During the late 1990s, the Air Force struggled with manpower supply problems. Recruiting failed to meet its numerical goal in FY99, and the proportion of high-quality recruits (high school diploma graduates with AFQT scores of 50 or above) fell every year from 1995 to 2000. Overall reenlistment rates frequently fell below their target rates, and reenlistment rates remained low in certain specialties. A number of factors have been proposed to explain these decreases: a booming economy with low unemployment, high private-sector pay for technically trained AF enlisted personnel and officers, and more frequent military deployments and hazardous duty assignments associated with peacetime military operations.

After 1999, the manpower supply situation improved. The Air Force increased its recruiting resources, Congress passed a multiyear increase in military pay in FY00, the economy softened, and an additional military pay increase took effect in FY02. Although the situation of the late 1990s is past, it has nevertheless stimulated discussion about the adequacy of the current military compensation system.

The purpose of this report is to provide information relevant to two compensation system changes under consideration within the Air Force: skill pay and capability pay. As we discuss in greater detail later, skill pay is intended to provide higher pay for certain skills, whereas capability pay is intended to provide compensation and incentives for superior individual capability. We also consider other changes that might be made to the current compensation system. Our approach is predicated on using empirical information about
personnel outcomes to gain insight into the shortcomings of the current system. By appealing to empirical information, we can move from the abstract to the concrete.

Our approach is not limited to empirical information. The manning challenges of the past few years do not necessarily reflect the manning challenges of the future. Furthermore, important aspects of the compensation system’s performance are not well captured by available data. For these reasons, past empirical information cannot be expected to cover the full spectrum of compensation effectiveness, and it is useful to have a conceptual perspective to delineate at least some of the additional aspects that should be considered.

As defense manpower research has progressed and the role of compensation as a strategic management tool has become better understood, the measures of personnel outcomes have broadened. In addition to meeting recruiting and retention targets, a compensation system should be judged on whether it retains high-caliber personnel and induces them to exert effort. It should assist in sorting personnel into positions of responsibility in accordance with their capability and productivity, and it should separate them when they are in excess supply relative to the organization’s requirements. This document attempts to address at least some of these broader measures.

The Air Force requires a compensation system that can be relied upon to serve its objectives of providing national security through air and space power. The compensation system must be able to deliver an adequate supply of personnel to meet its manning requirements. The personnel must be highly selected, well trained, and highly motivated. The compensation system must be dynamically responsive and sufficiently flexible to respond rapidly and effectively when manpower shortages occur or loom on the horizon. Since the Air Force’s capabilities in combat, combat support, peacetime operations, surveillance, mapping, intelligence, and so forth rely on its personnel, the compensation system must be viewed as a strategic management tool.

Yet the compensation system should support, not intrude upon, Air Force culture and the commitment of its personnel to accomplishing its objectives. It should operate automatically, be proactive rather
than reactive, be predictable rather than uncertain, have low administrative cost, maintain cohesion (not promote divisive comparisons), be seen as fair, and be cost-effective. It cannot, however, be all of these things at once.

Changes in something as fundamental as the structure of compensation can also affect an organization’s culture. Although it is difficult to place a value on culture—and often risky to challenge the status quo—it is nevertheless in an organization’s best long-run interest to be open to even radical change. But although change may be feasible and may address certain problems, the prospective disruption to culture can still be forbidding. While we recognize the importance of culture, we have decided to focus on the actual and desired performance of a compensation system. Cultural considerations might be more productively assessed after we learn more about the improvements that skill pay and capability pay could produce.

A fact worth emphasizing: The military compensation system plays a critical role in determining the experience mix of the force. Compensation is naturally not the only factor that influences experience mix. In particular, each service constructs its own personnel management system and thereby specifies its own promotion policy. The Air Force differs from the other services in having higher reenlistment rates and slower promotions among its enlisted force. Air Force first-term reenlistment is several percentage points higher than that of the other services, but airmen reach E-5 about two years later than enlisted personnel in the other services. Still, given a service’s promotion policy, the retention profile by year of service is strikingly similar across occupational specialties and fairly stable over time. Permanent changes in the level and rank/year of service structure of compensation can be expected to result in permanent changes to the retention profile and hence to the experience mix, all else being equal.

This fundamental fact makes it essential to know (or to question) whether today’s experience mix is optimal, and further, whether it is optimal to have nearly identical retention profiles across all specialties. Whatever form the compensation system takes, it must be able to support the optimal mix of personnel. Additionally, if the Air Force wants the flexibility to change the experience mix within or between specialty areas, the compensation system must also be able to support such diversity. This report addresses whether the changes in
the compensation structure suggested for discussion by the Air Force would permit such force flexibility.

In the 1980s and 1990s, the civilian economy changed in a way that increasingly rewarded, through higher earnings, those workers who were better skilled or had a college degree. The vastly improved economic opportunities for civilians with high-tech skills or with a college degree placed a burden on the services’ efforts to meet their personnel requirements with high-quality personnel, especially in technical skills. The burden was particularly great for the Air Force, which relies heavily on personnel in information technology and with knowledge-based skills. Although the economic boom added to the burden, the competition for high-tech workers has also come from the information revolution and the greater value of knowledge (human capital) in economies that increasingly produce services rather than commodities and manufactured goods. The existence of better civilian opportunities for those with technical skills and higher education raises the question of whether there should be more differentiation in military pay to ensure that the best and brightest are retained, especially in key occupational areas and for future leadership positions. Skill pay and capability pay are ways of providing such differentiation.

Thus, at the conceptual level a host of issues must be considered. The most fundamental issue is the effectiveness of the compensation system in meeting recruiting and retention goals as the economy heats up and cools down. In addition, the compensation system must be able to attract, keep, and motivate high-quality personnel. It must also induce them to sort themselves efficiently, so that the personnel most capable of leadership actually stay and become the leaders. Similarly, the compensation system should provide personnel with exceptional technical expertise the incentive to enter positions where they can apply that expertise—and not be driven from service by a lack of professional growth opportunities or inadequate compensation incentives. The sorting and incentive roles of compensation are important because, lacking lateral entry, the services must recruit capable junior personnel in sufficient numbers at the entry level and then identify, train, and advance them to the top of the organization to become senior leaders and technical experts.
Another role of the compensation system is to assist in separating personnel in circumstances of excess supply, particularly at the end of their careers. These separations must be seen as fair even though they cut short promising and promised careers. The compensation system must adjust rapidly enough to keep pace with the private sector and have the capacity to reward different skills differently on a temporary or more permanent basis. The compensation system must be able to scale up (accommodate a large increase in end strength) in wartime and scale down in peacetime. Finally, although we focus on active-duty personnel, the compensation system for the reserves must be able to meet reserve-manning goals and do so without adversely drawing personnel away from the active components.

We review recruiting and retention outcomes in Chapter Two and private-sector wage trends in Chapter Three, also comparing military compensation across the services. This information documents the pattern of retention outcomes across occupations and the decline in the percentage of high-quality accessions. In addition, it helps identify underlying, causative factors such as civilian wage growth, low unemployment, college enrollment, and peacetime military operations—as well as the current structure of military compensation. Together, this information informs our discussion of the Air Force’s late-1990s personnel situation and what steps might be taken to strengthen compensation and avoid future problems. In Chapter Four, we analyze a variety of options for improving the compensation system and consider the advantages and limitations of skill pay and capability pay in solving and preventing manning problems, relative to the current system. In Chapter Five, we conclude the report with a discussion of the importance of assuring sufficient flexibility in the compensation structure to meet alternative future manning requirements. We also point out the need for further assessment of skill pay and capability pay in regard to design (e.g., eligibility, amount, duration), effectiveness, and cost-effectiveness, in the event the Air Force or DoD decides to pursue these pay options.