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Should the Increase in Military Pay Be Slowed?

James Hosek • Beth J. Asch • Michael G. Mattock

Prepared for the Office of the Secretary of Defense

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Published 2012 by the RAND Corporation
1776 Main Street, P.O. Box 2138, Santa Monica, CA 90407-2138
1200 South Hayes Street, Arlington, VA 22202-5050
4570 Fifth Avenue, Suite 600, Pittsburgh, PA 15213-2665
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Library of Congress Control Number: 2012944168
ISBN: 978-0-8330-7414-0
Summary

Should the Department of Defense (DoD) slow the increase in military pay in coming years? And by doing so, can it achieve desired budget efficiencies while maintaining a workforce of sufficient size and quality to meet future military objectives? We believe the answer is yes, given a robust climate for recruiting and retention, expected changes in the size of the force, and favorable comparison between military and civilian pay. Therefore, we recommend that the rate of increase in military pay be slowed, and we offer several alternatives for implementation.

As the first half of fiscal year (FY) 2012 draws to a close, recruiting and retention remain in excellent shape. With a few exceptions, the military services’ active and reserve components have met or exceeded their recruiting and retention targets since 2009. Quality targets for recruits set by the Office of the Secretary of Defense have also been met and often exceeded. Indeed, overall recruit quality has steadily increased.

More recently, the United States ended the war in Iraq and plans to reduce its presence in Afghanistan over the next two years. This offers an opportunity for DoD to reconsider its force structure needs and, in turn, its future manpower requirements. In January, the Secretary of Defense revealed plans to reduce the size of the force by some 72,000 soldiers and 20,000 Marines over the coming years as part of a broader plan to cut departmental spending. As a consequence, recruiting and retention goals in the Army and Marine Corps are likely to be reduced significantly.

The third factor in our calculus, comparisons between military and civilian pay, have been increasingly favorable for much of the past decade, following pay actions put in place in the early 2000s when military pay lagged behind the civilian sector. Comparisons between military and civilian pay have become an important consideration in establishing pay increases for the military. Such comparisons typically involve two approaches. The first is to compare changes in basic pay (one element of military pay) to the Employment Cost Index (ECI) for wages and salaries in the private sector.

The second is to determine how military pay ranks in the wage distribution for civilian workers who are comparable to military personnel in terms of both education and occupation. When this approach is used, military pay is usually measured by regular military compensation, a more expansive measure of pay that includes basic pay, allowances for subsistence and housing, and the federal tax advantage deriving from the fact that allowances are not taxed. Basic pay comprises about 60 percent of cash compensation; regular military compensation comprises slightly over 90 percent. The remainder consists of special and incentive pay (including bonuses) and other allowances.
Military Pay Raises over the Past Decade

The National Defense Authorization Act of 2000 authorized a 6.8 percent increase in basic pay in fiscal year 2000 and basic pay increases equal to the percentage increase in the ECI plus half a percentage point (0.5) through fiscal year 2006.\(^1\) This legislation responded to three challenges facing DoD: (1) a growing gap between military and civilian pay for some portions of the military workforce, primarily in the mid-grade enlisted force; (2) deteriorating recruiting conditions faced by the Army and Marine Corps; and (3) retention difficulties in technical military occupational specialties in the late 1990s.

Following the terrorist attacks of September 11, 2001, and subsequent U.S. military operations in Iraq and Afghanistan, the basic pay increases—the ECI plus half a percentage point—were continued through FY 2010 as insurance against a decline in either the size or quality of the military workforce. In addition to the higher-than-usual increases in basic pay, the housing allowance was raised in the early part of the decade to cover the full expected cost of off-base housing. Together these pay actions succeeded in increasing basic pay and regular military compensation relative to civilian pay.

So, what do these policy decisions mean for military pay today?

- Basic pay is up 45 percent since 2000, substantially more than the ECI (up 33 percent) and the Consumer Price Index (up 31 percent). As a result, military pay buys a lot more than it used to.
- Basic pay, adjusted for inflation, has increased over the decade for officers and enlisted personnel in every age group and service. Since 2000, basic pay has realized average increases of 13 to 18 percent for enlisted personnel ages 18–27, 15 to 24 percent for enlisted personnel ages 28–37, and 13 percent for officers.
- The increases in regular military compensation, adjusted for inflation, are even more dramatic. Regular military compensation is up an average of 40 percent for enlisted members, with some variation by age group and branch of service, and 25 percent for officers. Growth in regular military compensation outpaced that of basic pay due to the increase in the basic allowance for housing.

While real military pay increased over the last decade, civilian pay did not, dropping 4 to 8 percent between 2000 and 2009 for most age and educational groups. As a result, military pay is now well above the 70th percentile of civilian wage distributions for most enlisted and officer age and education groups. In 2000, the Ninth Quadrennial Review of Military Compensation established that regular military compensation should reach at least the 70th percentile of comparable civilian earnings in order to sustain the size and quality force desired by the military departments. Between 2000 and 2009, regular military compensation for enlisted personnel grew from about the 60th percentile of civilian earnings for high school graduates to close to or even exceeding the 80th percentile, depending on the service; regular military compensation for officers increased from the 70th to the 85th percentile of earnings for civilians with a bachelor’s degree.

A number of other factors should also be taken into consideration when comparing military and civilian pay. One of the most important is the cost of health care. Active-duty ser-

\(^1\) For example, if the ECI increase was 3 percent, the authorized basic pay increase would be 3.5 percent.
vice members receive health care at no cost, and costs for their families are quite low. If these service members were employed in the civilian labor market, they would likely be required to contribute to health plan premiums in order to obtain similar coverage. These contributions reduce take-home pay for civilians. In 2000, average annual worker contributions to premiums for single and family coverage were $334 and $1,619, respectively. Moreover, as the cost of health care rises in the civilian sector, the value to service members of not paying health care costs increases. Between 2000 and 2010, health plan premiums increased approximately 150 percent—a growth rate that far exceeded the 31 percent increase in the cost of living over the same period. After incorporating the value of avoiding health care costs, military pay places even higher on the civilian wage distribution.

Furthermore, civilian employment conditions have been poor since early 2008, when the unemployment rate rose precipitously. The unemployment rate increased for all education levels and remains high at about 8.3 percent. Many of the unemployed have been so for long periods (more than 26 weeks), and the number of workers employed part-time has doubled since 2008, due in large part to the poor condition of the labor market. These factors affect the wages civilians can expect to receive—an aspect not fully reflected by the ECI, which accounts only for wages paid to employed workers. The distinction is significant: the expected weekly wage is 2 to 6 percent less than the average weekly wage of full-time workers. This difference translates to a reduction in earnings of about $25 per week for college graduates and $40–$50 per week for those without a college degree. Accounting for the possibility of unemployment further increases the gap between military and civilian pay.

**Implementation Strategies**

If DoD elects to move forward with limited pay increases in 2015, it must consider how to implement the changes. We offer three implementation strategies for consideration. The first is a one-time pay increase set at half a percentage point below the ECI. The second is a one-year freeze in basic pay. The third is a series of below-ECI increases, such as ECI minus half a percentage point for four years.

Each approach has its advantages and disadvantages. The first option, a one-time half-percentage-point increase below the ECI, yields lower cost savings than the other options—estimated at about $5 billion over ten years. However, it has the advantage of being a more cautious approach and perhaps more palatable politically. The second and third options are likely to be more costly politically. A pay freeze might be taken as a lack of regard for the sacrifices of service members and their families in the immediate aftermath of a decade-long war in Iraq. A prolonged, four-year period of lower-than-usual basic pay increases could be difficult to sustain, particularly if looming pay reductions create uncertainty for members and possibly reduce morale, which could ultimately affect recruiting and retention decisions. Implementing a pay freeze, which service members would likely perceive as a more severe pay reduction, could exacerbate these responses. On the other hand, the second and third options yield substantially greater savings than the first option and are estimated at about $17 billion over the next ten years.

Because we are unable to rigorously measure and assess the relative importance of these factors, we do not recommend a specific implementation approach. Policymakers will need to weigh the advantages and disadvantages of each option before rendering a considered judgment.
What we can recommend is slowing pay growth relative to the ECI, given current conditions and DoD’s stated workforce goals in terms of both quantity and quality. Recruiting and retention are in excellent shape, with all services and components meeting or exceeding recruiting and retention goals. Planned reductions in manpower requirements have been announced by the Secretary of Defense. And military pay compares well to civilian pay, ranking significantly above the 70th percentile benchmark. Given these conditions, it is feasible for DoD to slow the increase in military pay, which would enable savings in military personnel costs while achieving force management goals.

We recognize that slowing the growth in military pay could affect recruiting and retention more than expected and that planned reductions in the size of the force could be reversed or slowed. But in either case, targeted bonuses can be used to offset these effects. Further, with changes in military retirement also under consideration, it would be prudent to identify potential interactions between slowed pay growth and retirement changes and to evaluate the implications of those interactions for sustaining the current force. RAND has such research under way, with results expected in the fall of 2012.