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[Observations on the Method of Annually Adjusting Military Pay].
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Report to Rep. Melvin Price, Chairman, House Committee on Armed Services; Sen. John Stennis, Chairman, Senate Committee on Armed Services; by Elmer B. Staats, Comptroller General.

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Stat. 546; 37 U.S.C. 1008(b)). P.L. 93-419.

In 1967, the principle of providing automatic adjustments in military pay based on increases in Federal civilian salaries was established. Since that time, automatic increases in military pay have been indexed to the average percentage increase in General Schedule salaries. In the military, these automatic adjustment mechanisms result in: understatement of regular military compensation costs in the Department of Defense (DOD) budget; increasing portions of regular military compensation taking the form of tax advantages such as housing, potentially further decreasing the visibility of pay to military members; and increasing pay inequalities due to marital status. Portions of regular military compensation are not reflected in the DOD budget, and this absence impedes identification and evaluation of military compensation costs. Because the forms of military compensation are difficult to identify, members often undervalue their regular military compensation. Regular military salary, considered equivalent to civilian salaries, is greater for members with dependents than for single members of the same grade and length of service. The House and Senate Armed Services Committees should initiate action to require that military personnel accounts in the DOD budget and individual service budgets reflect the Federal income tax advantage of regular military compensation. The military base pay and allowances system should be replaced by a salary system. (RRS)

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-163770

June 2, 1978

To the Chairmen, House and Senate
Committees on Armed Services

We recently evaluated the procedures used to adjust military pay. The automatic adjustment mechanisms result in

- increasing understatement of regular military compensation costs in the Defense budget;
- increasing portions of regular military compensation taking the form of tax advantages, potentially further decreasing visibility of pay to members; and
- increasing pay inequities due to marital status, particularly among personnel in the lower enlisted grades.

Thus, these procedures compound the problems inherent in the base pay and allowances system that led us to recommend replacing the base pay and allowances system with a salary system ("Military Compensation Should Be Changed to Salary System," FPCD-77-20, Aug. 1, 1977).

These problems follow.

- The system conceals military compensation costs. Portions of regular military compensation are not reflected in the Defense budget. This absence impedes identification and evaluation of military compensation costs and also determination of the cost to the Government of proposed changes in the compensation system.
- The system provides large portions of compensation in the form of tax advantages and items rather than in cash. These forms of compensation are difficult for both members and managers to understand and measure. Members themselves undervalue their regular military compensation. Such misperceptions may imply

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that military compensation is unnecessarily high, since military pay, even though it is generally undervalued, is currently sufficient to support most attraction and retention programs.

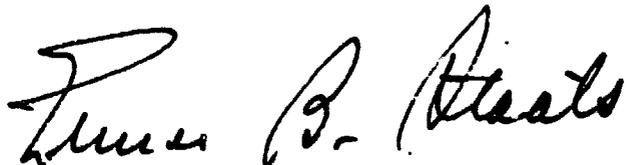
--The system is inequitable; regular military compensation, generally considered the equivalent of civilian salary, is greater for members with dependents than for single members of same grade and length of service. This feature may deter personnel without dependents from military service, while attracting personnel with dependents, who are more costly in terms of other benefits as well.

RECOMMENDATIONS

We recommend that your Committees initiate action to require that the military personnel accounts in the budgets of Defense and the individual Services reflect the Federal income tax advantage component of regular military compensation. (Federal tax advantage, which is now concealed in reduced Federal income tax revenues, currently amounts to about \$1.5 billion.) Also, we continue to believe that the military base pay and allowances system should be replaced by a salary system.

Enclosure I discusses the automatic adjustment procedures and their effects on the visibility and equity of military pay.

A copy of this report is being sent to the Secretary of Defense.



Comptroller General
of the United States

OBSERVATIONS ON THE METHOD
OF ADJUSTING MILITARY PAY

INTRODUCTION

In 1967 the principle of providing automatic adjustments in military pay based on increases in Federal civilian (General Schedule) salaries was established. Since that time, automatic increases in military pay have been indexed to the average percent increase in General Schedule salaries.

However, the military base pay and allowances structure differs from civilian salary structures. Regular military compensation (RMC), generally considered the military equivalent of civilian salary, consists of four parts.

- Basic pay, which is received in taxable cash 1/ by all members, varies by pay grade and time in service. All members with the same grade and longevity receive the same basic pay.
- The value of housing provided by the Government, or a cash basic allowance for quarters (BAQ) when Government housing is not provided, is nontaxable. BAQ rates and housing values vary by pay grade and marital status. Members with the same grade and longevity receive varying pay, depending upon whether they are married or single and whether they receive a cash allowance or are provided housing.
- The value of meals provided by the Government, or a cash basic allowance for subsistence (BAS) when meals are not provided, is nontaxable. BAS rates are different for officers and enlisted personnel. Officers and married enlisted personnel generally receive cash allowances, while single enlisted personnel are generally provided meals.
- Federal income tax advantage is the amount of additional cash income members would need to leave them with the same take-home pay they now receive if all their regular military compensation were subject to Federal income taxes. Thus, the dollar value of tax

1/Basic pay is fully taxable with respect to Federal, State, and local income taxes and Social Security taxes.

advantage, added to the sum of basic pay and quarters and subsistence values, reflects the equivalent taxable pay that would provide the member with the same take-home pay (after Federal income taxes) received under the base pay and allowances system.

Three methods have been used to apply the average percent increase in civilian salaries to the compensation elements described above. Descriptions of these methods are in the following sections.

LEGISLATIVE BACKGROUND OF AUTOMATIC ANNUAL ADJUSTMENTS IN MILITARY PAY

In April 1967, the President, in a message to the Congress on Federal pay, affirmed his commitment to achieving comparability with private industry pay. Accordingly, he proposed a 4.5 percent increase for Federal civilian employees in October 1967, to be followed by a two-stage increase in 1968 and 1969. These follow-on increases would be designed to close the comparability gap for Federal civilian employees.

In the same message, the President stated that "as civilian pay goes up, so should the pay of the Armed Services." He therefore recommended an equivalent 4.5 percent increase in military pay for 1967. However, the President did not recommend follow-on increases as he had for Federal civilian employees, but stated that when the study of the First Quadrennial Review of Military Compensation, 1/ then in progress in Defense, was completed, he would recommend further reforms in the military pay system.

Testifying in support of the President's military pay recommendation in September 1967, a Defense official stated that the principal increase in 1967 should be applied to basic pay for two reasons.

- (1) An increase in basic pay would benefit all members, while increases in the allowances would not.

1/Under 37 U.S.C. 1008(b), as added by Section 2 of Public Law 89-132 of Aug. 21, 1965 (79 Stat. 545,546), the President is required to direct a complete review of the principles and concepts of the military compensation system not less than once every 4 years. The First Quadrennial Review of Military Compensation was begun in March 1966.

Thus, the majority of first-term personnel, personnel serving in Vietnam, and personnel living on bases would not immediately benefit from an increase in the allowances. It was thought particularly undesirable to hold down first-term pay when large numbers of young men were entering military service during the Vietnam buildup, and when reenlistment rates were low.

- (2) A basic pay increase would be more valuable to career personnel because it would increase future retirement benefits as well as other elements of pay that were tied to basic pay.

The testifying official was questioned by a Member of the House Armed Services Committee about the wisdom of applying the increase principally to basic pay. Assuming that housing costs had risen relative to quarters allowances, the Member wondered whether a substantial increase in quarters allowances was justified. He was concerned that in the future quarters allowances might have to be increased at the expense of the amount available for a basic pay increase. Thus, the basic pay increase would be reduced, which might place the Committee in a difficult situation. The Defense witness assured the Committee that Defense officials believed the proposed approach would create fewer problems in future years. 1/

As stated earlier, the Administration's recommendation did not provide for follow-on increases similar to those proposed for Federal civilian employees. However, the Chairman of the House Armed Services Committee was reluctant to "ignore the possibility that future military pay increases might somehow become the victim of executive branch bureaucracy." He proposed an amendment to insure that, if the President or the Congress failed to act on future military pay increases comparable to Federal civilian increases, the Armed Forces would still be assured of comparable automatic adjustments.

1/Defense officials were aware that the First Quadrennial Review of Military Compensation would recommend that a salary system replace the base pay and allowances system for career personnel. Placing the 1967 raise mainly into basic pay would be consistent with future conversion to a salary system.

The amendment provided that basic pay would be adjusted upward whenever General Schedule salaries were adjusted upward. The increase in basic pay was to provide all members with an increase in RMC equal to the average General Schedule increase. Thus, while RMC was to increase at the same rate as civilian salaries, the entire increase would be reflected in the basic pay element of RMC. The percent increase in basic pay would therefore have to be larger than the percent increase in civilian salaries to insure this result. The amendment constrained increases to across-the-board increases; that is, members in all pay grades were to receive the same percent increase.

The Senate Armed Services Committee agreed to the amendment, stating that it should be considered "legislative insurance" in the event that the President or the Congress failed to act affirmatively on future military pay increases comparable to Federal civilian increases. The Senate Committee did not anticipate the amendment's becoming operative because Defense had indicated that the Administration's fiscal year 1969 military pay recommendations would be forwarded to the Congress early the following year. The Committee believed that any military pay legislation enacted in 1968 would, in effect, repeal the amendment.

Defense opposed the amendment in a letter to the Chairman, Senate Armed Services Committee. While supporting comparable increases in principle, Defense stated that the amendment would constrain military pay increases to across-the-board increases, while civilian increases were not to be applied across the board. Defense considered this result undesirable because:

- It believed it would be wrong to distribute the same percent increase across the board to all military members without regard to individual grade comparability.
- The amendment would, in effect, guarantee a minimum 6.2 percent increase in basic pay for all members in 1968 (based on the estimated civilian increase). Defense felt that the Congress should preserve its freedom to consider the Administration's fiscal year 1969 recommendations unhampered by a previous commitment as embodied in the amendment.

The amendment was enacted as Section 8 of Public Law 90-207 on December 16, 1967.

Legislation based on the recommendations of the First Quadrennial Review was never submitted to the Congress, and the automatic adjustment provision adopted in 1967, and intended to be temporary, remained in effect until 1974.

In 1973, Defense proposed legislation to reform the automatic pay adjustment procedure for several reasons.

- (1) The intent of the existing system was to insure that RMC increased by the same percent as Federal civilian pay. However, during the period in which the mechanism had operated, quarters and subsistence allowances had also been increased outside of the automatic process. Thus, military members had actually received increases in RMC greater than civilian pay increases.
- (2) Many members were being compensated twice for the same purpose. Members being provided housing and food by the Government were also being compensated in cash (in basic pay) for increases in the costs of housing and meals. Yet, Defense still had to pay the increased costs of providing these services.
- (3) Other elements of pay, based on basic pay, such as retired pay, were increasing by a greater percent than civilian pay.

The 1973 Defense proposal would have retained the principle of indexing RMC increases to the average General Schedule increase, but would have

- allowed the President to allocate future increases to all elements of RMC rather than to basic pay alone,
- given the President discretionary authority in distributing the increases among RMC elements, and
- coordinated all adjustments to RMC elements within the automatic increase process.

The Congress did not act on the proposal. Both Martin Binkin of the Brookings Institution and our office examined Defense's proposal and suggested an alternative, the "equal percentage method." Under this method, the cash components of RMC (basic pay and quarters and subsistence allowances)

would each be increased by the average General Schedule increase. 1/ Both studies concluded that the equal percentage method was preferable, primarily because it would be easier to explain, understand, and administer than would Defense's proposal. Both studies also concluded that the equal percentage method should be temporary, pending a broader review and reform of the military compensation system to be accomplished by the newly formed Defense Manpower Commission.

Defense agreed that the equal percentage method was the more logical, justifiable, and easily understood method. Accordingly, in 1974, it again forwarded legislation to the Congress to reform the adjustment mechanism. The legislation contained the equal percentage method.

Defense testified that the allowances should be increased so they would maintain a reasonable relationship with rising housing and food costs. It also said that, even though portions of past basic pay increases were due to increases in housing costs, it was still difficult to convince service personnel that housing allowances should not be increased.

Testifying officials were again asked about the logic of the method. If the allowances no longer maintained a reasonable relationship with expenses, perhaps there should be a catch-up raise in the allowances. Defense responded that its 1973 proposal would have allowed such a catch up but that there were two reasons for revising that proposal:

- (1) The Congress did not act on the proposal.
- (2) Assuming that adjustments would be within a matching increase mechanism, a dramatic rise in, for example, the cost of food would leave very little for a basic pay increase. This system would be less desirable to members than either the current or equal percentage systems.

Defense noted that in 1975, the law required a quadrennial review of the principles and concepts of the military compensation system, and that a reexamination of allowance levels could result in further recommendations concerning the matching increase mechanism.

1/It should be noted that the equal percentage methods does not take into account the Federal income tax advantage component of RMC when adjusting military pay.

The Armed Services Committees reported favorably on the equal percentage method. They stated that the Government had been paying twice for some factors in the pay increase calculation and that the method would result in savings to the Government by eliminating this double payment. Savings would be attained in three ways:

- (1) Increases in the allowances would be incorporated in the matching pay increase system, eliminating the possibility of separate increases in the allowances.
- (2) Members furnished quarters and subsistence would no longer receive increases in basic pay which were based on increases in food and housing costs, costs they did not have to defray.
- (3) Smaller increases in basic pay would also reduce costs associated with other entitlements based on basic pay.

The equal percentage method was adopted in September 1974 (Public Law 93-419).

In early 1976, Defense indicated that the Administration would again seek reform of the annual military pay adjustment procedure. It stated that quarters allowances were far below the fair market value of housing occupied and that the Administration planned to bring the allowances into line with fair market rental on a phased basis beginning in October 1976. This transition would be accomplished by allocating a larger portion of future increases to quarters allowances.

In March 1976, Defense forwarded proposed legislation stating that "military family quarters on the average have value substantially above the current rates of the BAQ, and military bachelor quarters have a value substantially below current BAQ rates." Defense wanted to adjust BAQ rates to more closely approximate the average value of military family quarters--the first step in replacing the BAQ "forfeiture" system 1/ with rents appropriate for the military quarters actually occupied. Defense proposed achieving this goal by placing portions of future basic pay

1/Members provided Government quarters do not receive BAQ. In effect, they "forfeit" BAQ for their pay grade, no matter what the value of the quarters they actually occupy.

raises into BAQ until BAQ rates matched the average value of military family quarters. It also proposed to rebate part of the BAQ increase to members without dependents provided Government quarters, in recognition of field and sea duty and the lower value of bachelor quarters.

The Defense proposal would:

- Limit reallocation dollars so that at least 75 percent of the increase that would have gone to basic pay under the equal percentage method would still be allocated to basic pay.
- Require that the rebate for single persons on sea or field duty or in Government quarters at least equal the amount reallocated from basic pay.
- Require that the President advise the Congress of his reallocation plans not less than 30 days before the effective date.
- Provide that an assessment of reallocations be made in conjunction with Quadrennial Reviews of Military Compensation and a full report be made to the Congress summarizing the objectives and results of past reallocations.

Defense indicated that it expected to reallocate 25 percent of the October 1976 basic pay increase to the basic allowance for quarters. It also indicated that future reallocations would be based on assessments of the compensation structure, the market value of Government quarters, and the cost of housing in the private sector. Cost savings would be significant if the proposal were enacted because

- part of the basic pay increase would be applied to quarters allowances, which would be forfeited by married personnel in Government quarters, and
- other pay items, based on basic pay, would also increase less rapidly.

The May 1976 report of the Senate Armed Services Committee rejected the provision for payment (or rebate) of quarters allowances to single personnel in Government quarters. The Committee stated that it rejected this move to fair market rental because:

- It would change the underlying concept of the quarters allowance (to provide a cash allowance when adequate quarters were not furnished). It was not clear whether this would (a) be desirable, (b) work in a wartime situation, or (c) save money.
- The Committee was provided no specific data showing how fair market rental charges would be made equitably.
- There was no specific long-term implementation plan available to the Committee.

The Committee did, however, recommend that the President be allowed more flexibility in allocating raises among the cash elements of RMC, noting that this would raise the allowances closer to actual housing costs (for personnel with dependents).

The House Conferees concurred in rejecting the fair market rental proposal but were adamant that reallocation of pay increases would be inequitable without the rebate. Senate Conferees agreed to include the rebate.

Section 303 of the Department of Defense Appropriation Authorization Act of 1977 amended section 37 U.S.C. 1009 to include a provision allowing reallocation of pay increases. Currently, military pay may be adjusted by the equal percentage method or by reallocating the increases specified by the equal percentage method among the cash elements of RMC, with the restriction that at least 75 percent of the increase that would have applied to basic pay under the equal percentage method would still apply to basic pay.

EFFECT ON DEFENSE'S BUDGET

Defense costs for basic pay, cash allowances, and subsistence for enlisted personnel are less under the reallocation method than they would be under the equal percentage adjustment method. The following table shows estimates of outlays for these items under equal percentage adjustments and under reallocation procedures. 1/

1/Our estimates are based on reallocations of 25 percent for fiscal year 1977 and 12 percent thereafter.

Defense Costs:
Basic Pay + Cash Allowances +
Subsistence for Enlisted Personnel

<u>Fiscal year</u>	<u>Equal percentage method</u>	<u>Reallocation</u>	<u>Dollar difference</u>
	----- (millions) -----		
1977	\$20,928	\$20,893	\$- 35
1978	22,404	22,337	- 67
1979	23,860	23,759	-101
1980	25,411	25,268	-143

Other outlays directly related to basic pay, for example, military retired pay and reserve drill pay, would also be less under reallocation procedures. Thus, total savings in the Defense budget resulting from the reallocation procedure would be greater than the table indicates.

EFFECT ON VISIBILITY OF MILITARY PAY

Military personnel costs

As was pointed out in our report, "Military Compensation Should Be Changed to Salary System" (FPCD-77-20, Aug. 1, 1977), the base pay and allowances system conceals military personnel costs. For example, the value of quarters provided by the Government are not reflected in the military personnel appropriation accounts of the Defense budget. The tax advantage which accrues to military personnel because quarters and subsistence are nontaxable is not reflected in the Defense budget. ^{1/} Thus, the cost to the Government of military personnel is understated in the Defense budget. As shown below, the percent of RMC costs reflected in the Defense budget decreases under both adjustment mechanisms.

^{1/}Tax advantage is estimated to total about \$1.5 billion in fiscal year 1978.

Defense Outlays
as a Percent of RMC (Salary) Costs

<u>Fiscal year</u>	<u>Equal percentage</u>	<u>Reallocation</u>
1977	89.2%	89.0%
1978	89.0	88.7
1979	88.8	88.5
1980	88.7	88.2

We believe that the true cost of military personnel should be reflected in the Defense budget. This is not the case under the base pay and allowances system, and these adjustment mechanisms result in increasing understatement of military personnel costs in the Defense budget.

Observations

In 1976, the Defense Manpower Commission (DMC) recommended the following principle with respect to efficient Defense spending: "The budgets of the Department of Defense and each of the individual Services should reflect the true costs or prices of the resources they use." It stated that this was necessary to guide Defense and the Services toward resource allocations which contribute most to national security. It further stated that the base pay and allowances system violated this principle since a large part of compensation, tax advantage, is not charged to the Defense budget, but hidden in reduced revenues to the Treasury.

In February 1978, Defense stated that it agrees with the DMC recommendation with respect to reflecting true costs in its budget and is trying to develop costs for the elements of military compensation. Defense also stated that it disagrees with conversion to a salary system and prefers a "modernized pays and allowances" system.

These Defense statements are apparent contradictions, since Defense has stated that a major disadvantage of a salary system is that it would increase the Defense budget, even though there might not be a net cost to the Federal Government. A major reason for that increase is that a salary system would more accurately reflect the true cost of military personnel because it would require that tax advantage be monetized and included in the Defense budget rather than concealed in reduced Federal income tax revenues.

The President's Commission on Military Compensation recently recommended that the base pay and allowances

system be retained rather than replaced by a salary system. Interestingly, one of the reasons for this recommendation was that converting to salary would require monetizing tax advantage which would increase the Defense budget. At the same time, the Commission recognized that monetizing tax advantage would more closely align the Defense personnel budget with true personnel costs and could result in no substantial net cost to the Federal Government. This directly contradicts our position, Defense's position, and DMC's position with respect to reflecting true resource costs in the Defense budget.

The Commission also stated that military compensation "should be fair in the eyes of the public at large as well as in the eyes of service members." In our opinion, for military compensation to be fair in the eyes of the public, it must be visible to the public. Currently, through the base pay and allowances system, parts of it are, in effect, concealed from the public. Furthermore, current pay adjustment procedures result in increasing concealment of military personnel costs.

Effect on member perceptions of compensation

RMC is a measure of fully taxable income which would result in the same after-tax pay as the member receives from the combination of basic pay and quarters and subsistence allowances. It therefore is an approximation of the civilian salary necessary to provide the same after-tax pay as the member receives in the military. 1/

The ability to measure RMC is thus important for the member or prospective member who bases decisions to enter and remain in the military in part on comparisons of the earnings potential in military service and civilian employment.

For members receiving cash allowances (the majority of married members and single officers), the adjustment procedures increase tax advantage--the RMC element which is generally the most difficult for members and managers alike to measure and understand. The reallocation procedure increases tax advantage at a more rapid rate than does the equal percentage method, as shown in the following table.

1/RMC will, in fact, underestimate the equivalent civilian salary. Estimates of the tax advantage portion of RMC consider only Federal income taxes. Additional tax advantages accrue because the allowances are not subject to Social Security or State and local income taxes.

Tax Advantage as a Percent of RMC

	<u>FY</u> <u>1976</u>	<u>FY 1980</u> <u>equal percentage</u>	<u>FY 1980</u> <u>reallocation</u>
Single officers			
0-1	4.3	5.4	6.0
0-2	5.1	6.8	7.6
0-3	6.1	7.8	8.8
0-4	6.8	8.5	9.6
0-5	7.4	9.2	10.8
0-6	7.9	10.3	12.3
Married members			
0-1	5.1	5.1	5.7
0-2	4.4	5.7	6.3
0-3	4.8	6.2	7.0
0-4	5.2	6.6	7.6
0-5	5.6	7.4	8.7
0-6	6.3	8.3	9.9
E-1	5.7	6.8	7.3
E-2	5.8	6.6	7.2
E-3	5.6	6.4	6.9
E-4	5.8	6.4	6.9
E-5	5.7	6.0	6.3
E-6	5.3	5.2	5.8
E-7	4.6	5.3	5.9
E-8	4.4	5.9	6.5
E-9	4.9	6.2	7.0

For these members, not only does the reallocation procedure allow an increasing portion of RMC costs to be concealed, it also decreases the percent of RMC visible to the member in the form of cash pay. Recent studies have shown that military members underestimate RMC. 1/ This problem may be aggravated as larger portions of RMC take the form of tax advantages. 2/

1/As was pointed out in our report on converting the military to a salary system, this may imply that military pay is unnecessarily high since, even though it lacks visibility, it is currently sufficient to support most attraction and retention programs.

2/As noted earlier, RMC underestimates equivalent fully taxable pay. The reallocation procedure will increase Social Security and State and local income tax advantages as well.

For single personnel occupying Government quarters, the same is true. Part of the increase in basic pay, which would have been taxable, is reallocated to a nontaxable allowance and received in nontaxable dollars (as partial BAQ). This group of personnel constitutes the vast majority of first-term enlisted personnel, whose underestimates of RMC are already the most severe.

Observations

The Third Quadrennial Review of Military Compensation stated that

"The 'tax advantage' component (of RMC) is irrelevant to the member; as a part of RMC, it is an element of the member's pay but is not an 'advantage' any more."

This statement is surprising, particularly since a major Service objection to a salary system is the increased tax liability that would result, especially with respect to State income taxes and Social Security taxes. Moreover, increases in military pay since 1974 do not account for the fact that civilian salaries are fully taxable, while military allowances are not. 1/ Thus, the civilian actually receives less than \$1, net of taxes, for each increase dollar. The military member is not taxed on increase dollars allocated to the allowances. Thus, the statement that tax advantage is no "advantage" is incorrect.

Furthermore, this statement may actually be a disservice to members, particularly those who are unfamiliar with the magnitude of the tax advantages associated with the base pay and allowances system. Such individuals may leave the military, perceiving civilian pay as superior to their military pay. They may find that after taxes 2/ and living expenses such as housing and food, they are no better off in terms of cash than they were while in the military.

1/ Since adoption of the "equal percentage" adjustment method in 1974, estimates of tax advantage are not considered when adjusting military pay.

2/ Civilian salaries are generally fully taxable for Federal, State, and local income taxes. In addition, for civilian employees covered under Social Security, salaries are subject to Social Security taxes. Basic pay is the only RMC element subject to these taxes.

The President's Commission on Military Compensation stated that a study currently underway at The Rand Corporation indicates that lack of pay visibility has little effect on retention. We have not yet had the opportunity to examine the analysis cited.

EFFECTS ON EQUITY OF MILITARY PAY

Differences in pay between married and single members

In our report on conversion to a salary system, we stated that we consider the base pay and allowances system inequitable. It compensates married and single personnel with the same grade and length of service differently, even if their duties, qualifications, and performance are equivalent. The quarters allowance, or the value of quarters provided, is greater for married personnel. 1/

Both adjustment procedures increase dollar differences in cash pay (basic pay and cash allowances) between married and single members. The following table illustrates this effect.

Differences in Average Annual Cash Pay
Between Married and Single Members
(Assuming All Members Receive Cash Allowances)

	<u>FY 1976</u>		<u>FY 1980</u>		<u>FY 1980</u>	
	<u>Dollars</u>	<u>Percent</u>	<u>Equal percentage</u>	<u>Equal percentage</u>	<u>Reallocation</u>	<u>Reallocation</u>
			<u>Dollars</u>	<u>Percent</u>	<u>Dollars</u>	<u>Percent</u>
0-1	435	4.1	554	4.2	651	4.9
0-2	493	3.5	628	3.5	742	4.2
0-3	493	2.8	628	2.8	754	3.4
0-4	490	2.3	623	2.3	760	2.8
0-5	535	2.1	681	2.1	848	2.6
0-6	601	1.9	765	1.9	982	2.5
E-1	593	9.8	755	9.8	877	11.4
E-2	544	8.2	692	8.2	805	9.6
E-3	432	6.1	550	6.1	640	7.1
E-4	530	6.9	674	6.9	771	7.9
E-5	612	6.8	779	6.8	885	7.8
E-6	720	6.7	916	6.7	1,053	7.8
E-7	755	6.0	961	6.0	1,120	7.0
E-8	669	4.5	851	4.5	1,006	5.4
E-9	696	4.0	886	4.0	1,071	4.9

1/Married personnel are more costly (and receive greater benefits) in terms of other elements of the compensation system as well, such as health care for dependents and moving expenses.

Single enlisted personnel are generally required to live on base and are fed in Government mess halls. They therefore "forfeit" the cash allowances. (They do receive a partial BAQ based on that portion of the basic pay increase reallocated to the quarters allowances.) Married personnel generally live off base and receive cash allowances. Thus, single enlisted members are perhaps more likely to perceive the differences in pay shown below. 1/

Differences in Pay Between Married
and Single Members (note a)

	<u>FY 1976</u>		<u>FY 1980 Equal percentage</u>		<u>FY 1980 Reallocation</u>	
	<u>Dollars</u>	<u>Percent</u>	<u>Dollars</u>	<u>Percent</u>	<u>Dollars</u>	<u>Percent</u>
E-1	2,317	53.5	2,949	53.5	3,073	55.9
E-2	2,317	48.0	2,949	48.0	3,063	50.1
E-3	2,316	44.6	2,949	44.6	3,041	46.2
E-4	2,537	44.4	3,228	44.4	3,328	46.0
E-5	2,766	40.4	3,521	40.4	3,631	42.1
E-6	2,917	34.2	3,712	34.2	3,852	35.9
E-7	3,069	29.8	3,907	29.8	4,068	31.4
E-8	3,214	26.4	4,090	26.4	4,246	27.7
E-9	3,368	22.9	4,287	22.9	4,471	24.2

a/These figures reflect differences in pay received in cash assuming married members receive basic pay and cash allowances, and single members receive only basic pay and a partial quarters allowance in cash.

It is not surprising that some single personnel complain that the system is inequitable. They argue that no other system pays higher salaries to married personnel solely because they are married. Their complaints extend beyond pay itself to the differing treatment of married and single personnel, particularly concerning housing policy. Single personnel, generally required to live on base, complain of a lack of privacy and subjection to inspections and barracks details. They point out that their married counterparts are not subject to these unpleasant and limiting living conditions.

1/The magnitude of differences in RMC is less, though still substantial, ranging from about \$1,700 to \$3,300. We have focused on cash pay because it is the most visible portion of RMC.

Observations

The vast majority of personnel in their first enlistment are single personnel. In 1967 the First Quadrennial Review of Military Compensation reported that single personnel were loath to tolerate the pay discrimination against them under the base pay and allowances system. It stated that many solved the problem by changing employment status rather than marital status.

In 1975, Martin Binkin of the Brookings Institution pointed out that the Army was attracting a disproportionate percent of recruits with dependents in relation to married males in the civilian population from which the Services draw most recruits.

In 1976, the Defense Manpower Commission stated that a compensation system which results in higher compensation for married personnel will tend to attract and retain a greater proportion of such personnel than one which does not.

These statements imply that the base pay and allowances system is relatively more attractive to individuals with dependents, who are more expensive to maintain in relation to their skills. It may deter attraction and retention of individuals without dependents. Although we have not seen conclusive evidence indicating whether, or to what extent, pay inequities alone actually deter attraction and retention of individuals without dependents, two points are important. First, the Third Quadrennial Review of Military Compensation stated that dependency status is more a function of changing marital patterns in society than it is of compensation. However, the increasing proportion of recruits with dependents appears to conflict with trends toward later marriage among young adults reported by the Bureau of the Census.

Second, as was pointed out earlier, when Defense requested reallocation authority, it recognized that bachelor BAQ rates already exceeded the value of military bachelor quarters. Thus, single members living on base were "forfeiting" amounts (the bachelor BAQ rates) greater than the value of their quarters. In other words, they were "overcharged" for the quarters they occupied. Single members will continue to be overcharged for military quarters under both adjustment procedures.

The President's Commission on Military Compensation stated that single members living in barracks complain about

these "overcharges." It further stated that it believes "such negative perceptions are likely to result in poor morale and job performance." We agree. We further believe that members' complaints concerning married-single differences in BAQ rates, along with complaints concerning the differing treatment of married and single personnel with respect to housing policy, are also likely to cause poor morale and performance.

When should reallocation stop?

Currently, there are no specific targets for BAQ levels, although several bases for determining "appropriate" BAQ levels have been considered. These include

- the cost to the Government of providing military quarters,
- mean housing expenses experienced by military personnel living off base, and
- housing expenses incurred by civilians at similar income levels.

In the absence of BAQ target levels, there is no point at which reallocation becomes inappropriate. Members occupying Government quarters, who "forfeit" the quarters allowance, may feel that future decisions to reallocate from basic pay to quarters allowances, particularly when maximum reallocation authority is exercised, are determined more by attempts to slow the growth in their cash pay than by attempts to develop "appropriate" BAQ levels. Similarly, personnel approaching retirement eligibility are likely to view reallocation as an attempt to reduce their retired pay (since it reduces the rate of growth in basic pay). These views may contribute to morale problems.

Since the relationship between BAQ rates and target levels, however defined, probably will differ by pay grade, ^{1/} it is likely that some grades will reach BAQ target levels before other grades. Members in those grades reaching BAQ targets more quickly may argue that further reallocation is inequitable, while BAQ rates for the remaining grades would still be below their targets. A possible solution, although questionable under existing law,

^{1/}These relationships differ if either the cost of Government-provided housing or mean housing expense is considered the appropriate basis for BAQ rates.

would be to reallocate different percents of basic pay to quarters allowances for different grades. We suspect, however, that such a practice would be considered inequitable by personnel receiving smaller percent increases in basic pay, particularly those personnel approaching retirement eligibility.

CONCLUSIONS

Current procedures for annually adjusting military pay (regular military compensation) result in

- increasing understatement of military compensation costs in the Defense budget;
- increasing portions of regular compensation taking the form of tax advantages, potentially further decreasing visibility of pay to members; and
- increasing pay inequities due to marital status, particularly among personnel in the lower enlisted grades.

These procedures compound the problems inherent in the base pay and allowances system that led us to recommend replacing the base pay and allowances system with a salary system. These problems follow.

- The base pay and allowances system conceals military compensation costs. Portions of regular military compensation are not reflected in the Defense budget. This absence impedes identification and evaluation of military compensation costs, and also determination of the cost to the Government of proposed changes in the compensation system.
- The system provides large portions of compensation in the form of tax advantages and items rather than in cash. These forms of compensation are difficult for both members and managers to understand and measure. Members themselves undervalue their regular military compensation. Such misperceptions may imply that military compensation is unnecessarily high, since military pay, even though it is generally undervalued, is currently sufficient to support most attraction and retention programs.
- The system is inequitable; regular military compensation, generally considered the equivalent of civilian salary, is greater for members with dependents than

for single members of the same grade and length of service. This feature may deter attraction and retention of personnel without dependents while attracting personnel with dependents, who are more costly in terms of other benefits as well.

We continue to believe that replacing the base pay and allowances system with a salary system would be a major step toward a more efficient military compensation system.

RECOMMENDATIONS

We recommend that the Committees on Armed Services initiate action to require that the military personnel accounts in the budgets of Defense and the individual Services reflect the Federal income tax advantage component of regular military compensation. Also, we continue to believe that the military base pay and allowances system should be replaced by a salary system.