same grade and length of service. (App. I shows the variations in quarters rates.)

In addition, married enlisted members generally receive a cash subsistence allowance and may buy their meals anywhere they choose, including the military dining halls. Single enlisted members generally do not receive a cash subsistence allowance. Their meals are provided in military dining halls. When the single member elects to eat somewhere other than at a military dining hall, he must pay for the meal out of his basic pay and forego part of his

pay, the Government-provided meal. In similar circumstances, the member receiving the cash allowance foregoes no part of his pay.

Married personnel are more costly than single personnel because of differences in quarters and subsistence costs and because of other existing benefits, such as dependents' medical care.

A compensation system, in our opinion, should be based on members' duties and responsibilities. A compensation system that provides different pay levels based on marital status is inequitable and inefficient. A salary system under which all members of the same grade and length of service are paid the same salary would reduce discrepancies in pay between married and single members. Members residing in Government quarters and/or taking meals in Government dining facilities would then be charged an appropriate fee for these items.

CHAPTER 3

EXPERIENCE OF OTHER COUNTRIES

Australia, Canada, and the United Kingdom maintain their armed forces on a volunteer basis and have discarded pay and allowances structures similar to that of the United States in favor of a salary system. Their major reasons for converting to a salary system included considerations similar to our own--military pay lacked visibility and was inequitable. Among the benefits realized were increased stability in the structure of military pay and improved morale.

AUSTRALIA

In 1970 the Committee of Inquiry was appointed to examine the military compensation system. The Committee was to establish principles and concepts for determining military pay levels and to review the practical working of the pay system, the nature of the special demands of service life, the practicality of a number of existing allowances, and other aspects relating to terms and conditions of employment. In formulating its recommendations, the Committee was to take into consideration the national requirement to attract and retain men and women for service in the armed forces and was to have as an objective that compensation of members of the regular armed forces should be readily comprehensible and its nature fully identifiable.

During its work the Committee found that service members generally believed that higher pay could be obtained by working in civilian employment. Service members also criticized the pay and allowances system. Their criticisms included:

- Inequities between the pay of single and married members were built into the pay system.
- Service members did not understand what pay elements were included in their compensation, the relationship between military and civilian pay rates, and how their pay was adjusted.

In 1971 the Committee of Inquiry recommended that, because of the current military pay system's inherent defects and inconsistencies, it was incapable of satisfactory modification and should be abandoned. The Committee also recommended the following principles for the military compensation system:

- There shall be objectivity and impartiality in compensation decisions and administration.
- There shall be an appropriate balance struck between internal and external equity.
- There shall be rational internal and external pay relationships.
- Military pay shall be expressed with maximum visibility and understandability.

As the Committee's reports became available, its recommendations were implemented. In 1971 enlisted member pay was alined with pay for the same level of work in the Australian public service, officer pay was alined with pay of professional grades of the public service, and general officer pay was alined with that of the heads of governmental departments. In early 1973 military pay was expressed in annual terms, as a fully taxable salary. This action completed the conversion of the Australian military compensation system from a pay and allowances system to a salary system.

In assessing the benefits of the military salary system, an Australian compensation official stated that transition to salary eliminated many of the problems of the pay and allowances system. The salary system improved the serviceman's understanding of his pay, permitted him to relate his annual salary to that of persons in the Australian public service and industry, and eliminated the marriage allowance which had created a pay inequity between married and single members. He further stated that an intangible benefit of the new salary system was the degree of stability it brought to the structure of military pay. He believed that this stability would make attraction and retention programs more effective.

CANADA

In 1965 the Canadian Treasury Board and the Ministry of National Defense created the Working Group to review the Canadian military pay and allowances structure. This Working Group was charged with the responsibility for developing the philosophy and principles necessary to establish and maintain a military pay structure and for applying the approved philosophy to an examination of the existing military compensation system.

In developing its philosophy and principles for military compensation, the Working Group proposed that the Canadian military pay system

- provide a level of pay which would attract and retain career-motivated individuals with the skills necessary to meet the requirements of a military organization and be equitable, considering factors of military service, with pay levels available in the civilian environment;
- insure that service members enjoy a standard of living equal to that of their civilian contemporaries;
- be designed to permit timely and equitable pay adjustments to compensate for changes in the national economy;
- encourage a high level of performance and provide the incentive for servicemen to advance;
- give full recognition to the conditions of service unique to the military;
- provide a system of remuneration for continuous or periodic exposure to special conditions of service involving abnormal hazard, responsibility, and unusual environment.

During its review, the Working Group encountered major complaints of members that reflected the shortcomings of the pay system. Members stated that the military compensation system (1) discriminated against single members by paying married members more for performing the same level of work, (2) created differences in pay between married members living on the civilian economy and those occupying Government quarters, and (3) paid service members in professional positions less than salaries paid for similar work in industry and the civil service. The Working Group concluded that the old system of pay was too confusing for military personnel to understand and for the Defense Ministry to administer.

The Working Group's findings and recommendations were presented to a Senior Steering Committee within the Ministry of National Defense in mid-1966 and were subsequently divided into two categories: (1) those which could be resolved by the periodic pay review date of October 1, 1966, and (2) those requiring further study. The recommendations that could be

implemented in the short term were (1) combining the marriage allowance and subsistence allowance in a single pay for rank (salary), (2) instituting a system of charges for married and single members' quarters, and (3) making increments of pay based on time in rank conditional upon achievement of performance standards. These recommendations, together with some minor changes, were approved, and conversion to salary was made in 1966.

In 1968, the joint Treasury Board/Department of National Defense Advisory Group on Military Compensation was formed to recommend changes to achieve compensation parity between the military and the public service. The Advisory Group found that public service pay was about 25 percent higher than military pay. Because this difference was so large, Canada took 2 years to achieve comparability between the military and the public service. The first increase occurred in October 1970, and the second occurred in October 1971.

Canadian compensation officials believed that the new salary system increased the visibility of pay and removed many of the inequities of the previous pay and allowances system. For example, the gap in pay between married and single members was closed by eliminating the marriage allowance. The salary system also helped simplify the administration of pay records. Further, military pay and pay in the public service were essentially equalized.

Although unable to quantify the benefits of conversion to a military salary system, Canadian officials believed it provided some assurance that the services would be better equipped to compete for the required personnel.

UNITED KINGDOM

In 1967 the Secretary of State for Economic Affairs, the Chancellor of the Exchequer, and the Secretary of State for Defense instructed the National Board for Prices and Incomes to undertake a continuous review of the pay and allowances system of the armed forces. In 1969 the board reported to the Prime Minister that it would be increasingly difficult to meet the armed forces' manpower needs in the 1970s because the number of men in the primary recruiting ages was declining, the portion of this age group that remained in school was rising, and the number of men going into civilian apprenticeship programs was rising.

The board recommended the adoption of a military salary system because the defects inherent in the old pay and allowances system might prevent the military from meeting its manpower requirements. These defects follow.

- Both single and married personnel viewed the differences in compensation based on marital status as outdated. The board noted that civilian pay did not distinguish between married and single members and that was the function of the income tax.
- It was reasoned that this attitude would be shared by potential recruits, the large majority of whom were single. The system was viewed as a disincentive to enlistment because it provided the lowest compensation to single members whom the services were most anxious to attract.
- The existing system was complicated, so that military compensation was difficult to convey to potential recruits.
- The same complexity made it difficult for service members to evaluate their compensation.

The armed forces agreed with the conclusions of the board, and a salary system was approved.

Preparatory work included (1) devising and proving methods of job evaluation for comparisons with work in civilian industry, (2) determining systems for applying charges for quarters and food, (3) considering the effect of the military salary philosophy on compensatory allowances and pensions, (4) revising regulations governing pay, pensions, and allowances, (5) assessing short- and long-term costs of introducing a military salary, and (6) considering the adoption of procedures and methods to provide regular adjustments of the elements comprising military salary.

The salary system, with salaries generally reflecting private sector pay rates, was installed in April 1970, except that the pay increase for single men (needed to bring their total pay into line with that of married men) was implemented in two parts, the first part being implemented on April 1, 1970, and the remainder on April 1, 1971.

In evaluating the benefits of a salary system, United Kingdom military compensation officials said that the new

military pay system developed confidence among service members that their pay was equitable and that, under normal conditions, their salaries would keep pace with civilian salaries. They further believed that the visibility salaries afforded compensation would enhance attraction and retention programs.

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The chart on the following page summarizes the conversion experience of the three countries.

Summary of Conversions From Base Pay and Allowances Systems to Salary Systems

Australia

What were the major criticisms of the base pay and allowances system?

Lack of equity between married and single members. Too complex--service members did not understand their pay.

What procedure was used in the conversion process?

1. Establish linkage with public service. (1971)
2. Conversion of pay elements to salary. (1973)

What were the estimated costs?

Expressed as a percentage of pay: 23 percent.

Canada

Lack of equity between married and single members. Lack of equity between married members in quarters and those drawing quarters allowances. Did not permit ready comparison with other pay systems.

1. Conversion of pay elements to salary. (1966)
2. Achieve comparability with public service. (1970 and 1971)

Expressed as a percentage of pay:

Percent
increase

1. To convert pay elements to salary 4
2. To achieve comparability with public service 22

Total 26

Increased stability in the structure of military pay. Improved servicemen's understanding of their pay. Eliminated inequities.

United Kingdom

Too complex--service members could not quantify their pay. Lack of equity between married and single members.

Conversion of pay elements to salaries generally reflecting private sector pay rates. (1970) Increase for single personnel staged over 2-year period. (1970 and 1971)

Expressed as a percentage of pay:

Percent
increase

1. To convert pay elements to salary 8
2. To provide comparative military pay rates 15

Total 23

Increased morale through equity of pay. Improved visibility of pay. Comparability of pay achieved.

CHAPTER 4

METHODS OF CONVERTING TO A SALARY SYSTEM

Converting to a salary system entails numerous considerations, including

- the initial salary levels for military personnel,
- the appropriate charges for Government-provided housing and meals,
- the reexpression of other compensation elements which are currently computed based on the value of an element of RMC,
- the method of periodically adjusting military salaries in the future, and
- the effect of salary limitations on flag and general officer pay.

The first two considerations are addressed in this chapter, and the others are discussed in later chapters.

The major consideration in converting to a salary system, in our opinion, is the determination of initial salaries for military personnel. Two methods of determining military salary levels have been considered in previous pay studies.

- Developing salaries based on the pay of a designated segment of civilian employees.
- Developing salaries based on current levels of RMC.

The two methods are discussed in the following sections.

SALARIES BASED ON PAY OF A DESIGNATED SEGMENT OF CIVILIAN EMPLOYEES

Pay rates for the majority of Federal civilian employees are governed through the principle of comparability with private enterprise pay for equivalent levels of work. Military pay rates, on the other hand, are not governed by an external measure of appropriateness--pay standard--although annual increases in the cash elements of RMC (basic pay and the cash quarters and subsistence allowances) are currently indexed to the average annual increase in General Schedule pay.

To determine military pay levels based on an external pay standard, it would be necessary to establish (1) the segment of civilian employees whose pay levels are to form the basis for military pay levels and (2) the mechanics of the assessment process, that is, the appropriate procedures for collection and aggregation of data and for the translation of civilian pay data to the military pay structure.

In 1967 the First Quadrennial Review of Military Compensation recommended determining military pay levels by linking the pay of military grades to equivalent grades (work levels) in Federal civilian systems, since military pay rates based on the Federal civilian rates would also be comparable with private sector rates.

A second possible approach is to link military pay directly to the pay of some segment of non-Federal employees. This approach would probably involve the design of a periodic survey of pay for equivalent levels of work in the non-Federal sector.

Developing the mechanics of the assessment process involves resolving numerous questions, some of which follow.

- If the standard selected for military pay is the pay of non-Federal employees, from which industries and establishments and for which jobs and work levels should the pay data be collected?
- If the standard selected for military pay is Federal civilian pay, what are the appropriate relationships between Federal civilian pay grades and military pay grades?
- In comparing civilian and military pay data, how should differences between military and civilian employment conditions, such as overtime, discipline, hazard, and transient life, be treated? Also, how should the differences in pay practices, such as use of bonuses and special pays, be treated?
- How much judgment should be permitted in translating civilian pay data to the military pay structure, how should it be exercised, and by whom?

Merits of the method

The First Quadrennial Review felt that the major advantage of determining military pay levels on a pay standard method was that it would assure both managers and members

that military pay was set and maintained on a par with pay in other employment, thus developing confidence in the system's stability and fairness.

We agree that the standard method would probably instill confidence in the system's stability. However, military service differs from civilian employment in many respects, including subjection to the military disciplinary system and the requirement for relocation as the needs of the service dictate. These negative aspects of military service may dissuade individuals from military service, even though military pay is comparable to civilian pay.

On the other hand, military service has positive aspects. An example is training and education programs, many of which provide vocational, technical, and professional training applicable to both military and civilian employment. The value of positive aspects may attract individuals to military service, even in the absence of comparable pay levels.

Further, these positive and negative aspects may balance differently at different career stages. For example, training opportunities in the early years of service may outweigh the negative aspects of military service, but in later years family relocations and separations may outweigh positive aspects.

We believe that the relationship between current military pay levels and those which would result from a pay standard requires careful consideration. DOD officials have stated that current military pay is generally sufficient to enable the services to attract and retain the desired quantity and quality of personnel. If the pay levels produced through application of a standard are higher than current levels, it follows that the Government would be paying more than is necessary for military personnel. If they are lower, recruiting and retention programs may be adversely affected.

REEXPRESS CURRENT LEVELS OF RMC INTO A SALARY

This method of converting involves incorporating the elements currently comprising RMC into a fully taxable salary. Therefore military salaries based on RMC are simply a reexpression of current pay levels. In 1976 the Defense Manpower Commission recommended the RMC method of conversion. As was pointed out earlier, members of the same grade and length of service receive different amounts of RMC. The following table illustrates this point.

RMC for Grade E-5 Personnel With 8 Years' Service (note a)

	Receiving cash quarters allowances			Residing in Government quarters (note b)		
	Family size 1	Family size 2	Family size 3	Family size 1	Family size 2	Family size 3
Basic pay	\$7,168	\$ 7,168	\$ 7,168	\$7,168	\$ 7,168	\$7,168
Quarters	1,231	1,843	1,843	288	2,820	2,820
BAS (note c)	923	923	923	923	923	923
Federal income tax advantage (note d)	<u>634</u>	<u>643</u>	<u>625</u>	<u>336</u>	<u>887</u>	<u>854</u>
RMC	<u>\$9,956</u>	<u>\$10,577</u>	<u>\$10,559</u>	<u>\$8,715</u>	<u>\$11,798</u>	<u>\$11,765</u>
Average RMC			\$10,562			

a/Basic pay and cash allowance rates were those effective Oct. 1, 1975.

b/These quarters rates are based on the estimated cost of Government quarters. (See app. I, columns 3 and 4 and footnote b.)

c/The cash subsistence allowance has been used in all cases because estimates of cost to the Government and fair market value rates were not available.

d/The standard deduction was used in calculating tax advantage.

Under the RMC method of conversion, it would therefore be necessary to establish a procedure for selecting the single amount to be paid to all members of the same grade and length of service. For example, one procedure is to average members' RMCs.

It is important to emphasize that RMC omits portions of military compensation for some specialties which would normally be included in civilian salaries. For example, military physicians receive special pay in addition to their RMC. The special pay is designed to provide a total pay package which will be sufficient, relative to civilian earnings opportunities, to attract and retain physicians for the military. Such bonuses and special pays would be retained under the RMC method of conversion.

Merits of the method

Since the RMC method of conversion involves only a re-expression of pay, no major change in pay levels need result. However, it is possible that current pay levels are unnecessarily high, particularly in view of the fact that military pay, even though it lacks visibility, is currently sufficient to support most attraction and retention programs.

The RMC method of conversion should, in our opinion, be less time consuming than waiting to establish an acceptable pay standard and then converting. Consequently, the benefits of visibility and equity could be achieved more quickly under the RMC method.

COST TO CONVERT TO SALARY--RMC METHOD

When we made our review, there was no current data available on the cost to convert using a pay standard. However, conversion costs for the RMC method had been recently estimated by LOD. These estimates represent the additional costs to OD and the Federal Government. (See p. 26.)

To estimate conversion costs, it is necessary to establish a procedure for constructing salaries and to determine charges for Government-provided food and housing.

Constructing salaries

As was pointed out earlier, since members of the same grade and length of service receive different amounts of RMC, the RMC method of conversion requires a procedure for selecting a single amount to be paid to all members in the same pay cell. ^{1/}

Since single members generally receive lower RMC than do married members, and since one of the conversion objectives is to equalize pay for married and single members, one procedure is to construct salaries based on the higher RMC received by married members. Thus the effect of this procedure is to provide essentially the same pay for married members as they receive under the base pay and allowances system and to increase single members' pay to that level.

^{1/}The term "pay cell" means a particular grade and/or length of service combination, for example, grade E-5 personnel with 8 years' service.

A second procedure is to compute as salary the average RMC of members in the pay cell. For those members residing in Government quarters and those provided meals as a part of their RMC, there are several ways to quantify these items.

- Set their value at the amount of the cash allowances, since these are the amounts withheld from members receiving Government housing and subsistence.
- Estimate their value at the cost to the Government for providing the items. This is the method normally used for valuing military quarters.
- Estimate their value based on the cost for similar items in the civilian community. This is called a fair market rental approach and is used for valuing nonmilitary Government housing.

The values placed on housing and subsistence provided by the Government will differ under these approaches. For example, the value of Government quarters for a single, grade E-5 member using the cash allowance rate would be \$1,231 but valued at \$288 if valued at cost to the Government. (Fair market rental rates were not available.)

Whatever method is used for quantifying quarters and subsistence provided by the Government, the effect of basing salary on the average RMC of members in the pay cell is to redistribute pay among the members in the cell. For example, consider the following information for grade E-5s with 8 years' service. (See p. 19.)

	<u>RMC</u>
Receiving cash quarters allowances:	
Family size 1	\$ 9,956
Family size 2	10,577
Family size 3	10,559
Residing in Government quarters:	
Family size 1	8,715
Family size 2	11,798
Family size 3	11,765
Average	\$10,562

The average RMC is \$10,562. Some of these members would therefore receive less and some would receive more than under the current system.

Establishing charges for Government-provided housing and meals

The Government provides housing each year for about 310,000 military families and 800,000 single members, and about 820,000 enlisted members are entitled to Government-provided meals. The value of these items is considered a part of members' pay. However, as was pointed out previously, there are several ways to quantify these items as an element of pay. Under a salary system, charges for these items and a procedure for adjusting the charges would be established.

Under the base pay and allowances system, the member residing in Government quarters is implicitly paying rent for those quarters in the amount of the cash quarters allowance he does not receive. If similar quarters in the private community cost more than that amount, the member occupying Government quarters enjoys a monetary advantage over the member who is not provided Government housing and must obtain quarters in the civilian community at greater cost than the cash quarters allowance. Conversely, if similar quarters in the civilian community cost less than the allowance, the member residing in the civilian community enjoys the advantage.

Under a salary system, charges based on cash quarters allowances would perpetuate inequities between members occupying Government quarters and those residing in the civilian community. Charges based on cost to the Government may also perpetuate such inequities. Charges based on fair market rental rates (see p. 21) would reduce these inequities.

Similar conditions and problems also exist for BAS. All officers and most married enlisted members receive a nontaxable cash allowance, while most single members are entitled to Government-provided meals. An appropriate charge for Government-provided meals will have to be determined.

CONVERSION EFFECT ON THE DOD BUDGET

Converting RMC to a salary will increase the DOD budget for several reasons. First, the reexpression of RMC as a fully taxable salary requires monetizing the Federal income tax advantage. Since the tax advantage is not reflected in the DOD budget, monetizing the tax advantage will

increase the DOD budget. But it will also increase Federal income tax revenues. 1/

The nontaxable quarters and subsistence portions of RMC produce additional tax advantages because they are not subject to State and local income taxes or to Social Security taxes. These additional tax advantages are not recognized as part of RMC. However, conversion to salary will increase members' State and local, as well as Federal, income tax liabilities and Social Security tax liabilities. If State and local tax advantages were monetized, this would cause an increase in the DOD budget which would not be recovered by the Federal Government but would be transferred to the States through increased State and local income tax collections. Monetizing Social Security tax advantages would also increase the DOD budget, but this increase would be returned to the Federal Government through increased Federal Insurance Contributions Act (FICA) collections.

The services' participation in the Social Security program will produce another increase in the DOD budget upon conversion to salary. Social Security taxes are levied in equal amounts on the member and DOD. Thus DOD's share of FICA taxes will also increase. 2/ However, this increase in the DOD budget will also be recovered by the Federal Government through increased FICA collections. Since the Social Security program operates essentially on a pay-as-you-go basis, the additional Social Security benefits payable to military members as a result of higher covered earnings would be financed through future FICA receipts.

Military members now receive gratuitous Social Security wage credits of up to \$300 each calendar quarter if their

1/Since the tax advantage depends on numerous factors other than military pay, we would not expect that the Treasury will recover the exact amount.

2/The Social Security taxable earnings ceiling for 1975 was \$14,100; for 1976, \$15,300; and for 1977, \$16,500. For those members receiving more in basic pay than the taxable earnings ceiling, conversion to salary would produce no additional Social Security tax liability for the member or DOD. However, basic pay of most enlisted members and junior officers is below the taxable earnings ceiling. Therefore these members and DOD would be subject to additional Social Security taxes upon conversion.

basic pay is below the taxable earnings ceiling. Social Security benefits arising from these credits are financed from general revenues. The rationale for providing the credits was that basic pay is a smaller portion of total pay for military members than salary is for the civilian. This means that military members are provided additional covered earnings credits because the allowances are nontaxable. These credits should be eliminated upon conversion to a salary system.

Some members may suffer a reduction in take-home pay as a result of conversion to a salary system. Other members, particularly single members, would receive increases in pay. (See p. 21.) Those members whose take-home pay would be reduced as a result of conversion could be protected through enactment of saved pay provisions. Such provisions would authorize payment of the difference between current take-home pay and that which would be received upon conversion. Saved pay costs would increase the DOD and the Government budgets. However, these costs would be nonrecurring. They would eventually be eliminated through general pay increases, longevity increases, and promotion increases.

Estimated conversion costs
under several alternatives 1/

The four conversion alternatives and associated costs presented on pages 25 and 26 were developed as part of an in-house DOD effort. When we made our review, these were the only recent estimates available to us. DOD said that the preliminary estimates did not attempt to assess methods of implementing a salary system, which could have a major impact on whether any substantial additional costs would be incurred as a result of conversion. For example, instead of a general pay increase for all military members in October 1977, single members' pay could be increased to equal that of married members. In this case, the cost of the salary system may be less than the cost of retaining the base pay and allowances system and providing a general pay increase. However, the DOD cost estimates do not consider such a strategy.

The estimates consider only an "instantaneous conversion cost," without taking into account other pay actions

1/Base pay and allowance rates used were those in effect in October 1975.

which would affect the relative costs of the two pay systems. For example, assuming that salaries for each pay cell are based on the average RMC of members in each cell, the total cost to the Government (ignoring saved pay) would remain about the same as the cost of the base pay and allowances system at the time of conversion. Saved pay would then increase the cost of the salary system relative to the cost of the base pay and allowances system. This instantaneous cost (on an annualized basis) is the conversion cost estimate prepared by DOD. (See alternative 4 below.)

When conversion to salary is considered in combination with a general pay increase, the additional cost of the salary system may be decreased, since a portion of the general pay increase would be offset by reductions in saved pay costs. The measure of conversion cost is then the difference between the estimated costs of the two systems after the general pay increase. Thus the estimate presented may overstate conversion costs.

Conversion alternatives

The four alternatives presented below differ with respect to the construction of salaries for each pay cell and the "rent" to be charged for Government quarters. Under all alternatives, members on sea duty would not be charged for quarters aboard ship. Subsistence rates included in salaries and subsistence charges are based on officers' and enlisted members' (BAS) rates under all alternatives.

Alternative 1--Salaries for each pay cell incorporate the with-dependent BAQ rate. (See app. I.) Members with dependents residing in Government quarters would be charged rent equal to the with-dependent BAQ rate. Single members residing in Government quarters would be charged one-half that rate.

Alternative 2--Salaries are constructed in the same manner as under alternative 1. Charges for Government housing would equal the cost of Government quarters as shown in app. I.

Alternative 3--Married members' RMCs are estimated using with-dependent BAQ rates. Single members' RMCs are estimated using without-dependent BAQ rates. Salaries for each pay cell are then constructed as the average RMC of members in the cell. Charges for Government quarters equal the cost of the quarters.

Alternative 4--Members' RMCs are estimated using BAQ rates for those members receiving BAQ, and the Government's cost of quarters for those members residing in Government quarters. Salaries for each pay cell equal the average RMC of members in the cell. Charges for Government quarters equal the cost of the quarters.

We emphasize that these alternatives are not the only approaches nor necessarily the best. We believe that alternatives incorporating the fair market rental concept (see p. 21) should also be explored.

Estimated conversion costs for the four alternatives are presented in the following table. The DOD columns show the estimated increase in the DOD budget, and the Government columns show the net cost to the Government.

Estimated Conversion Costs (note a)

	<u>Alternative 1</u>		<u>Alternative 2</u>		<u>Alternative 3</u>		<u>Alternative 4</u>	
	<u>DOD</u>	<u>Government</u>	<u>DOD</u>	<u>Government</u>	<u>DOD</u>	<u>Government</u>	<u>DOD</u>	<u>Government</u>
	(millions)							
Monetize Federal Income tax and advantage (note b)	\$1,420	\$ -	\$1,420	\$ -	\$1,290	\$ -	\$1,230	\$ -
FICA (employer's share)	345	-	345	-	310	-	285	-
Increased take-home pay (notes c and d)	765	765	740	740	280	280	45	45
Saved pay (notes d and e)	<u>145</u>	<u>145</u>	<u>440</u>	<u>440</u>	<u>625</u>	<u>625</u>	<u>655</u>	<u>655</u>
Total	<u>\$2,675</u>	<u>\$910</u>	<u>\$2,945</u>	<u>\$1,180</u>	<u>\$2,505</u>	<u>\$905</u>	<u>\$2,215</u>	<u>\$700</u>

a/The estimates were developed by a DOD in-house effort. Base pay and allowance rates used were those in effect in October 1975. Cost estimates rounded to nearest 5.

b/State and local income tax advantages and Social Security tax advantages were not monetized.

c/Consists mainly of increases for single members.

d/The effects of State and local income taxes were not considered in comparing take-home pay under the current system and the salary alternatives. FICA taxes, however, were considered.

e/Saved pay is a nonrecurring cost. It would eventually be eliminated through promotions, longevity increases, and general pay increases.

CHAPTER 5

OTHER ISSUES TO BE CONSIDERED

In converting to a salary system, the following issues should also be carefully considered.

- The reexpression of other compensation elements which are currently computed based on the value of an element of RMC.
- The method of adjusting military salaries in the future.
- The effect of salary limitations on flag and general officer pay.

REEXPRESSON OF OTHER COMPENSATION ITEMS

Converting to a salary system will affect not only the elements of RMC but many other pay elements as well. These items are commonly referred to as drag alongs because they are computed as a multiple or fraction of an element of RMC and thus change automatically whenever the RMC element changes. Appendix II presents a list of drag-along items and the RMC elements to which they are linked.

On converting to a salary system (by reexpressing RMC as a salary or converting to salary using a pay standard), RMC elements will lose their identity, which will require changes in drag-along computation formulas even if the level of the drag along is to remain the same as at present. For example, the most significant drag-along item is retired pay, which is computed as a fraction of basic pay. The formula for computing retired pay is terminal basic pay times years of service times 2.5 percent (multiplier), to a maximum of 75 percent of basic pay. If salary is substituted for basic pay in the retired pay formula, higher retired pay than at present would result unless the formula is revised, such as lowering the multiplier. The following table illustrates this point by comparing retired pay (1) under the present system, (2) under a salary system if the multiplier is not changed, and (3) to achieve about the same retired pay as under the base pay and allowances system.

Pay grades at 20 years' Service	Present system			Salary system			Maintain same retired pay as present system	
	Base amount (note a)	Total multiplier (note b)	Retired pay	Base amount (note c)	Total multiplier	Retired pay	Required multiplier	Retired pay
O-4	\$19,865	50%	\$ 9,933	\$24,728	50%	\$12,364	40.2%	\$ 9,933
O-5	22,950	50	11,475	28,447	50	14,224	40.3	11,475
O-6	25,373	50	12,687	31,489	50	15,745	40.3	12,685
E-7	10,541	50	5,271	14,285	50	7,143	36.9	5,271
E-8	11,948	50	5,974	15,862	50	7,931	37.7	5,974
E-9	13,630	50	6,815	17,860	50	8,930	38.2	6,815

a/Annual basic pay as of Oct. 1, 1975.

b/20 (years of service) times 2.5 percent.

c/The salaries used in this table are annual salaries produced by alternative 1 of ch. 4.

d/Percentages rounded to nearest tenth.

The above table illustrates another concern in the retired pay formula. If RMC is reexpressed as salary and retired pay levels are to remain the same as at present, enlisted members would receive a smaller portion of salary as retired pay than would officers. This occurs because basic pay comprises a smaller portion of enlisted members' RMC than of officers. This difference should be eliminated under a salary system. Therefore, converting to a salary system will require a careful analysis of the retired pay formula to insure that an equitable and efficient change is adopted.

A similar analysis of other drag-along items should also be performed. For some of these drag-along items, such as reenlistment bonuses and continuation pay, consideration should be given to reexpressing them as flat amounts rather than linking them to other pay elements. There is no reason, for example, that continuation pay should increase automatically whenever basic pay (or salary) increases, particularly if attraction and retention goals are being met with the lesser amounts.

In our opinion, no major costs resulting from drag alongs should be allowed to occur upon conversion to a salary system.

METHOD OF ADJUSTING MILITARY SALARIES

The annual adjustment of RMC is governed by 37 U.S.C. 1009, as amended, which requires that military pay be increased by the average percentage increase granted General Schedule employees. The increase in military pay may be allocated in one of two ways.

- The cash elements of RMC (basic pay, BAQ, and BAS) may each be increased by the average General Schedule increase (the equal percentage method).

--The President may reallocate up to 25 percent of the amount allocated to basic pay under the equal percentage method to the quarters and subsistence portions of RMC.

The second approach particularly can and does cause military members to receive different increases in RMC. For example, the pay raise effective October 1, 1976, was an average increase of 4.83 percent for General Schedule employees. However, when translated to the military under the second approach, RMC increases ranged from about 4.5 percent to 7.2 percent.

Under a salary system, indexing increases in military pay (salary) to the average increase in General Schedule pay means that military salary increases would always be across-the-board increases; that is, all military grades would receive the same percentage increase. The indexing method would not recognize that, over time, jobs within an organization and economic factors affecting pay, such as the available supply of people with necessary skills, tend to change. Also, requiring application of the same percentage increase to all military grades provides no flexibility in directing larger portions of pay increase resources to areas where attraction and retention problems are the most severe. Thus the method would not insure that compensation resources are distributed in the most efficient manner for supporting attraction and retention programs. Alternatives to the indexing method which allow flexibility in the application of pay increase resources should be explored.

EFFECT OF SALARY LIMITATIONS ON FLAG AND GENERAL OFFICER PAY

By law (5 U.S.C. 5308, 37 U.S.C. 1009), salaries for level V of the Executive Schedule set a ceiling on pay under most other Federal pay systems, including the uniformed services. This ceiling is applied to salaries in most of the systems, but in the uniformed services, it is applied to basic pay.

The current pay ceiling is \$47,500. Converting to a military salary system would mean that the entire salary, rather than basic pay alone, will become subject to the pay ceiling. Most members in the 0-8 to 0-10 pay grades and the Chiefs of Staff currently receive RMC totaling more than the ceiling and would therefore suffer a reduction in pay by the amount that the new salary exceeds the ceiling, as shown below.

<u>Pay grade after 26 years' service</u>	<u>Number of personnel</u>	<u>Annual basic pay</u>	<u>Annual RMC (note a)</u>	<u>Potential annual loss at conversion</u>
Chiefs of Staff	5	b/\$47,500	\$57,723	\$10,223
0-10	31	<u>b/47,500</u>	57,727	10,227
0-9	124	43,805	53,741	6,241
0-8	420	39,492	48,874	1,374

a/These figures assume FY 1977 cash allowances, BAQ and BAS.

b/Basic pay amounts received as of Mar. 1, 1977, subject to the pay ceiling. If there were no ceiling, Chiefs of Staff and 0-10s would receive basic pay of \$54,781 and \$49,648, respectively.

Saved pay could be used to insure that the members affected do not suffer pay reductions at the time of conversion. However, these members would receive no further pay increases until their salaries are overtaken by the ceiling. 1/ As can be seen from the magnitude of the differences between RMC and the pay ceiling, it would probably be from 1 to 4 years before members in these positions receive any increase, assuming a 6.5 percent annual pay adjustment. This is the percentage in the 1978 budget for Federal employee pay raises.

1/The adjustment of Executive Schedule salaries is governed by two provisions of law. The first is Sec. 225 of the Federal Salary Act of 1967 (Title 2, Public Law 90-206, 81 Stat. 642), which provides for a quadrennial review of Executive Schedule salaries and a process for their adjustment. The second is Public Law 94-82, which added 5 U.S.C. 5318 to provide that Executive Schedule salaries be increased annually by the average percentage increase granted General Schedule employees.

CHAPTER 6

CONCLUSIONS, AGENCY COMMENTS, AND RECOMMENDATIONS

CONCLUSIONS

The objective of military pay has changed from providing a reasonable standard of living at a minimum cost to the Government to providing pay that allows the services to successfully compete with other employers for the quantity and quality of military personnel required. However, the pay and allowances structure has been retained even though eminent study groups and commissions have repeatedly pointed out that it is inefficient in supporting this objective and have recommended conversion to a salary system.

We believe that salary is a better way to express military pay for the following reasons.

- Under the current system, members, managers, and the Congress have difficulty in accurately quantifying and evaluating military pay. Much of this difficulty stems from the "invisible" nature of compensation elements, such as Government-provided quarters and subsistence and particularly the tax advantage. A fully taxable salary should (1) increase members' awareness of their pay, (2) improve management practices and the efficiency of attraction and retention programs, and (3) place both the Congress and DOD in a better position to evaluate the military compensation system.
- A salary system would eliminate inequities in pay, RMC, between married and single members of the same grade and length of service.
- A salary system would more fully reflect the cost of military manpower rather than partially concealing it, through tax advantage, in reduced revenues to the Treasury.

AGENCY COMMENTS AND OUR EVALUATION

Advance comments from DOD requested on December 29, 1976, were not received. But DOD's position on the salary recommendation made by the Defense Manpower Commission was that the disadvantages of a salary system outweighed the advantages. The disadvantages cited follow.

1. In terms of total compensation, a salary system is not more able to meet its "equal pay for equal work" objective than is the pays and allowances system.
2. A salary system that does not reduce the take-home pay of service members will be somewhat more costly to the Government in time of war and to DOD even in peacetime.
3. A salary system will increase the size of the manpower portion of the DOD budget.
4. The military departments object to a salary system on the grounds that it is one more step in the progressive "civilianization" of the Armed Forces. It will not reinforce military customs, tradition, and way of life but will detract from them.

The Office of Management and Budget (OMB) said that changes in the expression of military pay, if necessary, should be accomplished in conjunction with changes in military pay levels. It believed that current RMC levels might not be "appropriate" pay levels for the military, and subsequent adoption of a pay standard would subject the members to more than one pay change.

Regarding DOD's first disadvantage, we recognize that a salary system will not result in members' receiving the same total compensation. But it will reduce the discrepancies of RMC by paying the same salary to all members of the same grade and length of service. By reducing the inequities in the base pay and allowances system, there will also be a reduction in the inequities in total compensation.

We do not know if a salary system would be more costly to the Government in time of war. We note, however, that DOD's apparent belief is that an inefficient and inequitable system, and possibly a costly one (see pp. 6 and 7) should be retained in peacetime so that the apparent cost of war might be less.

The third disadvantage cited is that a salary system will increase the manpower portion of the DOD budget. Although this is true, we believe it is a distinct advantage. It must be emphasized that the DOD budget does not now reflect the cost of military manpower. For example, the tax advantage element of RMC is not recorded in the DOD budget but is a cost to the Government in the form of reduced tax revenues. Reflecting the tax advantage in the DOD budget does

not increase the cost of military manpower; it merely records the cost more fully in the appropriate agency budget. Thus monetizing tax advantage (and reflecting it in the DOD budget) does not represent an additional allocation of resources to DOD or an increase in the real cost to the Government for maintaining the same level of national defense. It simply requires more accurate accounting of the current cost, rather than partially concealing it in reduced revenues to the Treasury. We believe DOD should fully report all of its compensation costs, and then the DOD budget can be recognized by the Congress, the member, and the taxpayer.

The fourth disadvantage cited was that a salary system is a step in the progressive "civilianization" of the Armed Forces and will detract from military customs, traditions, and way of life. OMB and DOD officials have stated that the services believe this would adversely affect combat effectiveness.

It must be remembered that the military competes for personnel with civilian employers. The increased visibility and equity of military pay associated with a salary system, in our opinion, can only aid in obtaining the personnel required by the services.

It is true that a salary system is a departure from the traditional method of paying military personnel. However, we fail to see the connection between combat effectiveness and the expression of military pay. It appears to us that combat effectiveness is related more to the quality of military leadership and dedication to duty than to whether pay is expressed in several different elements, RMC, or in one salary.

OMB officials noted that the act of change itself is a disadvantage. The act of change may be somewhat disruptive, but the impact can be minimized. Before any change, the members should be properly told of the need for change, method of change, and how the change will affect the members. The current inefficient and inequitable compensation system appears to be a much greater disadvantage than the conversion to a salary system.

OMB believes that a salary system should not be implemented without adopting a pay standard; that is, all changes to pay levels should be made at the same time. This may be an ideal concept, but the issue has been discussed many times over the past decade with little or no action taken. If a salary system is to be adopted based on

a suitable pay standard, we suggest that milestones be established for an expedient conversion. If this cannot be accomplished, we suggest that salary conversion be made based on RMC.

Also the RMC method may be a better approach to converting the military to a salary system than using a pay standard method. Visibility and equity of military pay could probably be achieved more quickly under the RMC method, and, since pay levels would remain essentially the same as the present, there should be no adverse effects with respect to attraction and retention of military personnel. In fact, retention and attraction programs should improve.

However, since current pay levels may be higher or lower than necessary, we consider the RMC conversion only an initial step. An examination of the effects of an RMC conversion should provide an indication of what additional changes in military pay, if any, are desirable and should place both the Congress and DOD in a better position to evaluate the military compensation system.

RECOMMENDATIONS TO THE CONGRESS

We recommend that:

- The military base pay and allowances system be replaced by a salary system.
- The executive branch be directed to draft and submit conversion proposals and establish milestones for converting the base pay and allowances to a salary system.

BAQ RATES AND ESTIMATED COST OF GOVERNMENT QUARTERS(ANNUAL RATES)

<u>Pay grade</u>	<u>BAQ rate (note a)</u>		<u>Estimated cost of Government quarters (note b)</u>	
	<u>Without dependents</u>	<u>With dependents</u>	<u>Without dependents</u>	<u>With dependents</u>
O-10	\$3,063.60	\$3,830.40	\$1,500.00	\$4,380.00
O- 9	3,063.60	3,830.40	1,500.00	4,380.00
O- 8	3,063.60	3,830.40	1,500.00	4,380.00
O- 7	3,063.60	3,830.40	1,500.00	4,380.00
O- 6	2,815.20	3,434.40	926.40	4,380.00
O- 5	2,635.20	3,175.20	926.40	3,900.00
O- 4	2,376.00	2,865.60	926.40	3,900.00
O- 3	2,106.00	2,599.20	926.40	2,940.00
O- 2	1,843.20	2,336.40	759.60	2,640.00
O- 1	1,447.20	1,882.80	759.60	2,544.00
W- 4	2,293.20	2,764.80	759.60	3,300.00
W- 3	2,066.40	2,548.80	759.60	3,300.00
W- 2	1,821.60	2,311.20	759.60	3,300.00
W- 1	1,648.80	2,138.40	759.60	3,300.00
E- 9	1,738.80	2,448.00	637.20	3,360.00
E- 8	1,620.00	2,289.60	637.20	3,360.00
E- 7	1,389.60	2,145.60	637.20	3,360.00
E- 6	1,274.40	1,994.40	288.00	3,120.00
E- 5	1,231.20	1,843.20	288.00	2,825.00
E- 4	1,083.60	1,612.80	288.00	2,580.00
E- 3	961.20	1,393.20	288.00	2,520.00
E- 2	849.60	1,393.20	288.00	2,460.00
E- 1	799.20	1,393.20	288.00	2,460.00

a/Oct. 1, 1975, rates.

b/These estimates are based on FY 1974 data and are not official. They were developed as part of an in-house effort by DOD. The method used to develop the estimates is consistent with methods used in the past for developing rates for Government-provided quarters.

DRAG ALONGS (note a)

Compensation element (<u>drag along</u>)	<u>Linked to changes in</u>
Retired pay	Basic pay
Reenlistment bonus	Basic pay
Continuation pay (dentists and some physicians)	Basic pay
Death gratuity	Basic pay
Accrued leave upon separation	Basic pay
Severance pay	Basic pay
Readjustment pay	Basic pay
National Guard and Reserve drill pay	Basic pay
Government contribution to Social Security	Basic pay
Pay, allowances, benefits, and retired pay of commissioned personnel of National Oceanic and Atmospheric Administration and U.S. Public Health Service	Same elements for officers in the Armed Forces
Family separation allowance (type 1)	Basic allowance for quarters
Dislocation allowance	Basic allowance for quarters

a/This list of drag alongs may not be inclusive.



EXECUTIVE OFFICE OF THE PRESIDENT
 OFFICE OF MANAGEMENT AND BUDGET
 WASHINGTON, D.C. 20503

MAR 8 1977

Mr. Victor L. Lowe, Director
 General Government Division
 U. S. General Accounting Office
 Washington, D.C. 20548

Dear Mr. Lowe:

As requested in your letter of December 30, 1976, we have reviewed the GAO draft report "A Salary System is Needed to Improve the Visibility and Equity of Military Compensation." [See GAO note 1, p. 38.]

We [See GAO note 1, p. 38.] recommend that the report be modified to include:

-- Identification of the disadvantages of a salary system and an assessment of them in comparison with its benefits (Chapter 4). This analysis is now lacking and is needed to support the report's recommendations.

-- Explicit consideration of the impact a salary system will have on the Defense budget in addition to that implicit in the table on page 36. [See GAO note 2, p. 38.]

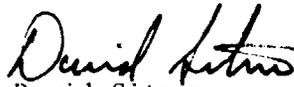
-- Sufficient analysis of relevant factors to support the conclusion that a salary system based on current levels of RMC is better than one based on a standard (pp. 27). A key component of any pay system is its adjustment process. Your analysis does not consider this factor. Accordingly, its conclusion cannot be considered to have assessed all relevant factors.

[See GAO note 1, p. 38.]

As you know, a Presidential commission is being established to review the findings of the Third Quadrennial Review of Military Compensation. One of the subjects to be addressed by this commission is a modernized

system of military compensation such as the one this GAO report addresses. We would, therefore, urge you to complete your review and publication process as quickly as possible so that the Presidential commission will have sufficient time to fully consider the official views of the Comptroller General on this important subject.

Sincerely,



David Sitrin
Deputy Associate Director
for National Security

GAO notes:

1. Deleted comments relate to matters which were discussed in the draft report but omitted from this final report.
2. Page number references in the appendix may not correspond to pages of this final report.

DOD POSITION ON THE DEFENSE MANPOWER COMMISSIONSALARY RECOMMENDATIONDefense Manpower Commission

Recommendation - The items currently comprising regular military compensation should be converted into a fully taxable military salary, and differences in the present regular military compensation based upon marital status should be eliminated.

DoD Position - The QRMC has studied the desirability of converting the present pays and allowances system into a fully taxable military salary and rejected the salary alternative. A "modernized pays and allowances" system was recommended instead. The salary alternative was rejected mainly for the following reasons:

o In terms of total compensation, a salary system is not more able to meet its "equal pay for equal work" objective than is the pays and allowances system.

o A salary system that does not reduce the take home pay of service members will be somewhat more costly to the Government in time of war and to the Department of Defense even in peacetime.

o A salary system will increase the size of the manpower portion of the Defense Budget.

o The Military Departments object to a salary system on the grounds that it is one more step in the progressive "civilianization" of the Armed Forces. It will not reinforce military customs, tradition and way of life but detract from them. The Department of Defense considers that the advantages of a salary system are outweighed by these disadvantages.

The President's Blue Ribbon Commission on
Military Compensation will review this issue.

Status -

Await recommendations by the President's Blue
Ribbon Commission on Military Compensation.



ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D. C. 20301

MANPOWER, ~~ARMY~~
RESERVE AFFAIRS
and Logistics

27 JUN 1977

Mr. H. L. Krieger
Director, Federal Personnel
and Compensation Division
U. S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Krieger:

This is in reply to your letter to the Secretary of Defense regarding your report dated 29 December 1976, "A Salary System is Needed to Improve the Visibility and Equity of Military Compensation," OSD Case #4499, FFCD 77-20.

The Draft Report describes in some detail many of the advantages and benefits of converting to a salary system for military personnel. There are also some disadvantages associated with such a system. Full assessment of the desirability of converting to a salary system requires a balanced consideration of both the advantages and disadvantages to the military personnel system. The Department of Defense believes that both should be presented in a report to the Congress on such an important issue.

I would also like to comment on the recommendation of the Draft Report to not establish a pay standard for military pay, but to convert to a salary first, then adjust to appropriate levels later if a standard is decided upon. We are currently facing a significant problem in the perception of the erosion of military benefits. The strategy for conversion to salary which the report proposes would add unnecessarily to this problem by maximizing the probability of having to reduce salary levels in the second step if the standard chosen resulted in a salary lower than current RMC. The Department of Defense has not yet taken a position on the question of a standard for military pay. But it would oppose the introduction of major compensation system reform in a manner which would unnecessarily increase adverse reactions to it among those directly affected.



Attached are some of the disadvantages of a salary system that represent the kinds of changes that should be made to the Draft Report.

The Department of Defense believes that the military compensation system can be made more equitable and make more efficient use of compensation dollars without necessarily increasing costs. In doing so, military compensation reform should not be used as a subterfuge for reducing the take-home pay of military personnel. It is recognized that manpower consumes a large, although diminishing, share of the Defense budget. However, if we are to maintain necessary military force levels, we must be willing to pay a fair price for that benefit. Military pay scales and benefits must be competitive with the private sector if we are to attract and retain the numbers and types of people needed. This means that in creating improved military compensation systems we should be fair to the taxpayer by not recommending systems or levels of pay higher than prudent assessment indicates are necessary for the adequate manning of our Armed Forces, and that we must at the same time remain fair to military personnel by not proposing systems or pay levels which would exploit their patriotism and dedication, or their contractual commitment to military service.

There are clearly both advantages and disadvantages to both the current form of military compensation and to a salary form of military compensation. They are complicated by the disadvantages of the act of change itself. The Department of Defense has recently completed the Third Quadrennial Review of Military Compensation (QRMC), the most extensive study of military pay and benefits ever undertaken. After much study of the relative merits and disadvantages of a salary system, the QRMC has recommended a modernized form of a pay and allowances system as the form of compensation which will best meet the future needs of a military organization. In another recent major study of military compensation, the Defense Manpower Commission concluded that a salary form of military compensation was preferable to the current system.

The Department of Defense has not yet reached a decision on the salary question. A Presidential Blue Ribbon Commission of distinguished citizens is being formed to examine the studies and analyses of the Third QRMC, the DMC, and certain other studies, and to make

independent recommendations on future military compensation policy. The Department of Defense will await the recommendations of that Commission before taking a position on changes to the form of military pay.

Sincerely,



ROBERT B. PIRIE, JR.
Principal Deputy Assistant Secretary
of Defense (MRA&L),

Attachment

Example of Disadvantages of a Military Salary System

In some forms, a salary system could increase the Department of Defense budget, even though there might not be a net cost to the federal government. This concern has been a major reason why a military salary system has not yet been adopted, despite recommendations to do so by the major study groups cited in the report. This should be included in the discussion of the budgetary aspects of conversion to a salary.

Alternatives to an increased DoD budget are either to reduce take home pay for military personnel or to reduce military manpower. The Comptroller General has previously stated (GAO Report B-165959, November 12, 1976) that these two ways to reduce costs are effectively closed to us, at least in the short run. Reducing the numbers of uniformed servicemen would affect current international commitments of the United States. If going to a salary were to reduce military compensation, it would exacerbate some of the morale and confidence problems DoD is finding in the armed forces at the present time; and add another negative to the problem of recruiting adequate numbers of volunteers. Another avenue of exploration open is that of management efficiency of the compensation system. These aspects of the issue should be included in the report.

A major consideration bearing on the salary system alternative is the concern of some military leaders over the progressive "civilianization" of the armed forces, and that the introduction of a salary form of military compensation would contribute to such a trend. The Military Departments express great concern that the steady undermining of military customs, traditions, and way of life will adversely affect combat effectiveness when the armed forces are again deployed in combat.

It is argued that the form of the compensation system chosen should reinforce and enhance the military values and the special features of the military way of life. A salary system will not do this. This disadvantage must be weighed along with the advantages of a salary system.

Another major aspect of the issue is how much a salary approach would really simplify the military compensation system. A fully taxable military salary is generally conceived of as replacing (through combining or establishing on the basis of a standard) at least the following items: basic pay, basic allowance for quarters, basic allowance for subsistence, and the federal income tax advantage on the two allowances which are tax exempt. This would remove these four items from the military compensation list and replace it with one salary scale. But over 45 special pays, allowances and benefits would probably remain in use. Nor is this surprising, since the system must be competitive for over 1500 separate skills and specialities. The federal civilian compensation systems and many private sector compensation systems share these characteristics as well. Thus, the introduction of a salary system would result in a single salary plus special pays and benefits system in lieu of a pay and allowances, special pays and benefits system. Large private sector employers similarly have systems of multiple salaries plus premium pays plus benefits. To the degree that benefits are related to dependency status and "need" in the military compensation system, as they frequently are in private sector and federal civilian systems, it is technically impossible for each member of the same pay grade and longevity step to receive precisely the same compensation. Thus, the salary system cannot really fully achieve one of the advantages attributed to it. Putting aside premium pays and benefits, and dealing with salary alone, the likely alternatives are a single basic salary rate plus a number of bonus type pays or a system of multiple salary rates with fewer bonus type pays. In either event the theoretical objective cannot be fully achieved. These aspects of the question should be described in the report to avoid ever stating the advantages of "simplification" deriving from the salary alternative.

The comments on the difficulty of estimating values for in-kind quarters in a pay and allowances system are well taken; it does make the visualization of the value of RMC more difficult. However, the draft report should also point out that placing appropriate values on these quarters is just as difficult for DoD. It would have to be done under a military salary system to obtain reimbursement for on-post quarters. The question of whether or not to implement a quarters rental system is under review now. If such a system were adopted, much of the visibility problem associated with quarters in-kind would diminish because cash BAQ then would be paid to all members. With it, a relative advantage of a salary system would also diminish. The discussion of the quarters issue should be expanded to present these aspects of it.

The Draft Report describes some of the reasons for conversion to a salary in foreign military systems. To present a balanced picture it should also describe the degree of success achieved to date: all, particularly the United Kingdom, are experiencing manpower shortages-- meaning that attraction and retention goals are not being met. Clearly it should highlight that the military salary in these compensation systems is at a premium rate above the selected civilian comparability standards in an attempt to counter the net adverse conditions of military service. These are not reasons, by themselves to reject the salary alternative, but they should be weighed in making the choice.

The discussion of a military pay standard also lacks balance. There are certainly disadvantages to seeking to establish a military pay standard. A significant one is the difficulty in selecting the proper standard to ensure competitive pay levels. But the fact that military service is substantially different from civilian employment probably argues for a pay standard rather than against it. Both sides of the issue should be presented.

PRINCIPAL DOD OFFICIALS RESPONSIBLE FOR
ACTIVITIES DISCUSSED IN THIS REPORT

	<u>Tenure of office</u>	
	<u>From</u>	<u>To</u>
SECRETARY OF DEFENSE:		
Harold Brown	Jan. 1977	Present
Donald H. Rumsfeld	Nov. 1975	Jan. 1977
James R. Schlesinger	July 1973	Nov. 1975
DEPUTY SECRETARY OF DEFENSE:		
Charles W. Duncan, Jr.	Jan. 1977	Present
William P. Clements	Jan. 1973	Jan. 1977
ASSISTANT SECRETARY OF DEFENSE (MANPOWER, RESERVE AFFAIRS AND LOGISTICS):		
John White	May 1977	Present
ASSISTANT SECRETARY OF DEFENSE (MANPOWER AND RESERVE AFFAIRS):		
Carl W. Clewlow (acting)	Feb. 1977	May 1977
David P. Taylor	July 1976	Feb. 1977
John F. Aherne (acting)	Mar. 1976	July 1976
William K. Brehm	Sept. 1973	Mar. 1976