



# **Defense Advisory Committee on Military Compensation**

**PUBLIC MEETING  
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## **Transcript**

*[September 13, 2005]*

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## PARTICIPANTS

This list includes members of the Committee participating in the meeting. (Committee member Dr. Martin Anderson was not present for any of the meetings; Dr. Walter Oi was not present for the afternoon session.)

No.	Name	Role
1	ADM Don Pilling	Chairman of the Committee
2	Mr. Frederick Cook	Committee Member
3	Mr. Joseph Jannotta	Committee Member
4	Dr. Walter Oi	Committee Member
5	Dr. John White	Committee Member
6	Gen Lester Lyles	Committee Member
7	Mr. Paul Hogan	Chief of Staff

## SIGNED-IN VISITORS

This list includes all signed-in (non-staff) visitors to the public meeting (both sessions).

No.	Name	Organization Symbol
1	Tom Philpott	<i>Military Update</i>
2	Steve Strobbridge	MOAA
3	Joyce Raezer	NMFA
4	Robert Claflin	OMB
5	Shalini Benson	OMB
6	LCDR Jennifer Mosser	USPHS
7	Mike Hayden	MOAA
8	Vince Cranley	<i>Army Times</i>
9	David Sevier	MAPA Group
10	Sherrin Christensen	OUSD(C)
11	S. J. Wagoner	AF/DP
12	Bob Daigle	OSD (PA&E)
13	Soyong Chong	OSD (PA&E)
14	Joe Barnes	FRA
15	Ed Dockery	FRA
16	Erin Harting	EANGUS
17	Fran Murphy	Pentagon Channel

## TRANSCRIPT – MORNING SESSION

**Admiral Pilling:** Normally what I would like the Commission to talk about this morning is how you would go about developing an architecture for improvements to the military compensation system. If this was a group that was trying to design an industrial facility like an office building, you'd sort of know how big your workforce was going to be, you'd have certain ratios of number of conference rooms to offices, and a whole set of ground rules on what you'd put in that office building, and then you'd turn to an architect and ask him to come up with a plan. Well, we have a problem that's, I think, infinitely more difficult. It's not clear what the objective force looks like, and I think we'll start our discussion this morning talking about – are there characteristics of any objective force that we could use to sort of give us some insights, and then I'm going to ask Paul Hogan, the chief of staff, to present a brief on some proposed ground rules or principles, if you will, on how you would evaluate potential changes to the compensation system. And then, if we have time and we have thoughts, we might want to talk about, well, what would be the next step if we are asked to come up with an architecture, because we don't really have an architecture here today, we just have a set of principles. So with that, I'll start.

My opinion is that you might be able to conclude that one of the characteristics of any objective force for the military is there will be certain skill sets which require youth and vigor, and you want to have a compensation system so that as people who are in those skill sets, what's called combat arms, for a general term, as they age, their abilities will deteriorate

with age, and you want – you either want a – you want to have a system that can either utilize those individuals differently, or to be fair to them if they leave the force, and how they can be rewarded. And at the same time you would have skills in the force that you'd want people to stay around much longer than you would expect. For example, my example is that of medical corps, where doctors improve, and so having them leave early, or let's say at exactly 20 years, may not be in the best interests for medical support. So that's one sort of characteristic you could attribute to any objective force, and hopefully you would then have tools that would allow you to manage the force to preserve those concepts.

We have not been briefed on the results of the Quadrennial Defense Review, so we don't have the full background on what the objective force thinking is in the Pentagon right now, so we're sort of at a loss, but I think that's one principle that we might want to have. Then I was going to ask the commission members if they have any other thoughts on other things we should consider as attributes of this objective force.

**General Lyles:** Let me just add one other, and I agree with you, Don, I think those are the kinds of attributes that we need to pay attention to, and everybody has been focusing on exactly those things. But I was struck by a conversation we had recently where the term – though this is not literal, so please don't quote me – that an objective force that is both muscle and grit but also feeble and smart. Now the latter is not a literal statement, so please don't quote me on that, but I think that we need to also make sure that the objective force has the right kind of compensation to attract those technically competent personnel that our military is going to need for the future to deal with the systems that we have and the systems we're going to have in the future, and the things that we potentially can envision that will help on national security objectives. Some of that is addressed by your comment on having experience. People stay longer, they get more experience, etc. But that's not necessarily the case when you talk about [a] technically competent workforce. You may want some people who are very young and know the latest technologies, etc., and you need to attract them so they don't all go off to industry or – and have other things to consider. So the architecture, I think, needs to include the things that you mention, but we also should make sure we don't overlook the feeble and smart part of that potential future workforce.

**ADM Pilling:** That's fair. Anybody else?

**Mr. Jannotta:** Isn't the current architecture – wasn't it designed – when? Let's say retirement.

**ADM Pilling:** I think – 1948, I believe.

**Mr. Jannotta:** 1948. So a lot has happened since 1948, and these things need to be put up on the radar screen so we can look at them and make sure that what's there, or if changes are needed, that they get made.

**ADM Pilling:** Right, and one of our previous sessions, the staff talked to us about the cliff vesting rules, that if you're going to realize any retirement benefits you have to get to 20 years. And so what that does is you see a significant drop-off in retention as soon as people hit 20 years. And so if you're going to retain some of the skill sets like I mentioned, like doctors, you want to have a system that will encourage them to stay. Anybody else?

**Mr. Cook:** Admiral, I think we've been told by the senior leadership that they'd also like people to stay in position longer. Maybe that's field grade officers and senior enlisted, maybe that's all of – and maybe it's not even a compensation issue per se. Maybe it's something you handle that's not compensation-wise, but I think that is one of the characteristics that they're looking for in the objective force.

**ADM Pilling:** I know the Secretary certainly has talked about flag officers staying in place for longer tours.

**Mr. Cook:** Mm-hmm.

**General Lyles:** Can I add another one, Don?

**ADM Pilling:** Sure.

**General Lyles:** I think, even though I'm not sure if it's in our charter or not. We talked about this early on in one of our meetings, but somehow we need to at least have a potential add to the architecture for the civilian part of our, of the workforce, the military workforce. And again I don't think that's part of our charter per se, but if you look at the objective force, you look at the future force, we have to recognize that it is not all uniformed personnel, and somehow we need to at least think about or recognize that there's another portion there that also potentially has some compensation needs that perhaps we shouldn't address in our deliberations, but we should make sure there's room, if you will, in our deliberations for factoring that into the equation.

**ADM Pilling:** Anybody else before we go on?

**Dr. White:** I just want to support that.

**ADM Pilling:** Sir.

**Dr. White:** I think that's absolutely right. And in fact, in terms of the larger issue we ought to extend it to the total force in terms of the non-government employees who we rely on to provide us with capabilities.

**ADM Pilling:** Okay. Paul, we'd like to ask you to go through your slides on the framework.

**Mr. Hogan:** We'll talk for a few minutes about a framework for improving the compensation system. And we start with the premise that I think is self-evident, that the current compensation system has indeed produced a force of motivated volunteers that is without peer in the world, so along with Hippocrates, our first premise should be, "Do no harm" with changes in the compensation system. Yet we can observe some things that need to be looked at, as was mentioned. The current compensation system is inherited largely unchanged – there have been some changes – but largely unchanged from the draft era. It contains certain elements of paternalism and a lack of choice. It has a certain emphasis on just a deferred compensation system, largely for a career force, and has some elements that would be characterized as needs-based and with a significant in-kind component.

There are some elements of the system that limit – that apparently limit the ability of force managers to shape the force, and limits the flexibility to meet staffing challenges. In particular, we've talked previously about the 20-year cliff vesting. We know the difficulties that causes in downsizing, but it also probably shapes force decisions in ways that we probably don't fully understand, and we need to be aware of what that is and how possibly it might be improved.

Discretionary pays, pays that can be targeted to particular problems and allow compensation to vary by more than rank and year in service, are probably among the most flexible elements of the compensation system, but they're a small portion of the total, and a good question would be, should those be increased as the share of total compensation. This is just as background.

There also have been some recent changes to the compensation system that would appear to add significantly to increases in personnel costs, and yet at least the direct improvement in readiness and capability are not immediately apparent. So we want to make sure that any future changes to the system should help the compensation system support an efficient, capable volunteer professional active and reserve force.

So the notion here is that we have a compensation framework or a set of guidelines, so to speak, that is criteria for compensation change, and it may be a way to increase the likelihood that the types of changes that may be made in the future will indeed move the entire compensation system and the force in a coherent direction, a direction which leads to increased readiness and capability in a volunteer force environment.

So this framework would be a generally agreed upon lens of filter with which to evaluate proposed changes. Its principles or a set of similar principles – certainly in this briefing we don't claim that these are unique. I do claim that they're quite reasonable, but they certainly could be improved upon. These principles or a similar set of principles would be adopted, say, by the ULB, and would be a framework that would be recognized or at least folks would be aware of these principles in Congress and OMB, and that they would have these available to evaluate compensation changes also.

A proposal which is consistent with all or most of these criteria would – could be recognized as one that's likely – nothing is certain – but likely to move the system in a desirable direction, one where we're going to increase force capability and force readiness. Conversely, one that – a particular proposal that seems to be inconsistent with many or most of these criteria would face an additional hurdle of overcoming that fact and have to explain that particular change is likely to improve the system in spite of being inconsistent with a set of, we hope, relatively reasonable principles.

I'm going to turn right now to these principles or criteria. And the first, and one of the most important, is force management. The notion here is that proposed compensation change should be linked to an improvement in force management. And we use "force management" relatively broadly, to include the ability to attract, retain, and motivate members of the active and reserve forces, but it also includes the ability for force managers to shape the force into one that's the most capable for meeting missions. A proposal should be linked to force management, and where possible these linkages should be empirically established, but it's certainly recognized that in many cases the research and so forth won't be empirically established. But at least it should be – there should be a logical relationship between the direction the

compensation is changing and what you expect, what problem you're solving and how it's going to solve that problem or make the force management better.

The second criterion is flexibility. This is one that's – I'm sure is on everybody's list, and it's also on this list, and the notion is that a proposed change should increase the flexibility of managers in meeting staffing challenges, not reduce it. Where possible it should be targeted to a particular problem. The solution should be adjusted to meet the demands, so to speak, and that the particular change that's being proposed does not place constraints in other areas that will limit force management and flexibility indirectly.

**ADM Pilling:** Could you give us an example of the second or the third type of “change does not place constraints in other areas”?

**Mr. Hogan:** Um, let's suppose that one wanted to – one believed that deployment to Iraq, hypothetically, was causing retention problems, and so forth, and a proposal would be to significantly increase some type of deployment pay for Iraq. But as you craft such a proposal, you need to be careful that if you say that pay for a combat zone should be increased and so forth, that this could put future – if it's in legislation, it could put future constraints on deployment and so forth and create some of the types of problems that, for example, the deployment that's been suspended since the 9/11 has imposed. So that would be one hypothetical example where you need to be careful in crafting – your good intention is to craft a solution to solve a particular problem, but the way you have crafted it could place constraints in the future that could make it very difficult for the Secretary of Defense to deploy forces in Kuwait or elsewhere that are also technically combat zones.

**ADM Pilling:** Joe, did you have a question?

**Mr. Jannotta:** No.

**ADM Pilling:** Yeah, Kuwait was what I had in mind.

**Mr. Hogan:** Yeah. Okay, so the flexibility, and in general, within an overall budget authority, you should have the flexibility to allocate compensation resources where they are needed most and be able to reallocate when conditions change.

**Dr. White:** That's a very robust statement. There obviously are some limits. For example, you may want to provide more compensation in some form – your example of Iraq – for ground forces in Iraq. You don't want to reduce airmen's regular military compensation to do that. So you – what you're – it seems to me what we're really concerned with here is at the margin, where we make adjustments beyond the base. That's where we need the – do you agree with that?

**Mr. Hogan:** Yes sir. And of course, you know, you're never going to have perfect flexibility, but this is a criterion that a proposal provides greater flexibility, greater authority to adjust compensation. SRB, selective reenlistment bonus, is a great example. General authority is provided, a budget is provided, and the individual service can choose where in its



MOS's, ratings, AFS's, it can allocate the SRB where it's needed most, it can make changes during the year – a very flexible element of compensation.

**ADM Pilling:** I think, following up on Dr. White's comments, the flexibility to allocate compensation resources gets to the heart of the issue. We're not talking about taking money away from people...

**Mr. Hogan:** No.

**ADM Pilling:** ... which that sort of says you could if you wanted to.

**Mr. Jannotta:** Right. Isn't it also safe to say that to make the kind of adjustments that we've needed to make to keep the force effective, we've had to put all these – a number of S&I's, we call them, special incentives, I guess – and that needs to be looked at. There are maybe, what, 60 of these now, Paul?

**Mr. Hogan:** Yes sir.

**Mr. Jannotta:** So that comes back to this whole system was designed at a point in time and we've adapted, but it needs to get looked at in that sense. Is that correct?

**Mr. Hogan:** Absolutely, and as a matter of fact, as we proceed there will be one criterion that kind of gets right at that issue.

**Mr. Jannotta:** Okay.

**Mr. Hogan:** Simplification. And Mr. Jannotta is, I think, referring to a system of special and incentive pays, arguably among the most flexible, not all of them, but most – but many of them – but yet there's 60 plus of them. And this criterion would suggest that in reviewing and evaluating proposals for change, changes that simplify the system rather than making it more complex, are preferred. I mean, to the extent that's an easy one, who would disagree with that. But we should be aware of proposals that result in a proliferation of more pays, that increase administration and management costs. Proposals that rationally consolidate pays, reduce administration and management costs are generally preferred. And, you know, what one immediately comes to mind there is this 60 plus special and incentive pay system that we have now, many of which are on the books and people have to look up and find out, you know, what they are and who is authorized and so forth. They're not – many of them complicate the system rather than simplify it. Many of them make it a little bit less flexible. Special and incentive pays in general have the ability to provide this variation and this flexibility that we need, but they – but according to the simplification criterion, they need to be looked at from the criterion of, can we make this a simpler system of special and incentive pays.

**ADM Pilling:** But we got to the way we are now, I think, because there was concern that if you had it all in one big pot it was an easy mark. So that's the down side of it.

**Mr. Hogan:** The next criterion is again, I think, one that no one, or very few, would disagree with: taking a systems approach to compensation changes. The proposed change should consider all the implications for incentives and force staffing. In particular, the active and reserve linkages should be explicitly considered when they're relevant, and, in my opinion, they're relevant most of the time. Even increasing active duty bonuses to increase retention has potential implications for the reserves. Not a reason not to do it, but a reason to understand the implications and make sure you want to do it. So the proposals should be thoroughly analyzed to avoid unintended consequences for staffing and cost.

This next one might be a little bit different than is on some lists for compensation criteria, but where possible the proposed changes should attempt to expand choice, volunteerism, and market-based compensation. And by that what's meant is the proposal should attempt to account for member preferences and for differences in those preferences, and they're important, to take advantage and not work against differences in preferences across members. And a recent example, and it's also an example of the third tick mark there, is assignment incentive pay in the Navy, where it's clearly taking full account of members' preferences for assignments, but, and also it is a market-based pay.

Expand member choice, where possible – not always able to do that, but proposals that would do that would be preferred, other things equal to those that didn't – and that the compensation should be market-based where possible. And that is that the solution should be sized to meet the problem. One way to do that, for example, is the way the Navy's done it in assignment incentive pay. We do that now in adjustments for selective reenlistment bonus levels, and so forth. The opposite of that, the thing probably to be avoided, are pays that recognize a problem but the size is, because of lack of information, is somewhat arbitrarily based, compensating a differential for hardship duty, for example. And there's no way over time to adjust it to get the right size, so the market-based principle would be that, perhaps because of lack of information, you have to a good honest guess at what the right amount of that compensating differential is, but you have in mind a mechanism that, over time, the particular differential would adjust to close to the right amount, the market clearing amount.

**Dr. White:** Paul, may I ask, could you go back to that? I wanted to ask you a question. When we say "market based" in this case, you mean not only the traditional notion of the public labor market, but you mean the internal market.

**Mr. Hogan:** Yes sir. Actually, it's – I think we do a pretty good job on the external labor market, adjusting compensation through enlistment bonuses and so forth, up or down when unemployment and economy changes, to clear that external market. This would also focus on, as you mention, the internal market. We do a good job, I think, on the enlisted side with the SRB program. Those are adjusted as situations change, as demand changes, and so forth. And that's kind of one type of model.

**Dr. White:** But we've got to balance this against some of the other criteria. You could conceive of a whole proliferation of pays for all kinds of needs, right? Location changes, duty changes, training changes, and so on, which would make the system, in fact, more complicated and maybe not overall as responsive as we'd like it to be.

**Mr. Hogan:** That's absolutely right. And this does not mean that – observing that the proposal should be market-based does not mean that it should be a solution that's so narrowly tailored that it's a special pay for a particular situation. The

other principle, simplification, would be to look for a broad application. For example, if the issue is assignment and hardship, can you think of a way to get a single, or one or two pays, that would attack that problem, rather than eight or ten separate pay elements?

The next is efficiency, presumably also on most people's lists. In this particular version, the basic notion, I think, is fairly straightforward: of different ways to get the job done, we should try to find the least costly way to do it. That doesn't mean that members are not paid, compensated well and fairly. It just means if there's two or more ways to do it, to staff the force, that you should attempt to do it in the most efficient, least costly way.

Some general notions here are that, based on the literature, that one would have a prior sentiment for preferring cash-based solutions to in-kind solutions; for preferring current compensation to deferred compensation; and for preferring targeted to across-the-board. But those generalities clearly have exceptions, and obviously cases can be made for those exceptions.

**ADM Pilling:** But the motivation for the current versus deferred compensation is partly that only 15% of the enlisted force ever gets the deferred compensation?

**Mr. Hogan:** Yes sir. There's – we observe, and the OSD actuary tells us, that about 15% of recruits who walk in the door on the enlisted side will ever retire. The economics literature that's been applied here also tells us that junior and mid-level enlisted and officers tend to prefer up-front cash to deferred compensation. You know, it's been revealed that they have relatively high discount rates for future compensation. It doesn't mean that deferred compensation isn't the right answer for some problems, but when considering particular solutions, how to increase the reenlistment rate at the first term, you would not immediately go to the deferred compensation solution. You would probably go to a cash compensation solution.

**Dr. Oi:** We have another problem that faces us, don't we? Namely, there are three actors to the party. There are the active duty personnel, men and women. There is the employer, the services. And then there's the Senate and the House, Congress. And the question here is – Congress in trying to bolster the Social Security system has now made it mandatory that all enlisted men pay into Social Security, including the 15% payroll tax. And the question here is, is this the Congressional will, or is it an efficient solution, given the participants to the exchange? Plus the fact that Social Security will eventually come back to them in Social Security benefits, but at age 67, and that's a hard one, because we have to bring in the Congressional will, and that is something that we don't know how model right.

**Mr. Cook:** That because they don't want to be modeled.

**Mr. Hogan:** And I would point out, and it's important to note, that the basis for these criteria is improving the staffing, the readiness of the force. There are other reasons for making changes.

**Dr. Oi:** Didn't we put the enlisted ranks into Social Security in order to grow the Social Security trust fund?

**Mr. Hogan:** I'm sorry?

**ADM Pilling:** I don't remember the rationale. I don't know.

**Dr. Oi:** Because you know, we have a pretty generous pension plan right now for the military, and we're piling onto it Social Security.

**Mr. Hogan:** Yeah.

**Dr. Oi:** And it looks like it's a Congressional mandate.

**Mr. Cook:** Could I pick up on Dr. Oi's comment? Talk about this efficiency in a slightly different perspective, but using your three parties at the table, let me also throw three things into the efficiency. The GAO report says we have a very expensive total compensation program now. Well, you've got sort of a – total cost is up there. You have under the current system a high deferred cost, relatively low – I'm not saying it's below market – relatively low cash compensation //no audio while tape is flipped// ... service member doesn't appreciate and value the program that he or she has in relation to its cost. Ah! But let me add a fourth: promises made that need to be kept.

So if you look at that kind of a situation that you're in, you have some constraints on what you can do with the current program with the current force, in rebalancing. If you decide – if we decide that we did want to rebalance the force, the program...

**Mr. Jannotta:** The current architecture.

**Mr. Cook:** ... the current architecture, so you have to think – if you say to yourself, well, we really should be rebalancing, how do we rebalance without breaking the promise and without breaking the budget, okay? If those are your constraints, you're led down a path that says you have to think about, or you should be thinking about a new program for new people that is a different program, which then gets you into the difficult thing where you have two programs sort of running concurrently for a long period of years. But within those constraints of the promises and the current force and all, I think that's where you're led to go, if you want to try and improve efficiency without spending more money. We could improve efficiency, right? We could increase current pay and keep the promise, but I think we've got some budget constraints.

**Mr. Hogan:** And I should point out, in general it's in the employer's interest for – and I don't mean the military, but any employer's interest – to keep promises, because once you get a reputation for not keeping your promises, folks are not going to stay in that, in your employ very long. They can't count on you. And so keeping promises, I would say, is part of an efficient compensation system in most cases.

**Mr. Jannotta:** And of course General Motors is stuck with some promises that basically have the company on the edge of bankruptcy. So it's an issue here.

**Mr. Hogan:** Yep. Survival.

**Dr. White:** Let me raise a different point. I want to go back to the "Prefer current over deferred comp" and your point about 15% of the enlisted getting retirement. Another piece of analysis we looked at said that of those who do not go to retirement, they get about 30% of the total compensation, versus 70%. Should we on equity grounds try to rebalance that

number? Are we in a situation where in fact we want to examine whether or not that allocation is in the best interest of the individuals and the best interest of the services?

**Mr. Hogan:** I would – as an analyst, I would argue that that’s an observation by itself. It’s not a prescription for change necessarily. Based on that observation, does it lead you to believe that there are some force management problems associated with that distribution, and then, if it is, then the prescription for change would be based on the force management solution that happens to be related to that mix. The mix itself is just a piece of data to start with. That’s the way I would view it.

**ADM Pilling:** We haven’t gotten through your list yet, but Dr. White used the word equitable, and I don’t know whether you’re going to have – any change you propose should be perceived as fair and equitable by the force.

**Mr. Cook:** Excellent. Yes.

**ADM Pilling:** Maybe if it’s not on the list now, we can talk about adding it to the list.

**Mr. Hogan:** Yes sir.

**Dr. White:** If I may, one other addendum. When we talk about fairness and equity, which are so important here, and talk about promises, I think we have to spend a little time thinking about what promises are we referring to. What in fact is a promise?

**ADM Pilling:** Right.

**Mr. Hogan:** The next criterion is that costs of proposed changes should be transparent and quite visible, that the full cost should be made clear – the current, near-term costs as well as the longer term costs over time. If the particular change is going to induce changes in behavior, these need to be analyzed both for their – intrinsically for the, because of the behavioral changes, and for the implications that they may have for costs. And finally, that all costs should be considered – DOD costs that occur in the DOD budget, but also costs to other agencies and costs in foregone tax revenue.

A final criterion is probably not – hasn’t appeared on a list before, but the notion is leverage. And the idea here is, where possible, proposals should leverage existing benefits in the civilian and private sector, not crowd them out. Conversely, proposals should not encourage substitution of a DOD benefit for civilian or private sector benefits. And here the application is probably most relevant for proposals for increases in certain in-kind types of benefits that may be available in the civilian sector, and maybe the solution is making that information available, making greater access and perhaps increasing in cash compensation to access those benefits. But the basic notion is to leverage the benefits that are available in the civilian and private sector and not crowd them out through substitute programs.

**ADM Pilling:** Am I reading that to mean – I’m sorry, Joe?

**Mr. Jannotta:** I was just going to say, one of the focuses of the committee is the quality of life factor, and there's a whole series of quality of life issues that we've seen that accounts for, what is it? About 12% of the compensation of the...?

**Mr. Hogan:** It's substantial.

**Mr. Jannotta:** It's substantial. And we've used terms like "force management," "readiness." We use the term "empirically." These are some of your terms, I think, Paul. And "transparency," and the quality of life... //interrupted by fire alarm test// I don't know what that says about what I'm saying. //laughter// At any rate Paul, if you would comment on that, because I think //test continues//

**ADM Pilling:** I think we should just suspend the discussion for a few minutes. //test stops temporarily//

**Mr. Jannotta:** Paul, would you put the quality of life issues in the context of this a little more clearly for us?

**Mr. Hogan:** Yeah. I do believe that these criteria would... //test resumes – tape is stopped until testing ends// ... I hope that Lt. Col. Birden negotiated a discount for this time slot //laughter// and I hope I answered your question, Mr. Jannotta. //laughter// I think these criteria, and some more so than others, would apply to various quality of life types of initiatives. Particularly, number one, force management, is the quality of life proposal going to solve, or help solve, a problem, a potential problem of force readiness, retention, recruiting, and so forth. And the other one that I think is particularly pertinent to quality of life is the one that's up there right now, leverage. Is the best way to solve that problem through a new DOD-sponsored program, or is it by taking better advantage of programs that exist, services that exist around military bases and so forth. And that's not to say that the answer should be – is always yes or no. It's to ask that question on that issue.

Child care is an obvious question. It's clearly linked to force readiness. When the unit deploys, it places – it's likely to place an increased burden on the demand for child care that wasn't there when the unit did not deploy. Are there solutions in the local area to do that, or does the service need to provide particular child care services for that event because it's unpredictable and intermittent, and the civilian sector won't be able to do it on its own. Those are kind of the kind of questions...

**Mr. Jannotta:** I think I would say that – I was in the Navy in the 50s, and the dynamics of the family situation then as opposed to now was quite different. The demographics are quite different, I think, too. There are – more are married, I think like 70% of the officers are married and over 50% of the enlisted men and women are married. So there's a different dynamic. Not to mention the social dynamic, which is different today than it was then.

**ADM Pilling:** Paul, I was going to make a comment that your second tick there is sort of aimed at medical care, I think, where we see the migration of the retired population, even though they're in second employment jobs, second careers, migrating to TRICARE, and then there is some sentiment on the Hill to extend TRICARE Reserve Select to all reservists.

**Mr. Hogan:** Right. And the – you know, one way to see the Admiral's issue with the TRICARE for the pre-65 retirees is, because the premiums are significantly lower and the co-pays are lower for TRICARE, the retired member rationally

makes a choice not to take the civilian employer's health care and to take the DOD-sponsored TRICARE. The member saves a thousand, maybe two thousand dollars. The cost to DOD is six or seven thousand dollars, depending on what the actuaries tell us. And, I mean, it's a case where, to provide a benefit that's valued at one or two thousand dollars, DOD is paying six or seven thousand dollars. It may be that that's just the way life is and DOD has to absorb that. But if there are reasonable ways to make sure that if you're providing a \$2,000 benefit, it's only costing \$2,000 or less, that would be a good thing to do, I think people would agree on that.

**Dr. Oi:** Can I return a minute to quality of life issues?

**Mr. Hogan:** Yes sir.

**Dr. Oi:** This is a very tricky issue, because, you know, there are certain things that maintain morale and culture, and in public finance we have a concept of private goods, public goods – we always talk about national defense and the lighthouse; lighthouse is now gone – but we also talk about merit goods. And these are things we don't want to let free choice and market forces determine the equilibrium prices and amounts. And I think that's true of the quality of life issues. And then the hard issue, what sort of subsidies do we want to provide and how do we want to provide those subsidies and to whom? And I think that's an issue that has to be confronted. It's not an easy issue, but I think it comes under this rubric in the public finance literature of merit goods.

**Mr. Hogan:** Right. The...

**Dr. Oi:** You know, it's morale and culture.

**Mr. Hogan:** Yes sir. Let me just elaborate on that.

**Dr. White:** //unclear// the issue, Walter, of whether you're going to provide it in-kind or in terms of cash.

**Dr. Oi:** Well...

**Dr. White:** For each – they may be merit goods, but don't you still have that challenge...

**Dr. Oi:** Well, in the case of education, we've divided it two ways. For the elementary schools, we provide it in kind. And for community and higher education, we subsidize it, don't we?

**Dr. White:** Mm-hmm.

**Dr. Oi:** And it's a hard, you know, problem, how we divide it up.

**Dr. White:** Yeah.

**Dr. Oi:** When do we choose to go in-kind and when do we choose to go with subsidies? And then, you know, there are demerit goods, like alcohol. The big increase in the mortality rate in Russia is apparently due to the increased consumption

of alcohol. The price of alcohol dropped 58%, and the death rate of male adults skyrocketed. But I think that this is an issue where we have to confront it in terms of this public finance literature on the concept of merit goods.

**Dr. White:** Right.

**Mr. Hogan:** And I believe in the presentation last time it probably didn't come out, but in the paper underlying it, the group that was working on the quality of life kind of addressed this idea of the merit goods or, I think the word that we used was "productive consumption," that is, you want to provide gymnasiums on base because you want to make it easier, easy for members to maintain fitness, things like that. It's a benefit, but it's also productive.

**Mr. Jannotta:** One thing I would say is that in today's world, the family is more central, I think, to morale than it perhaps was – well, probably it was in my day too, but today it's more central, and I think the spouse in particular is very important to that morale factor, that ability of whoever the member is to go off to Iraq or wherever. That's a very important dynamic, and I think it's a little different today than it was some years ago.

**Dr. Oi:** But we've got to confront the issue of the mom going to war and the daddy staying home to take care of the kids, which is happening more and more with today's armed forces.

**Mr. Jannotta:** The dynamic, you're right. It's complicated.

**Dr. Oi:** Yeah.

**Mr. Hogan:** The notion that these could be applied is relatively straightforward. Each particular criterion has an easily suggested question associated with it that you could probably answer in most cases yes or no, and in some cases I'm sure there's maybes. But this would be an example of, kind of, such a compensation framework checklist so to speak, which no one can see, but that's... //laughter//

**General Lyles:** Paul, with that sort of framework and outline there, let me come back to the discussion about deferred versus cash, and it touches on something that Joe just mentioned yesterday, and it's probably a subset of your simplification criteria that you have up here, and that's the question of is it marketable. And when I say marketable, I mean marketable to the consumer, to the people we're trying to touch. Can we really convince and sell it to the young men and women who are going to have to take advantage or who will take advantage of these compensation schemes. And I keep coming back to the words that Fred has hinted, that it's a different thing in the private sector. Deferred compensation is preferred, as opposed to cash, and I think the factor there is that somehow it's more easily explainable to them, uh, the benefits, and somehow we have to make sure that our schemes are marketable, that we can sell it to the individuals – they really understand what they're getting.

**Mr. Hogan:** Absolutely.



**Mr. Cook:** Picking up on that, the private sector has come to the belief over a series of years that people understand and value a 401(k) plan versus a pension plan, even though they both might cost the same amount, and our analog to the 401(k), of course, is the savings plan, TSP, so I think following on what...

**Dr. Oi:** But the data don't hold that up, Fred, because defined benefit plans are increasing, and the pensions under defined benefits have increased in the last five years.

**Mr. Cook:** Not my data. The defined benefit plans are declining.

**Dr. Oi:** No, I look at the Bureau of Labor Statistics data, and current population survey, and they show defined benefit plans increasing in popularity, in coverage. It's an interesting.

**Mr. Cook:** It's a fact-based question that can be resolved.

**Dr. Oi:** Yeah, I know, but part of that was because the stock market crashed in 2000, 2001.

**Mr. Cook:** Oh, there's no doubt there's a – 401(k) plan essentially transfers risk from the employer to the – benefit and risk, both sides of it, you're right about that.

**General Lyles:** Assuming that assumption is correct, in some respects we do a disservice to our young men and women in the military in assuming that they can't also understand the benefits of this.

**Mr. Cook:** Right, right.

**General Lyles:** And we just automatically sort of say they need cash or they want cash, when I think we probably can do a better job of explaining the benefits and the attributes of what the current system is, even, to them than we do today.

**Dr. White:** There's also a question, don't you think, in that regard, of whether or not the current system is too complicated? The individual's got to – has to analyze the paycheck.

**General Lyles:** That's why I put it as a subset of your simplification question up here...

**Dr. White:** Mm-hmm.

**General Lyles:** ...as opposed to a separate attribute, that simplification would also include the marketability aspects.

**Mr. Hogan:** Yeah, certainly.

**Mr. Cook:** Well, you will not find me to be a total advocate for mirroring the private sector, which I think is basically moving away from benefits totally. It's thrusting them all onto the government. But we have to look at the – it's the difference that we have now between the private sector – should that gap be narrowed somewhat? And picking up a bit on the Admiral's comments, you know, fair and equitable? Which I'm not sure that we need up here, but, you know, one of

the things we do in the private sector in designing compensation programs is we think of it as a marketing problem. We think of there being a consumer, and us of having a product that we're offering to that consumer. We're designing a product, essentially, and our product is in competition with other employers' product. So you're trying to design a product that will be appealing to, and cost-efficient, and appealing to the type of people that you want to get. You're in a competition, because they've got – they can move, they can move around. And our people can move around too. And also just, well, we think of it – we think of the compensation program as having attributes of like being a Darwinian selection mechanism, meaning that it will attract to you and retain with you those types of people who like and favor the compensation attributes that you've designed into your program. So you have to think about who do you want, what do they want, and design a program for that, which really comes full circle down to the whole objective force – brings us back to the QDR.

**ADM Pilling:** Fred, are you saying that “fair and equitable” is implicit in that list?

**Mr. Cook:** Well, I've been thinking as Paul went through this, “Have we got everything that we need? Can I think of anything else?” And these are like screens to which you put and test our proposals. Do they meet these criteria? I'm torn. I think we could add a “fair and equitable” as a ninth criteria – fair and equitable, and appealing to the force that you want, which is a little bit side different from fair and equitable, isn't it?

**General Lyles:** It's almost like the marketing thing that I mentioned.

**Mr. Cook:** Yeah.

**General Lyles:** I agree. I think fair and equitable is such an important factor in there, and that we will probably do ourselves a favor by adding it so we don't lose visibility on it.

**Dr. White:** I agree with that, but we then have a concern about fair and equitable, what to what?

**ADM Pilling:** Right.

**Dr. White:** You know, how are we measuring? Because there are some things that are relatively easy, but there are other things that are very, very difficult in terms of what is fair and equitable.

**ADM Pilling:** Well, I had wondered, if you were to talk about changing premiums and co-pays for TRICARE for the retired community, because they haven't been changed in...

**Dr. White and Mr. Cook:** Right.

**ADM Pilling:** ...what? Ten or fifteen years? Would that be perceived as fair and equitable?

**Dr. White:** Mm-hmm.

**ADM Pilling:** Retired pay has been going up with the cost of living for those 10 years.

**Mr. Cook:** Good example.

**Dr. White:** Right, right.

**Mr. Cook:** It's got to pass that screen.

**Dr. White:** Right.

**ADM Pilling:** Yeah. It would pass the screen of "It's fair and equitable," you know, the fact that we haven't changed it in 10 or 15 years.

**Mr. Jannotta:** And certainly...

**Mr. Cook:** I'd favor adding it as a criterion

**Dr. White:** In one sense we have changed it, that is to say, the cost to the individual relative to the benefit has changed, and we haven't adjusted that to the change.

**ADM Pilling:** Right.

**Mr. Jannotta:** I would think applying what you're saying, Don, to the major issues, retirement and health care and areas like that, I think it's very important to have that sort of an overlay, where it's a little harder when you're getting – you've got a rifle on, you're looking at a very small area.

**Mr. Hogan:** The difficulty – and by the way, for those of you, this is the staff's work, this is not yet adopted by the committee, so I just want to make that clear. Hence the discussion of what should be in, what should be out, and so forth. The fair and equitable criterion has, at least for me, and I would ask, you know, others to see if there is a solution to that, that, if you notice, we had some tick marks that were more or less empirically verifiable. The leverage: are there private sector, civilian sector alternatives to it, and so forth. I'm sure what kind of tick marks you put under fair and equitable, to say that we could all agree that if it satisfies empirically, it satisfies this, then it's fair. If it empirically doesn't satisfy that – not that we all don't have shared ideas of what fair and equitable is, and I would argue that for at least 50 to 60 percent of ideas that come by, most of us would agree that something is fair or something is, quote, not fair. But on those marginal ones, the 30 or 40 percent, I'm not sure what we would look at to say that this is fair other than, from your perspective it's fair, but from my perspective it may not be fair. And that's the general problem I see with that criterion.

**Mr. Jannotta:** It's a question of judgment, really, is what comes into play. It's the judgment of us, this group here, that will come...

**Dr. White:** Well, it's also a question, I think, Joe, of what is the standard. I can remember an issue when I was in the building about – people came and said, "Airmen at Aviano are earning a different amount of pay than marines at Aviano doing the same work." Now, does that mean it's not fair and equitable? Because on the other hand, the Marine Corps

would say, "But it's fair and equitable with all other marines." So if you change it for airmen at Aviano, right? Then it's not fair and equitable with other marines, and so on and so forth. So it seems to me we've got to get into thinking about how these things...

**General Lyles:** So that's why we had all those guys who wanted to go to Aviano.

**Dr. White:** That's right. //laughter// You wondered why...

**ADM Pilling:** Well, I think this is a good topic for discussion in our group, and I think it also plays back a little bit to Dr. White's point on what's a promise.

**Dr. White:** Right.

**ADM Pilling:** I mean, the way we got to TRICARE for Life, essentially, was the retired community over 65 was saying they were promised medical care for life. And it stopped at age 65. And we found brochures that the Army had produced – recruiting brochures – that said "medical care for life." So that was sort of a...

**Dr. White:** So we ought to send the Army the bill for them? //laughter//

**ADM Pilling:** I mean, that was delivering on a promise. I mean, all the chiefs and the chairman made that a personal issue in 2000.

**Mr. Hogan:** And just to go back to an earlier point, in the private sector there's also strong incentives for employers to keep promises. But, for example, in the case of United Airlines, where they essentially cut pensions by 50% overnight, from their view they would say, "Well, it's better to keep half our promises than none of them," because from their view survival, being able to provide any pension was at stake. But...

**Mr. Cook:** Well, we're not the private sector.

**Mr. Hogan:** Right.

**Mr. Cook:** Or we're not subject to those constraints.

**ADM Pilling:** Right.

**Mr. Cook:** I think it's fairly easy to recognize a promise is a promise, and fairly easy to know what's fair and equitable. Does it pass a smell test? Can you explain it to someone with a straight face looking at them? Put yourself in their shoes, if they were in that situation. You don't have to agree with them, but if they've given you the explanation, you know, is it credible to you? Is it solidly based? I think we can deal with this as a criterion.

**Dr. White:** At the same time, while we don't have any private sector constraints, we have budget constraints, and we're forced to make choices, that is, to the extent that you price up all manpower services, you're going to have to take it out of something else – modernization programs or something. So we've got to find a balance to that one too.

**ADM Pilling:** It turns out those marines in Aviano were under my command in '97, and it was tough to explain to them why they were getting less. //laughter//

**Mr. Hogan:** Okay, just a summary – we've offered a particular framework. We recognize that it's not unique. There could be other criteria or perhaps some of our criteria could be replaced. But we do believe at this point that this type of framework or a framework that's in a similar spirit will be very useful to – as guidelines to evaluate proposed compensation changes. And a consistent application of the framework doesn't guarantee a successful outcome, that is, a force that's ready, capable, motivated. But it's going to increase the likelihood that compensation changes would move in that direction.

**ADM Pilling:** Okay. Do we have some thoughts on whether we should be adopting a framework like this? And on the fair and equitable point, so we don't get too hung up on that, it would probably be worthwhile to see the ticks that Paul Hogan would put underneath the fair and equitable rules, as a candidate to add to this list. But on the list that we've seen so far, what is it, nine of them, Paul?

**Mr. Cook:** Eight.

**ADM Pilling:** Eight? Does anybody see things that are unreasonable or not easily quantified or...?

**Dr. White:** I would make a suggestion, Don, and that is that we use this list, because I think it's a very good list that Paul's done, as we go through our deliberations. And a product of our deliberations should be such guidance more generally, as you //pointing to Mr. Hogan// mentioned, in terms of the Department, in terms of OMB, and in terms of the Congress. We'll know better whether or not as a practical matter these are the right ones once we wrestle with them in the context of all these various specific issues around special and incentive pays and retirement pay and so on and so forth.

**ADM Pilling:** Now, we are due for an interim report to the Secretary and to Dr. Chu by the end of September and we may want to say that we have developed this compensation framework for evaluation of potential changes to improve the military compensation system, and we will learn how vibrant and robust this is as we examine alternatives.

**Dr. White:** Right, right.

**ADM Pilling:** Unless people disagree with it. Walter?

**Dr. Oi:** I'll waive and let you people go.

**ADM Pilling:** Okay. Did you vote? //laughter – end of tape 1//

**Dr. Oi:** //joined in progress//... so that we get people serving in the corps or serving in the Army and Navy for up to 55 and 60 years of age.

**ADM Pilling:** Well, what I think I have a consensus on is we will go with these eight, and we'll examine if you can quantify "fair and equitable" in a way that you could get more than 50% of the people to agree that something is fair and equitable. We'll defer that for a future meeting. We have one more meeting before we have to make our interim report anyway. So if you could flesh out, Paul, the ticks underneath "fair and equitable" that would be helpful. Anybody have any thoughts on the next steps in, you know, an architecture, because an architecture is much more complex than just a set of principles. It's really, how do you do this?

**Mr. Cook:** Well, I think in terms of building blocks. You take your compensation program, and maybe the easiest way of starting is you've got four building blocks. You've got current cash, you've got current in-kind, you've got deferred cash, and you've got deferred in-kind. Quality of life maybe is a fifth building block, in a non-monetary delivery, but – no, that's current in-kind, current in-kind. And together they form your house, your program. And so that's your starting point. You look at each one of those blocks, and under the systems approach you want to, you know, a change here has implications here. So you can't just say, "Okay, we're going to change the pension system." You know? We ask, "Well, what does the total new program look like?" Because someone will – the market, who looks at the new program, has to look at all the building blocks and see whether it's better, or...

**Dr. Oi:** What was your first building block?

**Mr. Cook:** Current cash, current in-kind...

**Dr. Oi:** I think the first building block should be the basic pay table.

**Mr. Cook:** Yes, but that – okay, that's part of current cash, it won't include the S&I.

**Dr. Oi:** Oh, no, no, it's more than that.

**Mr. Cook:** Sir?

**Dr. Oi:** It's more than that. It's not only the major component in cash, but it's also the command structure. And I think that's a critical part to the compensation package. And I'd like to move very much toward looking hard at the basic pay table and whether or not, you know, we could break the mold that the honorable Mr. Hook gave us 57 years ago.

**Mr. Cook:** Hook, right? Not Cook. //laughter// I'm more than 57, but I wasn't advising DOD back then.

**ADM Pilling:** But Walter, the changes you have in mind, is that getting away from time in service and more towards time in grade? Those kind of changes?

**Dr. Oi:** I want to go time in grade, and I want to increase the number of pay grades in the enlisted ranks. And I would also like to increase the steps so that we have a different promotion schedule. Like right now, by the time we get to officers who are reaching the 20-year point, nearly everyone is right at O-5, 6. Okay? Very few on either side of it. If we look at the enlisted guys, they're all piled up right around E-7, 8, 9, and there's no more room to promote, and they leave at the end of 21. And, you know, there's a lot of life left in a 21-year-old [sic]. Look at Roger Clemens and Randy Johnson. Sammy Sosa is probably older than all of them put together. //laughter// But I think that, you know, people are different today. They're healthier, stronger. And we've already gone to whether or not women can serve in combat arms, and even though they're not as strong as men in terms of upper body strength, I think Congress made the right move there.

**ADM Pilling:** If I hear what you're saying, you would like to structure an incentive system that would encourage the enlisted and officer force to serve beyond 20 years.

**Dr. Oi:** And the incentive being higher pay for rank and time and grade, rather than years of service.

**Mr. Cook:** Mm-hmm. I think that's on our watch list. Yeah.

**ADM Pilling:** Right.

**Dr. Oi:** And I think that that should be the first part of the building block, because that right now is, what? 70% of pay, Paul?

**Mr. Hogan:** Yes sir.

**Mr. Cook:** Current cash is 70% of total pay?

**Dr. Oi:** 70% of cash pay, at any rate.

**Mr. Cook:** Oh.

**ADM Pilling:** Comes from the pay table.

**Mr. Cook:** Yes sir.

**Mr. Hogan:** Comes from base pay.

**ADM Pilling:** Right.

**Dr. White:** Walter, you also then need some – the ability beyond 20 to manage that force in a different way. I agree with you in principle, in terms of age and experience. You have people who are far healthier and more able to make a contribution at an older age than before. But at the same time we've still got to worry about what that promotion flow looks like, whether or not we don't create another bottleneck in terms of promotion of the sort that we have at 20 years.

Some of that you can deal with in the context of what you mentioned earlier, and that is modifications to the retirement system in ways that provide participation in retirement benefits by more people.

**Dr. Oi:** Well, when I first got into this business a long time ago, I was up in Ottawa, and a corporal picked me up at the airport and drove me into the city, and so forth. That guy was 48 years old and a corporal. Okay? And the Canadian armed forces felt that if you can do the job and if it's not a command position, that what was the necessity to promote him to sergeant? And I think we need that kind of flexibility in the system.

**ADM Pilling:** So I think you would be in favor of removing the high-year tenure.

**Dr. Oi:** Yeah, I would be. You mean the "up or out", yeah.

**ADM Pilling:** The "up or out," so E-8's are out at 24 years and...

**Dr. Oi:** Something like that, and E-9's at 28.

**Mr. Cook:** I would think – I have a contrary view to that, unless you're just going to have a lot more E-8's and E-9's, because if you have a system that has a lot of long service, higher ranked people, and limits on the number of people that you can put into those, and they're held by people who are already there, then you have removed or diminished the opportunity for promotion, which I think is the major incentive that exists within the armed forces.

**Dr. White:** Right, correct.

**Dr. Oi:** In big corporations today, with a thousand or more employees, we have people there with 30 years of service with the firm who are at very low rungs on the promotion ladder, aren't they?

**Mr. Cook:** Right, yes sir.

**Dr. Oi:** Can't we do the same thing with the military? Why is it that everyone who stays has to be able to command a platoon?

**Dr. White:** I don't think it's everybody who stays, Walter, I think it's an issue of whether or not you don't want to continue to include and incentivize quality growth in the force. And the device by which we do that may be examined, but it seems to me that principle is critical. We have a high-quality force. One reason – the fundamental reason is that people who are – who attain senior grades, enlisted or officers, have gone through a lot of rigorous training and professional development, and that's good.

**Dr. Oi:** Yeah, I agree with you, but does everyone have to do that?

**Dr. White:** Well, it just seems to me very hard to identify those who do and those who don't, in terms of...

**Dr. Oi:** How do we do it in the private sector?



**Dr. White:** Well, I think it's a different problem in the private sector. We're asking a – the mission is different, and therefore we're asking them to do something that's quite different, and my point view, my private sector experience, it helps me in terms of thinking about what we're dealing with here, but it isn't a terribly good guide, because everything is so different in terms of the private sector.

**Dr. Oi:** well, in 1948, what percentage of the force were in the ground combat units? It was at least double the percentage now.

**Dr. White:** Yes.

**Dr. Oi:** I mean, we've changed. I mean, before...

**Dr. White:** That's a change in a different dimension, and I agree with you. And in fact the force has changed.

**Dr. Oi:** When we were in college, the football team had 6 coaches. If you go to UCLA today, they have 30 coaches. Okay? The way that we're producing football is different. They way we're producing defense is different. And I think we have to recognize this, and that there are more rooms for coaches and there are more rooms for guys who are picking up uniforms and stuff. You know, I...

**Dr. White:** I just don't want to get away from the stress on quality of the force. I think that's so critical to the kind of magnificent force that we have.

**Dr. Oi:** I agree with you, if we have the same kind of force and the structure of the force that we had in 1970.

**Mr. Cook:** Well, that's a fundamental issue. This is a fundamental issue. The private sector achieves exactly what you want, but they do it because people – well, there are two things, I think. People are paid in the private sector based upon the job that they hold. The military system is a classification system of rank. You're paid by your rank, not by your job, which gives us great flexibility to move people around. It's a wonderful system. The private sector system doesn't use that at all. Now, if you have someone who's great and valued, and they've sort of peaked out at some mid-level position, the other thing we have in the private sector is we have mechanisms to keep rewarding and motivating that person without promotion. They can stay there as long as they want. And by staying there, they are not holding back anybody else beneath them.

**Dr. Oi:** Yeah.

**Mr. Cook:** That's how we do it.

**Dr. White:** Hey, Fred, let me make a couple of comments. I agree with you. Two comments. First of all there's no such thing, as you well know better than I, as "the private sector" when it comes to compensation. Truck drivers are different from clergymen, that are different from football players, that are different from heart surgeons, okay? So there's no, we know...

**Mr. Cook:** No big corporate structure kind of a pay table.

**Dr. White:** Right, exactly, we don't, you know – the second point, which we also know, is we spend a lot time – I have and you have – sitting in board meetings arguing about what the structure for the compensation ought to be, without a lot of wisdom, frankly, in the conversation. Much more hunch about, “Well, maybe we ought to give more incentive, maybe we ought to give less incentive. Maybe we ought to have...” who knows, blah, blah, blah, blah, blah.

**Mr. Cook:** Privately.

**Dr. White:** //laughs// Right?

**Mr. Cook:** Well.

**Dr. White:** So all I'm saying is, it can inform our judgment, but it doesn't point us in a particular, it seems to me, point us in a particular direction.

**Mr. Cook:** But Walter really asked, how do we accomplish this incentive?

**Dr. White:** Yeah, no, no, I agree, I'm not responding to that.

**Mr. Cook:** But it's a different system...

**Dr. White:** It's a different system.

**Mr. Cook:** ... and, uh, there are certain – Admiral, there are certain sort of givens, almost unstated givens in our work that we accept without even critically examining. Right? And one of them would be the rank structure. No lateral entry, you know, you take your people, you get them in young, you train them, and they stay with the system. Certain givens that we're not going to challenge. We're going to have – we're not going to have different, I don't believe, basic pay structures for different services. We're not going to have a different pension plan for the Marines than for the Air Force, even though you might intellectually argue the forces are different and maybe it would, but you're just not going to do it. So there are certain constraints that we have that we have to work under.

**Mr. Jannotta:** Generally, Fred //unclear, stutters// the private sector is moving more and more to pay for performance, as opposed to pay for just a job, a place that you fill.

**Mr. Cook:** Sure.

**Mr. Jannotta:** It's skewed...

**Mr. Cook:** Variable pay...

**Mr. Jannotta:** Variable pay...

**Dr. White:** But the public sector is too, Joe.

**Mr. Jannotta:** Pardon?

**Dr. White:** Public sector is too, in terms of...

**Mr. Jannotta:** Yes, and in fact it's a management and it's a competitive world, and so I think that's another factor that comes into play here.

**Mr. Cook:** I view it as a //unclear, crosstalk//

**Mr. Jannotta:** Well, I think it's different.

**Mr. Cook:** ... just to make it explicit that the military is basically a meritocracy, and does have pay for performance, but it's in the form of promotion that we do it. We have no system, and I don't think any of us are even thinking of having a sort of a bonus pool whereby, you know, we take all our E-5's and say, "Well you did a better job this year on your objectives, so here's \$10,000." We don't really have that. The private sector would have it, but...

**ADM Pilling:** I mean, your example would be the captain of the ship could decide what to pay his E-5's for the next year based on how they perform.

**Mr. Cook:** Yeah, right, right. I don't think we're going to go down that road.

**ADM Pilling:** I don't think we're going to get there either. //laughter//

**Mr. Cook:** Well, you could, but I don't think we're going to do it.

**Dr. White:** Let's not.

**Mr. Cook:** Maybe, I wonder if our ultimate report ought to be explicit about the things that we accept as givens? You, know, are not changing?

**ADM Pilling:** That's not a bad thought.

**General Lyles:** Yeah, I think we're going to have to do that.

**ADM Pilling:** Because of the – in the front piece, here's what we sort of assume, here's the...

**Dr. White:** Yeah, constraints.

**ADM Pilling:** Yeah, constraints. Any other discussion?

**General Lyles:** Yeah, just to add to this discussion. You started off by asking us about the framework, and I think we're all agreed that the framework, whether you include fair and equitable or not, is a valid one for right now. And Fred offered some building blocks to go within that framework, and I think that they were good. As I understood Dr. Oi's comments, he was suggesting that we don't overlook looking at promotion and other things as part of those – the building blocks, and I think that's a valid thing to do. The thing that keeps coming to mind for me is to make sure that we don't get so rigorous as we look at this topic that we fail to think out of the box, if you will, and fail to look at some things that may be completely, radically different than today. We're going to lay out some assumptions, but I think we need to also make sure that we don't overlook a chance to do something that will radically change the way we address this whole problem. So I guess in some respects I'm agreeing with Walter that we owe it to, I think, our charter and owe it to the SecDef to offer something that might be a little bit different, and we may reject it, but I think we at least need to look at it.

**ADM Pilling:** Right. And as Paul started off with, we want to do no harm, which is how I got to the fair and equitable thing. It has to be viewed by the force as fair and equitable.

**General Lyles:** Yes.

**ADM Pilling:** Anybody else, before we take a break for lunch?

**Dr. White:** One other comment that I think, I just want to make explicit, it's a real challenge, and I think it can be done in this framework, and that is the relative, in terms of fair and equitable treatment, the relative merit of an alternative, because we're going to change some alternatives and then other alternatives, and that's going to get very complicated in terms of what you said, architecture, and what it is that we're actually going to do, and we ought to think about some sort of, at least, judgments about it. If we emphasize one thing – if we emphasize changes in bonuses, does that mean we're going to make an adjustment someplace else?

**Mr. Cook:** Right.

**Dr. Oi:** Can I voice a small objection to the “no harm” principle? //laughter//

**ADM Pilling:** Yes sir.

**Dr. Oi:** It's wrong. //laughter// I mean, the whole compensation principle that Pareto gave us says that if the benefits are such that the winners can compensate the losers, and there's a surplus, then we ought to do it. All right? And I think that, you know, Vilfredo Pareto was right, and if we hold to this “no harm” consequence, we're going to be carrying a lot of baggage around with us.

**ADM Pilling:** Let me be more clear what I meant by “no harm.” No harm to the current force, so that they think that what we're proposing is not fair and equitable.

**Dr. Oi:** No, I think that even there, if we can compensate them we ought to. I mean, we do that now. We say we want to downgrade the Air Force //fire alarm test – laughter// Saved by the bell. //laughter – unidentified speaker asks, “Do you have a little button under your desk there?”//

**ADM Pilling:** Okay, all right. Walter, did you want to continue on this Air Force point? //laughter//

**Dr. Oi:** No, I believe that – look, the Air Force is reducing. There’s going to be harm to some people because they would have liked to have stayed to 20.

**ADM Pilling:** Right.

**Dr. Oi:** So we offer them a compensation scheme, and we hope the winners can compensate the losers, and that on balance we’re better off. But I think that this – looking at “no harm” focuses the thing on giving the people who are presently incumbents a property right. And I think that that’s not the way you want to progress and proceed. I read, I’ve only read Vilfredo Pareto in translation, I’ve never read the original, so that I’m probably not the accurate person to look at this, but isn’t it right that we don’t – that if the winners can compensate the losers, we ought to go ahead with it?

**ADM Pilling:** Right, and perhaps “no harm” is a bad way of describing.

**Dr. Oi:** No, it’s a point that Saul Pleeter made – we want no net harm.

**ADM Pilling:** Right.

**Dr. White:** Right, so if you’re going to compensate – there’s no harm by definition because you’re going to – you’ve got surplus by which you’re going – with which you’re going to compensate the losers, and therefore they’re made whole, and therefore there’s no harm.

**ADM Pilling:** Right.

**Dr. Oi:** No net harm.

**Dr. White:** No net harm, right.

**Dr. Oi:** Which is the point that Saul Pleeter makes. That’s just a footnote, not a major change. //laughter//

**ADM Pilling:** Well, if we have no further discussion, I think we adjourn for lunch, and we’ll reassemble back in here at 1:00 and to hear from the Military Coalition. Okay, thank you very much. //stop tape//

## AFTERNOON SESSION

**ADM Pilling:** ... //joined in progress// open up the second public session of the day, and we have three representatives of the Military Coalition here, and I think the order in which you're going to go is going to be Mr. Barnes, who is the co-chairman of the Military Coalition, then Mr. Strobridge, another co-chairman, and then Mr. Puzon, who is the co-chairman of the Military Coalition Guard and Reserve Committee. Is that the order you're going to make your presentations?

**Mr. Barnes:** That is correct, sir.

**ADM Pilling:** Well, thank you for coming today.

**Mr. Barnes:** Thank you, thank you, Admiral. The Military Coalition thanks you for this opportunity to address the committee and express concerns about compensation and benefit issues. My name is Joe Barnes. I'm the national executive secretary for the Fleet Reserve Association and also co-chair of the Military Coalition.

Since the committee already met with NMFA on family and quality of life issues, this presentation will focus on other topics. I will summarize concerns about pay comparability and compensation cost and value. Then Steve Strobridge from MOAA will address the unique conditions of service and the importance of institutional benefits. And finally, Ike Puzon from NRA will address the increased demands on the guard and reserve and the importance of upgrading their personnel benefit programs.

Shortchanging military pay raises has contributed to major retention and readiness challenges since the advent of the all-volunteer force. As a result, restoring military pay comparability is a top priority. During the last 7 years, Congress reversed the practice of capping annual pay raises below the average civilian's pay level. Capping military raises has been proposed by successive administrations as a way to trim the budget, and OMB advocated capping pay raises at the inflation level and increasing bonuses and special pays rather than keeping military pay on par with private sector wage growth.

Maintaining pay comparability with the private sector is a fundamental aspect of sustaining the all-volunteer force. Years of pay caps left military pay lagging civilian compensation by 13.5% in 1999, resulting in major readiness challenges reported by service and defense leaders. Fortunately, the gap has since been reduced to 4.9%. The Coalition supports DOD's goal of establishing military pay at the 70<sup>th</sup> percentile of private sector pay for similarly experienced and educated workers, with targeted raises as needed to achieve that standard in the basic pay table on a cell-by-cell basis.

Senior enlisted personnel and warrant officers are better educated and more highly trained in this age of technology, while accepting greater responsibilities and increased authority. Their leadership skills are sorely needed, and the Coalition believes additional targeted raises are particularly needed to reestablish pay comparability for these communities.

Special and incentive pays are important for the services to compete in the marketplace for personnel in high-demand skills. But these must be in addition to an overall comparability standard for regular military compensation. The Coalition believes that it is unwise to step back from the traditional military institutional model and shift to a civilian style occupational model that pushes more money into skill-specific pays and bonuses or establishes different pay scales for

different specialties. A common core personnel and compensation system that includes basic pay and allowance tables and other benefits recognizes that a member is a member, regardless of specialty or service.

Many measures being used to describe current trends in military compensation are misleading. For example, GAO reports that compensation costs rose 29% between 2000 and 2004, and that the average cost of military compensation is \$112,000 per member. The Coalition believes such figures are not presented in a reasonable context. Basing analysis on 2000 is inappropriate for measuring cost growth, since the military compensation package was acknowledged as having considerable problems at that time. There was an 11.4% cumulative pay shortfall, DOD provided no Medicare supplemental coverage for older retirees, and the Joint Chiefs of Staff was supporting repeal of the REDUX retirement system.

Increasing pay and benefits over the next four years was essential to addressing recruiting and retention problems that resulted from scrimping on benefits in the past, and focusing solely on the cost to government for these enhancements detracts from important questions. First, what is the value to our nation of military members' service and sacrifice? And, what price will the country pay if we suffer inadequate military recruiting and retention? An appropriate formula for determining compensation value for service members is pay and benefits received divided by work and sacrifice expended. Much has changed since 2000, and our troops are now working harder and sacrificing far more. In fact, it can be argued that service and sacrifice is more than 29% greater now than in 2000.

The cost of doing government business is also part of this, from providing schools for dependent children to building housing and barracks, to providing food in military dining facilities. A GAO report assigns a \$23,000 annual health care benefit cost to each active duty member, including not only the cost of providing current care, but an imputed actual accrual charge for all future care provided by DOD and the VA for the rest of the member's and his or her family's lives. This all-consuming cost accounting methodology may be reasonable for budgeters, but it does not reflect compensation value. It's a cold and one-sided analysis that so carefully counts every dollar the government will spend on treating service-incurred wounds and disabilities, or on providing disability compensation without scant if any consideration for the lifetime cost in life expectancy, quality of life, and lost earnings to service members with service-connected disabilities.

This concludes my presentation. Steve Strobridge will now discuss unique conditions of service, retirement, and medical issues.

**Mr. Strobridge:** Thank you, Joe. Mr. Chairman, as Joe said, my portion of the testimony will cover military institutional benefits that play such a critical role in offsetting the extraordinary demands and sacrifices inherent in a military career.

I hope every member of the commission will read Lt Gen Benjamin O. Davis's minority report to the 1978 President's Commission on Military Compensation, which quoted some eloquent testimony on this topic by the Secretary of the Air Force at the time. The Secretary cited military service as a unique calling that is unlike those of any other country or corporation. He listed their risks, long hours, frequent moves, disruption of families, and a long list of other sacrifices. "In short," he said, "we ask them to surrender elements of their freedom to serve and defend the society with the highest

degree of freedom in the world, and one which has the highest standard of living and an unmatched quality of life. Implicit in the concept of military service must be long-term security and a system of institutional supports for the serviceman and his family that are beyond the level of compensation found in the private sector.” And that concludes the quote.

Those from whom we demand such loyalty, commitment, and sacrifice have earned and deserve reciprocal loyalty and financial and, yes, even paternal commitment in return. That includes ensuring that they are treated fairly later in life. For example, we know the impact of failing to provide inflation protection for retired pay and survivor benefits – analysts can give that to you to the penny – even though today’s young troops may not appreciate that, and even some of the older ones may not the full value of that.

The government has an obligation, though, not to take advantage of their misunderstanding or naiveté on those kinds of issues. Too often military people are looked at as human capital, in essence commodities from whom the efficient objective is to extract maximum service at minimum cost. Dr. Chu has said that the 19-year-old doesn’t care about retirement – he wants a pick-up truck. Fortunately Congress over the years has been wise enough to see that it’s not enough to meet the short-term desires of a 19-year-old new enlistee. Members and families get more sensitive to in-kind and deferred benefits as they get older and incur all those sacrifices of the career, the multiple moves, the family separations and so forth. There’s a good reason why military surveys consistently show that military retirement is the single greatest career retention incentive. And there’s a reason why the REDUX retirement benefits cut became a bigger and bigger concern as those REDUX-eligible cohorts progressed through their careers.

Similarly, treating the military 20-year cliff vesting as a military/civilian inequity ignores the fundamental military and civilian differences and also some real-world cost issues. Civilian-style vesting works with civilian-style working conditions. Members facing an undesirable assignment or their third or fourth family separation at the 10- or 12-year point would have far less incentive to continue serving if they knew they could leave and take a good chunk of their military retirement benefits with them.

We all know that a government already concerned about retirement costs is not likely to simply add money to the current system to fund vesting, Thrift Savings Plan matching, and so forth. The harsh reality is that any money needed to pay those additional retirement benefits to people who leave early almost certainly will come at the expense of reductions for those who serve 20 years. We’ve seen that time and again. The Coalition does not see that as a formula for long-term retention and success. Too often we tend to assume that those people who now stay 20 would stay 20 and maybe even serve longer. The REDUX reduced the value at 20 and kept it the same at 30, on the assumption those people would just stay longer. In fact, the reason why people don’t stay is because they don’t like the adverse conditions of service.

We’re particularly perplexed by government leaders’ mixed messages on military health benefits. It was only a few years ago that the Pentagon pushed to eliminate co-pays for active duty families in Prime, to cut out-of-pocket costs for those assigned away from military facilities, and it was only a few years ago that Congress enacted TRICARE for Life and the TRICARE Senior Pharmacy program to redress the significant shortfall in health benefits for older retirees, and those, as Admiral Pilling talked about, were endorsed by the service leaders at the time. //no audio while tape is flipped//



...//rejoined// deserve no constancy in return? We understand that the Department of Defense has health cost pressures, but that's an issue for the whole country, not just for the Department of Defense. Shifting costs to military beneficiaries, in essence just aping corporate employers who don't share the same kinds of obligations to their employees, is not the appropriate answer in the Coalition's view. DOD may need to seek efficiencies in delivery, may need to seek, to examine voluntary incentives for beneficiaries to use any civilian health coverage they may have, as well as seeking increased funding to sustain the richer and also richly deserved military health benefit. It's simply wrong to change course and act as if these costs were unforeseen or that they are somehow the fault of military beneficiaries who already are observing far more than their share of national sacrifice. That goes for retirees as well, who absorbed similar sacrifices in past hot and cold wars.

It's also important not to forget that, before the enactment of TRICARE for Life, older retirees already spent decades when DOD spent nothing to supplement Medicare, even though the vast majority of large corporate employers already did so. Surely military retirees have some health care sweat equity for enduring those out-of-pocket costs all those years.

That concludes my portion.

**Mr. Puzon:** Mr. Chairman, the members of the Guard and Reserve Committee of the Military Coalition thank you for the opportunity to address the committee and express concerns about compensation and benefits issues affecting the total guard and reserve family. My name is Ike Puzon. I am the co-chair of the Guard and Reserve Committee.

As you know, since 9/11 our nation has activated over 500,000 members, or 57% of the Selected Guard and Reserve personnel, who train regularly and are assigned to military positions, and this number, as you know, is going up. Today they face the same challenges as their active counterparts, but they also do have added concerns. Guard and reserve operational tempo is placing enormous strains on reservists, their family members, and, the added concern, their civilian employers, as we see today in response to Iraq, Afghanistan, and now Hurricane Katrina. Homeland defense, homeland security, support to civil authorities, and the war on terror operations worldwide continue to not just generate demands on our citizen military members, but actually increase the stress on their participation.

Under current policy, reservists can expect and always have expected multiple lengthy activations over the course of a reserve career. Juggling family, as we all do, military commitment, as we all have or do, and civilian employment is more and more difficult for the guard and reserve force. Worsening recruiting and retention numbers are proof of the stress and concerns. For a long time guard and reserve volunteers have been major contributors to the national security and homeland security, well before it was named homeland security. These members must meet every deployment standard applicable to active duty members, and have done so for a long, long time.

Because of the dramatic increase in operations and personnel tempo, it should be clear that compensation schemes designed in the 1950s no longer address today's realities. Any changes in the compensation model must ensure that the guard and reserve remains an essential element for a national security strategy, the homeland defense, and support to civil authorities, as well as homeland security strategy. Last year Congress recognized the need for a comprehensive review of

the guard and reserve forces by establishing a commission to examine the roles and missions of these forces in depth. We appreciate your review of reserve compensation, and we look forward to that commissions review also.

Recently your committee and the Reserve Compensation Committee presented a framework for improving reserve compensation. The TMC feels that any reserve compensation system change must adequately reflect the demands increased on reserve service, without creating a disproportional incentive. While there is a need to review and simplify the reserve duty order system, some recently developed models propose scrapping the current model of paying one day's basic military pay for each reserve component four-hour drill in favor of a day-for-day pay model. We believe that the current drill pay system is sound and does properly compensate those that are volunteering to serve their country. They are being mobilized. Changing this part of compensation would have negative and long-lasting impact.

Current compensation models and tools such as bonuses are effective, but should not be the only driver in guard and reserve compensation. The GAO reports that 41% of guard and reserve members take a pay cut when called to active duty. There is a need to fairly address the civilian income and retirement plan losses. One incentive is to upgrade the reserve retirement system, a system built nearly 60 years ago. Current guard and reserve usage drains guard and reserve members' long-term civilian compensation. Failure to react to the increased demand on guard and reserve members will have far-reaching, catastrophic effects on guard and reserve members' recruiting, participation, and career intentions.

Continuity of health care is a major issue for the guard and reserve leaders, members, and their families. Last year TRICARE Reserve Select and the pre- and post-activation TRICARE coverage began to address the need. However, they do not provide the long-term coverage necessary to attract and retain volunteers into the reserve service. We believe that DOD does address federal workers' health coverage if activated. They must provide and look at this in-kind feature of reserve compensation in recognition of the fundamental in the nature of reserve service. If our nation is expecting these volunteer guard and reserve members to permanently increase their service, and we will, and sacrifice more, and they will, they should not be compensated using outdated part-time models. Guard and reserve members will serve as much as a quarter of their working lives in military service on full-time military duty. Overwhelmingly they are ready to do their service.

Some other issues: the elimination of BAH II, which was highlighted by the Selected Reserve Compensation Committee. We believe the BAH II is outdated, unfair, bears no relation to the actual, real housing expenses. We believe strongly that guard and reserve members activated for more than 30 days should be eligible for full, locally based BAH.

Compensation credit for military service: the role of the guard and members has changed dramatically, as we've discussed. The maximum number of inactive duty training days in points that could be credited was 60 during the Cold War era. Then the cap was changed to 75 and recently to 90 points. Again, this is a reflection of the increased usage of the guard and reserve. We strongly believe that members should be permitted to credit all inactive duty military training performed towards retirement. Placing a ceiling on these points serves as a disincentive to the professional development and lengthy training readiness requirements.

Reserve enlisted bonuses, special pay, incentive pay: guard and reserve members must maintain special skills sets the same as active duty members. Currently guard and reserve members are receiving only 1/30<sup>th</sup> of pay for each day of specialized duty. In certain cases, in certain special skill sets, guard and reserve members actually perform more special duty days during the month than active duty average. We strongly believe that this should be reviewed, since it limits guard and reserve members' special pay.

We urge you to recognize that there has been a dramatic and permanent increase in the service and sacrifice of the total guard forces. Compensation must be structured to suit the new reality provided by value-added incentives to reservists, their families, and employers, in exchange for a compromised civilian career stability, earnings, and long-term financial security.

My colleagues thank you, the TMC thanks you, and the guard and reserve members of the TMC are grateful to the committee for an opportunity to express these views. With the guard and reserve force and recruiting and retention efforts at high risk, and active duty troops and families already overworked, as well as civilian employers overstressed, the last thing the military need is another benefits cuts threat. We thank you.

**ADM Pilling:** Thank you very much. I think we'd like to ask you some questions, if you're willing. And I'd like to start with Mr. Barnes. You talked about "a member is a member," and we shouldn't be putting special pays or anything that would differentiate members from each other too much. Are you saying that the Military Coalition is not in favor of pay for performance?

**Mr. Barnes:** Admiral, no, we're not saying that. I believe the focus should be on a consistent pay system with performance and skill sets addressed with bonuses and special pays. There's been a great deal of discussion in recent years about perhaps establishing separate pay systems for technical specialties, for example, apart from a consistent pay table. We've been urging the Department to develop, based on the 70<sup>th</sup> percentile benchmark, a reference pay table for several years, and I think the Department's moving towards that. But that's what we're in essence saying.

**ADM Pilling:** Okay.

**Mr. Strobridge:** Sir, if I might add a comment. You know, the term "pay for performance" is pretty vague and it means lots of different things to different folks. You know, you get into the pay-banding kind of thing. And I think our view is getting back to some of the things that were discussed this morning. There have been some people who have actually proposed different pay tables for different services, entirely different pay tables for different skills, and I think if that's what you're talking about, "pay for performance," then no, we don't support that. We feel strongly that promotion is supposed to reflect performance, and there may be some things that reflect grade. There may be some specific ways to reflect performance. I don't want to say we'd never do that. But a lot of the special pays are there to reflect unique service conditions, hazardous conditions, and it's kind of hard to say, you know, when you're under fire, what – how you measure different people's performance. There was a comment this morning, do we want to just turn it over to the captain of the ship to decide, and I think we would agree with the comment this morning, no, we don't want to do that.

**ADM Pilling:** Right. I was just referencing when we had the senior enlisted advisors at our last session, virtually every one of them said they support pay for performance, but they weren't very clear on what that really meant, other than the head nods if you change the time in service requirements for pay to time in grade requirements to reflect early promotions.

**Mr. Strobridge:** Sir, I think that kind of reflects what they're told to say.

**ADM Pilling:** Okay. And for Mr. Puzon, I noticed that in your section you had a framework for evaluating changes to the compensation system that had six characteristics in it. The same six were in the eight we talked about this morning. Did you see anything we talked about this morning that you wouldn't want to be on your set of characteristics?

**Mr. Puzon:** Well, sir, I think I was addressing that when I said if you change the pay model to pay 1/30<sup>th</sup> of the drill – for the drill period vice the current drill pay, I think that would be catastrophic. You know, to begin with, overwhelmingly reserve members and guard members don't join for pay, but it becomes important later on. I think initially if they're young, they do. But as the mid-years, they don't. but that drill pay becomes very important as a compensation.

**ADM Pilling:** Other members? John?

**Dr. White:** May I follow up, Mr. Puzon? I was struck by your comment about drill pay and how it's sound and shouldn't be changed, but since you didn't propose any alternative, I didn't understand where you were going. In other words, I could conceive of a system that would be quite different, but also you may like. So tell me a little bit more why you feel so strongly.

**Mr. Puzon:** Well, I – well, I'll just put it this way. It's not just an 8-hour period that a member always does, okay? But that system was created as a – the one-day period for a drill period, and the other part was created as a compensation, I would assume, but it has worked well to keep members drilling. So I don't know that we're necessarily supporting you change the 4-hour period at all. I mean, if that's what you're asking.

**Dr. White:** No, I know you're not, but I just didn't understand, I mean, we could – if we thought of something more innovative and so on? I lived under that system as a reservist perfectly fine. I don't have an objection to it. I'm just trying to figure out, because we've got to figure out what's best. Do you have any other ideas about how to do this?

**Mr. Puzon:** I would say, sir, the four hours of drill pay, if you're going to change it to 1/30<sup>th</sup> day for the whole day, that's what I'm saying is negative. The only incentive I see is if you were to say, you could get more drills, you know, in other words, if you started on Friday and you just – or whatever those drill days are, and you get more drills, that might be the way to do it to accomplish what the 1/30<sup>th</sup> pay system was looking for, or the tool or the scheme. Other than that I don't see that changing. I don't know if my colleagues do or not.

**Mr. Strobridge:** If I can add a comment. I think one of the things that's reflected in the Coalition's view on that is prior proposals to shift the reserve compensation system to say, basically, you know, the current system provides two days' pay for one day's work. We really ought to shift, provide one day's pay including all pay and allowances for one drill period. But past proposals that have done that would have ended up cutting reserve pay. And so then they've had to pile on some

additional compensation as an incentive, as Ike said, to continue serving. And to us that's a distinction without a difference. That's not really that much different than the rationale for the extra payment of the extra day's pay for the second four-hour period. Basically it's a recognition that you have to add some kind of added incentive for these folks to serve in that kind of capacity over that long a time and put up with the disruption in their civilian careers and lives.

**ADM Pilling:** Mr. Cook?

**Mr. Cook:** Follow up on that, Mr. Puzon? The idea that I'd heard expressed – I'm not sure where, but that you, uh – the 1/30<sup>th</sup> pay, which is a negative, would be offset by travel reimbursement, which is not now. It had been presented thus, sort of, as a combination deal that would be fair. Would you comment on that?

**Mr. Puzon:** Yes sir. I see that as important, but, you know, you have now members that don't travel outside the 50 miles. I mean, if you're in a major metropolitan area, you wouldn't get anything anyway. But if you're in current trends, you are. But I still don't – let's put it this way: I support the travel issue, but, you know, we were trying to address that, and it has been addressed in the tax issue, but I don't see that offsetting the commitment that you're asking that member to make. Now go to back to what I said earlier: a lot of times these members are not just giving 8 hours. They're giving 10, 12, you know, hours and still only getting the 8 hours pay. And I know that sounds somewhat ridiculous, but if that were to offset, I'd be interested to look at it.

**ADM Pilling:** General Lyles?

**General Lyles:** Yeah. Mr. Puzon, you gave us, as Admiral Pilling said, you gave us six sort of framework, or five framework concepts similar to the ones that we had. I'd like to ask Mr. Barnes and Mr. Strobridge if they think that we missed anything relative to the framework that we laid out. Are there some things that you would add either differently from the ones that we have, or eliminate some, or add some completely different set of framework for looking at this problem?

**Mr. Barnes:** Unfortunately I was not here for the briefing this morning, general.

**ADM Pilling:** Ah, you missed a great show.

**Mr. Barnes:** I apologize.

**Mr. Strobridge:** Well, I was here, and I do have to say that I was a little concerned, and it goes back to something that Joe talks about. I think there was an almost exclusive focus, except for the half-hour discussion that the commissioners had on the equity issue, for example, which I thought was essential and I was grateful to hear that discussion. I think there was an almost exclusive focus in the presentation on the government's point of view. In other words, what does the government get out of this transaction? I think, as Joe talked about, in the cost accounting, or even in this issue about the reimbursement of the reserve members for travel, I think there is a terrible lack of concern – not concern, but lack of accounting for the level of sacrifices that members are incurring to make these – to do the service. In other words, you know, in our written testimony, we talked about , and Joe talked about, how do you tote up the cost of disability

compensation, all the VA health care in the future, which is for disabilities, without recognizing the cost to the member of incurring that disability? How do you recognize the cost of providing the barracks and providing the food in kind without recognizing that most of those enlisted members would prefer not to live in the barracks? They'd prefer to live off base and have the same freedoms that other people have. Or in the case of the reservists, we want to tote up the cost, if we were going to do it, which we don't, of reimbursing them for their travel costs, without recognizing these members are incurring those travel costs out of their own pockets right now. We talk about doing the same thing for PCS expenses, without recognizing that the service members are spending more than they're reimbursed every time they make a move. So I would ask that the commission – and I recognize that you were working to do that this morning in the latter half of the discussion – that in these measures that we're putting up on the board, we recognize that it's not just what the government gets that we have to be concerned about. We have to be concerned about the member's perspective, and I think you were getting at that. It has to be perceived as fair and equitable, and it's tough to do that without going down this list that you had and put yourself in that service member's shoes – and most of you have been in that service member's shoes – and say, "How would that apply to me? How would I feel, you know, if I had the economists, you know, and the analysts telling me that this is the way my compensation is going to be built? What would I tell them in return?"

**General Lyles:** Good comment. As you heard this morning, we struggled a little bit trying to figure out how to quantify fair and equitable, and you just sort of outlined perhaps a way we could begin to get at that, so I appreciate the input. That's just what we needed to hear.

**Mr. Strobridge:** And the thing is, you know, there's a tendency to ignore the things you can't quantify. Well, military life is built around unquantifiable sacrifices, and I just don't think we can ignore those.

**General Lyles:** Thank you.

**ADM Pilling:** Mr. Jannotta?

**Mr. Jannotta:** As you know, one of the things that we're looking at is the quality of life for the service members, and I was struck, Mr. Strobridge, by your comment, "adverse effects of military life." I know that certainly there is that when it comes to Iraq and – but beyond that, can you help us a little bit, how you would write that down? What are some of the adverse effects as you see them?

**Mr. Strobridge:** Certainly, sure. There's, you know, the normal ones that everybody realizes, but I think there's also the idea of the up-or-out promotion system, you know, which is – most of these things, they're two-sided coins. They're needed to manage the force, and I'd put the 20-year cliff vesting in there in the same coin. You have to have a powerful incentive to pull people to service outside, you know, despite those conditions. But part of it is the fact that the vast majority of people are going to be booted out of service and have to start over in mid-life, at the very time their kids are in college and they're incurring a lot of expenses. I think that the testimony by the Secretary of the Air Force back in 1978 was very eloquent about talking about people who give up the very freedoms that other Americans take for granted. The ability to tell your boss no. The ability to get fat without going to jail. You know, these are pretty fundamental things that I think a lot of people forget about.

**ADM Pilling:** I'd like to ask Mr. Strobridge a question. See if I understood what you said. You were talking about 20-year vesting and you've seen time and time again that changes to the 20-year vesting fail. I can think of only one change, the REDUX. Were there other examples?

**Mr. Strobridge:** Right. I guess, I think that I'm talking about the reality – and I heard some of that this discussed this morning. We're talking about cost-neutral issues, we're not talking about being able to spend a whole bunch more money. And yet if we vest, we're going to pay people who leave who would have left anyway. The money's got to come from somewhere. And in past proposals, whether it's the President's Commission on Military Compensation in 1978, there have been a whole raft of other proposals, including REDUX, which envisioned creating incentives to serve careers, not by putting more money out there for the people who serve longer careers, but by reducing the incentives to serve 20. And to me that is counterintuitive, because it keeps people from getting to 20. If you don't get to 20, you're never get to 28 or 30.

And it's just the reality that a government that is already concerned and complaining about the cost of health care – and I put the – I had a good conversation with – and he's not there anymore, he's over in the Senate – Charlie Abel, the Deputy Undersecretary – we talked about this very issue. And I said, "How do you make up for the fact that, if we pay people to leave, where is that money going to come from? How are we going to – that reduces the pull to 20. If I can take my money with me, and I'm facing another assignment, by definition you have reduced the economic pull to 20 because I can take part of that – that money is mine whether I stay or leave. So then what do we do?" And his answer was, "Well, maybe we need to plus it up for 20." And I said, "You really think that's going to happen? You're going to pay people to leave, and then the government will offset, will bid against itself, in essence, by paying more to the people who stay? It's not going to happen." I think we've all seen these kinds of things.

**Mr. Jannotta:** I'm not quite sure I understand where you are on this, Mr. Strobridge, in the sense that up-or-out idea, the cliff...

**Mr. Strobridge:** Well, I think the – we're at the point where it's hard to envision a practical alternative that doesn't envision, if you vest people who leave, that doesn't also envision plussing up the amount of compensation for people who stay. You know? Would I support that? Yes, certainly, I'd like to be fair to people who leave, but I get back to the point that this isn't civilian business. You know, we've got a tough job pulling people to serve, to serve, to fill future leadership jobs. We have to have powerful incentives. So if you're going to create a disincentive by paying people who leave, you have to then put more money into people who stay for career, which means plussing up the retirement system. It doesn't mean, you know, putting more money into cash compensation. And I don't think that anybody on the panel believes that you're going to get the opportunity to have enough money to do that.

**ADM Pilling:** John?

**Dr. White:** Mr. Strobridge, you made a statement, and I would like you to elaborate. You said current defense leaders' rhetoric directly contradicts decades of institutional effort to provide the unique military package needed to offset unique military service conditions, and proposes backtracking on initiatives that almost all government leaders enthusiastically embraced a few years ago.

**Mr. Strobridge:** Yes sir. To me, TRICARE for Life is the quintessential example of that. A few years ago, you had the Joint Chiefs of Staff go to the President and say, and testify before Congress, saying it's really not right that, you know, military folks, as was talked about before, were promised health care for life, and yet when they reach 65 we drop them from the military health coverage. General Motors doesn't do that, Ford doesn't do that. You know, other corporate employers don't do that. The military shouldn't do that either. And so Congress said, you know, you're right, we'll go ahead and do it. And yet right now we're talking about, you know, we see time after time all kinds of news articles and this GAO report, and to me the very genesis of this commission is because now the current defense leaders are saying, "That costs too much. We don't want to do that. You know, it's not appropriate. We've got to cut that back and shift more costs onto military people."

**Dr. White:** I guess I haven't heard current defense leaders say that. I guess you have //cross talk//

**Mr. Strobridge:** Yes sir, we hear it all the time. We see it in the newspapers. We've got reporters right here who have quoted them on it in the newspapers.

**Mr. Jannotta:** I guess I would say that I'm guilty of the fact that we have laid on, at General Motors and other places, these benefits that at the time, given life expectancy, all these things, looked very doable and achievable, but now General Motors and a lot of other companies are faced with bankruptcy, or they're on the edge of bankruptcy. So there is an economic reality here that this nation and we, all in this room, have to face.

**Mr. Strobridge:** Certainly, but I think that we also have to recognize, sir, that those kinds of bankruptcies are not the fault of the employees. I would look at the executives who designed cars that didn't sell, designed airline models that didn't work...

**Mr. Jannotta:** That's sort of cat out of the bag, though, isn't it, Mr. Strobridge?

**Mr. Strobridge:** Yes sir. I understand, it is, yes sir. But the government is not going to go bankrupt.

**Mr. Jannotta:** And I raise my hand as one who's guilty.

**Mr. Strobridge:** Yes sir, but the government is not the same. Those companies can go bankrupt, as the case was made earlier this morning, they do in fact face a real situation where the answer may be either paying half a loaf or going out of business and getting nothing. The government doesn't face that scenario. The government's not going to go out of business. The one institution in the world that can keep its promises is the United States government.

**Dr. White:** Well, that depends on the size of those promises.

**Mr. Strobridge:** It can keep those promises, sir. It may not choose to, but it can. You know, one other – if I can comment. You know, one of the things that we run into is the Department of Defense's contention that the cost of TRICARE for Life, that the cost to concurrent receipt is somehow eating into the cost of weapons systems and providing guns and bullets and those other things. I have a great – I have an extremely hard time understanding how anybody can give that credibility.



The administration can make up the budget, the administration has the ability, they've got a requirement to fund those things which Congress passed by law and made mandatory entitlements, so if they're not submitting a budget that's sufficient to meet those other needs, who do look at? They have a capacity to send a budget over to the Hill. They may say, you know, you forced this on us, but we've got to meet the readiness requirements, and Congress may then cut it, but I would argue, Congress will never cut that kind of budget. And it's a conscious choice not to submit it. But that's not the fault of the people who had the problems that Congress fixed.

**Dr. White:** Well, our problem is, of course, looking forward at what ought to be done here...

**Mr Strobridge:** Yes sir.

**Dr. White:** And it seems to me it's legitimate for us to worry about future system costs...

**Mr. Strobridge:** Absolutely.

**Dr. White:** ...personnel and manpower costs, and that they shouldn't be infinite.

**Mr. Strobridge:** And I don't have necessarily a problem with that. What I have difficulty with is when we start toting up costs, and as Joe talked about earlier, we lost sight of the value of what the country's getting for this. And I would contend, when we look at what the troops over in Iraq and Afghanistan today are sacrificing, or in bearing the entire 100% of the burden of national sacrifice on full-time war – those troops are on full wartime mobilization. Nobody else in the country is. And I think we – it's easy to forget about that when we're toting up the cost. We've got to think about what we're getting for that cost. To me, national defense is the number one priority in the country, and there is no reason why we should be saying that the country can't afford to defend itself.

**Mr. Cook:** Admiral, I'm just speaking for myself, I just wanted the Military Coalition to know that, from my perspective, GAO doesn't speak for the Department or for this committee.

**Mr. Strobridge:** Yes sir. I appreciate that.

**Mr. Cook:** One follow-up? Mr. Puzon, when we got briefings from the senior military advisors on reserve affairs, one of the suggestions was that we get government initiatives to encourage private employers to support the guard and reserve commitments of their employees. I presume you would support that, but we've been having a little trouble trying to figure out – what are some examples of what that might be, that we might consider? Do you have any in mind? Tax incentives, things like that?

**Mr. Puzon:** Well, I would think... //end of tape// ...that's probably one area. The other one probably would be intangibles like if they have to take leave of absence to go do training, something like that. Possibly what they're talking about employers – incentivizing that through taxes. In other words, I'll give you more leave if I get, you know, more tax benefit. There's just been several proposals recently that employers would get more tax credit based on the number of employees

that were activated. That is another incentive that we've tried – this committee, Coalition has tried to get through Congress, and that's – that may be what they're talking about. Those are three things I can come to – comes to light.

**Mr. Cook:** Thank you.

**ADM Pilling:** Dr. White, you have...?

**Dr. White:** Mr. Barnes, you mentioned that in looking at costs, someone, maybe it was GAO, had used the base year 2000 and calculated a number...

**Mr. Barnes:** Yes sir.

**Dr. White:** ...and you objected to that year?

**Mr. Barnes:** Yes.

**Dr. White:** Could you tell me what year you would pick? I mean, we've got to figure out what's going on here.

**Mr. Barnes:** Underst-...

**Dr. White:** And we've got to do that based on analysis.

**Mr. Barnes:** Yes sir, I understand the challenge. Since 2000 we've encountered 9/11, we've had a significant increase in guard and reserve mobilization, we've seen operational commitments expand, and in some of the services end strengths are being decreased. The pressures are significant, but just focusing on that timeline to make the case about the increased costs of benefits seems flawed. A broader perspective perhaps would be in order. Since 2000 we've seen the most generous pay and benefit enhancements based on the problems with recruiting, retention, and overall military readiness. So they were necessitated, they were essential to sustaining the all-volunteer force. And using that baseline as the read in this period of time, rather than going back perhaps 15 years or going back to a time before that, seems to skew the argument and feeds into the costs that – or the case that these benefits have gotten much too costly. The value of military service is very difficult to quantify solely on monetary terms. I understand the challenge the commission has on this.

We see instances consistently year after year that the Department is looking to reduce funding, appropriations for benefits. The commissary system is an example. There's an unrelenting effort to reduce the appropriation for the military commissary system, which delivers a tremendously beneficial benefit. It's very, very important. But yet there's a constant effort to reduce the appropriation on that benefit, speaking of quality of life as an example.

**Dr. White:** So how do when we have the right balance? Would you agree – I'm not putting words in your mouth – that if we look at a system and that system manned the force appropriately as part of an assessment in terms of quality, and it's fair to the people, that in fact the retention rates are what we want, the accession rates are what we want – not describing today, I'm just describing, sort of, standards in terms of how we know that we've done the right thing or are doing the

right thing. We always do more, but, I'm sorry, Mr. Strobridge, there is a limited amount of resources here. So does that meet your standard?

**Mr. Barnes:** Are you speaking to...?

**Dr. White:** To you, Mr. Barnes, yes.

**Mr. Barnes:** I would – I believe using that time frame is flawed, as it's...

**Dr. White:** No, no, I'm not – I'm sorry, I probably didn't – probably wasn't clear. Looking at a criterion in terms of whether or not we are meeting the responsibilities to the country in terms of the force, and that if that force is perceived by the leadership to be of the appropriate quality, and by the force itself, and if it has adequate retention rates which reflect, obviously, the willingness of people to serve, and adequate accession rates, which again reflect willingness to serve, is that a standard that you would support in terms of saying, "Yes, if we're there, we are where we ought to be"?

**Mr. Barnes:** I think that's a reasonable approach. Going back to your initial question, it – the analysis here on costs should be much broader than this period where we had this...

**Dr. White:** I don't have any – I don't have a quarrel with that. That's fine.

**Mr. Barnes:** Okay.

**Dr. White:** Thank you.

**Mr. Strobridge:** Sir, if I could add a word. I think your question is a reasonable one about what time period do you pick. And I think you can pick almost any point in time, because things change all the time. You know, whenever you compare, it's apples and oranges. I think the main thing that we would ask is that when we're talking about how much the costs have looked at, in the same way that I talked – suggested looking at your other standards from the point of the military member, I would say, what has changed on the service member's side? To recognize that part of those costs are costs of doing business, you know. It's not just money we gave to the people. The standard for how you judge where you are – I think the Coalition has always felt that we have to have a series of compensation principles to live by, and that's the same kind of thing you're struggling with.

As Joe talked about, one of those is pay comparability, general pay comparability of RMC with private sector pay. One of those is that we're going to protect people with inflation protected retirement. In other words we're not going to get them into a situation where they're going to outlive their benefits and their benefits are going to decline in value over the years. I'm reluctant – certainly recruiting and retention adequacy is one measure. I think too often in the past that's been used as the only measure. The answer on pay raises – the reason we scrimped on pay raises is because people in OMB said, "Look, retention's fine, so we can cut pay." To me that's like driving in the rear view mirror. The only thing you can guarantee is eventually you're going to have an accident. you have to have a principle for establishing how we're going to provide the compensation. Part of that is, for regular military compensation, what has compensation increased in the

private sector. Once we establish a level of comparability, we're going to sustain that. Even though retention is good today, we're not going to take advantage and scrimp because we think we can today, because we know that's going to cause us a problem tomorrow.

**Dr. White:** But suppose in the future that standard allows us, provides us with a surplus, with a surplus of people. Then are you still going to adhere to that standard?

**Mr. Strobridge:** You know, the services have means of getting people out that they don't need, whether it's reenlistment quotas. If you change – we did the biggest draw-down in history, outside of World War II, in the late 90s, and Congress provided incentives that, to me, that worked very, very well. So we have some tools designed specifically to do that that have been used very successfully.

**ADM Pilling:** Mr. Cook.

**Mr. Cook:** Mr. Puzon, the written brief indicates that senior guard and reserve leaders are rightly concerned over worsening recruitment, retention, and force structure, if action is not taken to relieve pressures on the forces, etc. Are we talking about a situation that now exists in recruitment and retention numbers deteriorating, or one that potentially could exist?

**Mr. Puzon:** Well, certainly we're talking about current, but I believe also their concern is for the out years, where we're going to be ten years, five years down the road.

**Mr. Cook:** Are we not meeting our retention goals now?

**Mr. Puzon:** I don't believe we are in certain services. We are in some, obviously.

**ADM Pilling:** I have a question of the Coalition. We've seen information that there are health care providers out there that are willing to establish TRICARE for Life preferred patient provider organization or PPO's, and they have suggested to us that they have run these proposals by the Coalition and you were supportive. Is that the correct analysis of the view?

**Mr. Strobridge:** I think I know the group that you're talking about, sir, and I think one of the things that – one of the caveats we put on that is that that would have to be a voluntary participation.

**ADM Pilling:** Right.

**Mr. Strobridge:** In other words, not forcing people into it.

**ADM Pilling:** Right.

**Mr. Strobridge:** I think that we expressed an interest in exploring that possibility, yes sir.

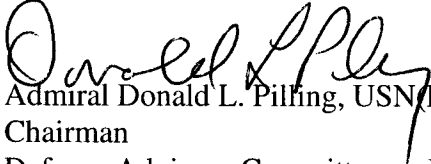
**ADM Pilling:** Because the way they expressed it to us, they would be more efficient and they'd be able to take some savings and provide dental care and optical care to the enrollees.

**Mr. Strobridge:** And we expressed a willingness to explore that, yes sir.

**ADM Pilling:** Okay. Any other questions from the commissioners? No? Well, thank you very much. We appreciate it. Thank you very much. I don't think we have any more discussion from this morning, so I think we can wrap it up. So thank you. //thank yous all around//

### END ###

I hereby certify that, to the best of my knowledge, the foregoing transcripts are accurate and complete.

  
Admiral Donald L. Pilling, USN (Ret.)  
Chairman  
Defense Advisory Committee on Military Compensation

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