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Comparisons between Military and Civilian Compensation Can be Useful, but Data Limitations Prevent Exact Comparisons

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Mr. Chairman and Members of the Subcommittee:

Thank you for providing me this opportunity to discuss our most recent report on military and civilian pay comparisons and the challenges associated with those types of comparisons.[1] The Department of Defense's (DOD) military compensation package, which is a myriad of pays and benefits, is an important tool for attracting and retaining the number and quality of active duty servicemembers DOD needs to fulfill its mission. Since DOD transitioned to an all-volunteer force in 1973, the amount of pay and benefits that servicemembers receive has progressively increased.[2] When it is competitive with civilian compensation, military compensation can be appropriate and adequate to attract and retain servicemembers. However, comparisons between the two involve both challenges and limitations. Specifically, as we have previously reported,[3] no data exist that would allow an exact comparison between military and civilian personnel with the same levels of work experience. Also, nonmonetary considerations complicate such comparisons, because their value cannot be quantified. For example, military service is unique in that the working conditions for active duty service carry the risk of death and injury during wartime and the potential for frequent, long deployments, unlike most civilian jobs.

In addition, there is variability among past studies in how compensation is defined (for example, either pay or pay and benefits) and what is being compared. Most studies, including those done by the Congressional Budget Office (CBO) and RAND Corporation, have compared military and civilian compensation but limit such comparisons to cash compensation—using what DOD calls regular military compensation—and do not include

[1]GAO, *Military Personnel: Military and Civilian Pay Comparisons Present Challenges and Are One of Many Tools in Assessing Compensation*, GAO-10-561R (Washington, D.C.: Apr. 1, 2010).

[2]Historically, "basic pay" has been the largest component of military compensation, and is paid to all servicemembers according to their respective rank and years of service. Congress has provided for and DOD has also implemented over the years a number of additional benefits—some of which may be deferred until after the completion of active duty service. An example is the Post 9-11 Veterans Educational Assistance Act, which expanded the education benefits available to qualified active duty and reserve component members.

[3]GAO, *Military Compensation: Comparisons With Civilian Compensation and Related Issues*, NSIAD-86-131BR (Washington, D.C.: June 5, 1986) and GAO-10-561R.

benefits.[4] DOD has also conducted studies comparing military and civilian compensation as part of its Quadrennial Review of Military Compensation (QRMC)—a review required by law, every 4 years, of the principles and concepts of the compensation system for members of the uniformed services.[5] The 2008 QRMC (the 10th) focused on seven compensation-related areas, including the adequacy of compensation, and it recommended, among other things, the inclusion of both cash and some benefits—such as health care—when assessing military compensation. The 10th QRMC also found that, when some benefits were included, military compensation compared approximately with the 80th percentile of comparable civilian compensation—that is, that 80 percent of the comparable civilian population earned less than the military population in the comparison. Previously, the 2004 QRMC (the 9th) found that regular military compensation met the 70th percentile of comparable civilian cash compensation.

The National Defense Authorization Act for Fiscal Year 2010 required that we conduct a study comparing the pay and benefits provided by law to members of the Armed Forces with those of comparably situated private-sector employees, to assess how the differences in pay and benefits affect recruiting and retention of members of the Armed Forces.[6] Earlier this month, we issued our report.[7] My testimony today summarizes the findings of that report. Specifically, my statement will (1) examine total military compensation for active duty officers and enlisted personnel, (2) compare private-sector pay and benefits for civilians with those of officers and enlisted personnel of the Armed Forces, and (3) assess the 10th QRMC's recommendation to include regular military compensation and select benefits when making such comparisons.

We focused our work on active duty servicemembers' perspectives on compensation—that is, cash compensation and the value of benefits to servicemembers versus the costs to the government of providing

[4]Regular military compensation is the sum of basic pay, allowances for housing and subsistence, and the federal income tax advantage—which is the value a servicemember receives from not paying federal income tax on allowances for housing and subsistence. It was initially constructed by the Gorham Commission in 1962 as a rough yardstick to be used to compare military and civilian-sector pay.

[5]37 U.S.C. § 1008.

[6]Pub. L. No. 111-84, § 606 (2009).

[7]GAO-10-561R.

compensation. To conduct our work, we identified and reviewed studies on compensation by such organizations as CNA Corporation (CNA), CBO, the Congressional Research Service, DOD, GAO, and RAND. We interviewed officials from DOD's Office of the Under Secretary of Defense for Personnel and Readiness, including the Deputy Under Secretary of Defense for Military Personnel Policy and officials within the Directorate of Compensation, as well as officials from CNA, CBO, the Defense Manpower Data Center, the Bureau of Labor Statistics, and the Military Officers Association of America. To assess total military compensation, we reviewed a 2008 DOD-commissioned report[8]—completed by CNA—and identified estimated values for the elements of military compensation (that is, regular military compensation, health care, retirement, and additional tax advantages). We also identified the employee benefits available to active duty servicemembers and used DOD survey data to identify the utilization rates of these benefits by servicemembers. To compare military compensation with private-sector pay and benefits of comparable civilians, we used CNA's report to identify estimated values for private-sector compensation—pay and benefits—for comparable civilians. In addition, we reviewed the methods CNA used to estimate values for several benefits—retirement, health care, and additional tax advantages.[9] Finally, to assess the 10th QRMC's recommendation to include regular military compensation and select benefits when comparing military and civilian compensation, we conducted a review of recent literature on compensation—including regular military compensation and select benefits—and interviewed DOD officials and other knowledgeable individuals in the fields of compensation and human capital management. We conducted our work in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

[8]James E. Grefer, CNA Corporation, *Comparing Military and Civilian Compensation Packages* (Alexandria, VA: March 2008).

[9]For example, servicemembers do not pay Federal Insurance Contributions Act (FICA) tax and state tax on their housing and subsistence allowances.

Total Military Compensation for Active Duty Officers and Enlisted Personnel Is Broad and Difficult to Assess

DOD provides active duty servicemembers with a comprehensive compensation package that includes a mix of cash, such as basic pay; noncash benefits, such as health care; and deferred compensation, such as retirement pension. The foundation of each servicemember's compensation is regular military compensation, which consists of basic pay, housing allowance, subsistence allowances, and federal income tax advantage. The amount of cash compensation that a servicemember receives varies according to rank, tenure of service, and dependency status. For example, a hypothetical servicemember with 1 year of service at the rank of O-1 and no dependents would currently receive an annual regular military compensation of $54,663, whereas a hypothetical servicemember with 4 years of service at the rank of E-5 and one dependent would receive an annual regular military compensation of $52,589.[10] In addition to cash compensation, DOD offers current and retired servicemembers a wide variety of noncash benefits. These range from family health care coverage and education assistance to installation-based services, such as child care, youth, and family programs.

While many studies of active duty military compensation have attempted to assess the value of the compensation package, most did not consider all of the components of compensation offered to servicemembers. CBO, RAND, and CNA have assessed military compensation using varying approaches. All of their studies include some components of compensation—for example, cash compensation beyond basic pay, which includes housing and subsistence allowances, the federal income tax advantage, and, when possible, special and incentive pay. However, these studies did not assess all components of compensation offered to servicemembers. Thus, the results of these studies differ based on what is being assessed, the methodology used to conduct the assessment, and the components of compensation included in the calculations.

The most recent study, a 2008 DOD-sponsored study performed by CNA, assessed military compensation using regular military compensation and some benefits (specifically, health care, the military tax advantage, and

[10]These estimates come from DOD's regular military compensation calculator, available at http://militarypay.defense.gov/mpcalcs/Calculators/RMC.aspx.

retirement benefits).[11] In particular, the results of this study state that in 2006, average enlisted servicemembers' compensation ranged from approximately $40,000 at 1 year of service to approximately $80,000 at 20 years of service.[12] Additionally, in 2006 the average officers' compensation ranged from approximately $50,000 at 1 year of service to approximately $140,000 at 20 years of service. Our analysis of CNA's 2008 study found that overall, CNA used a reasonable approach to assessing military compensation; however, we provided comments on two issues. In general, we agree that when assessing military compensation for the purpose of comparing it with civilian compensation, it is appropriate to include regular military compensation and benefits (as many as can be reasonably valued from the servicemembers' perspective). For example, in order to value health care, CNA estimated the difference in value between military and civilian health benefits, because servicemembers receive more comprehensive health care than most civilians.[13]

As mentioned previously, we identified two areas for comment with regard to CNA's approach. First, with regard to retirement, health care, and tax advantage, CNA's methodology makes various assumptions that allow the study to calculate approximate values for these benefits. While the assumptions are reasonable, we note that other, alternative assumptions could have been made, and thus, in some cases, could have generated

[11]CNA was commissioned by the 10th QRMC to conduct a study comparing military and civilian compensation. The results of the study were used by the QRMC. Typically, discussions of the military tax advantage focus on the savings that arise because the allowances for housing and subsistence are not subject to federal income tax. However, CNA's study also included an estimation of the expected annual tax advantage that servicemembers receive because they do not pay state and FICA taxes on their housing and subsistence allowances and can often avoid paying any state income taxes depending on their state home of record.

[12]We did not verify the calculations underlying CNA's reported estimates of the value of these select benefits.

[13]Specifically, active duty servicemembers are automatically enrolled in TRICARE Prime and do not pay premiums or out-of-pocket expenses for their healthcare whereas many civilians do not receive any health care benefits from their employers and even those who do usually pay some out-of-pocket expenses and part of the premium. By calculating the amount that the typical civilian worker pays for premiums and out-of-pockets expenses, CNA found the difference between what civilians and servicemembers pay. In other words, the benefit servicemembers receive is avoiding the costs civilians would have to pay to receive comparable health care.

substantially different values.[14] Second, the CNA study omits the valuation of retiree health care, which is a significant benefit provided to servicemembers. Nevertheless, we note that CNA's study and other studies of military compensation illustrate that valuing total military compensation from a servicemember's perspective is challenging, given the variability across the large number of pays and benefits, the need to make certain assumptions to estimate the value of various benefits, and the utilization of benefits by servicemembers or their dependents, among other reasons.

Military Compensation Generally Compares Favorably with Civilian Compensation in Studies, but These Comparisons Present Limitations

In comparing military and civilian compensation, CNA's study as well as a 2007 CBO study,[15] found that military pay generally compares favorably with civilian pay. CNA found that in 2006, regular military compensation for enlisted personnel averaged $4,700 more annually than comparable civilian earnings. Similarly, CNA found that military officers received an average of about $11,500 more annually than comparable civilians. Further, CNA found that the inclusion of three military benefits—health care, retirement, and the additional tax advantage for military members—increased the differentials by an average of $8,660 annually for enlisted servicemembers and $13,370 annually for officers. A 2007 CBO study similarly found that military compensation compares favorably with civilian compensation. For example, CBO's report suggested that DOD's goal to make regular military compensation comparable with the 70th percentile of civilian compensation has been achieved. We note that the major difference between the two studies lies in their definitions of compensation. CNA asserted, and we agree, that the inclusion of benefits allows for comparisons of actual levels of compensation and provides some useful comparison points for determining whether servicemembers are compensated at a level that is comparable to that of their civilian peers, although the caveats that we discuss below should be considered. CBO also noted, and we agree, that including benefits can add another level of complexity to such analytical studies.

[14]For example, when applying discount rates to value retirement benefits, the rate assumed affects the value of the retirement. To illustrate, if a person is to receive $100 in 20 years, the present value of that money is $3.65 using 18 percent, $10.37 using 12 percent, or $31.18 using 6 percent.

[15]CBO, *Evaluating Military Compensation* (Washington, D.C.: June 2007).

However, while these studies and comparisons between military and civilian compensation in general provide policymakers with some insight into how well military compensation is keeping pace with overall civilian compensation, we believe that such broad comparisons are not sufficient indicators for determining the appropriateness of military compensation levels. For example, the mix of skills, education, and experience can differ between the comparison groups, making direct comparisons of salary and earnings difficult. While some efforts were made by CNA to control for age (as a proxy for years of experience) and broad education levels, CNA did not control for other factors, such as field of degree or demographics (other than age), that we feel would be needed to make an adequate comparison. As another example, one approach that is sometimes taken to illustrate a difference, or "pay gap," between rates of military and civilian pay is to compare over time changes in the rates of basic pay with changes in the Employment Cost Index.[16] We do not believe that such comparisons demonstrate the existence of a pay gap or facilitate accurate comparisons between military and civilian compensation because they assume that military basic pay is the only component of compensation that should be compared to changes in civilian pay and exclude other important components of military compensation, such as the housing and subsistence allowances. We note that CBO also previously discussed three other shortcomings of making such comparisons in a 1999 report.[17] Specifically, CBO noted that such comparisons (1) select a starting point for the comparison without a sound analytic basis, yet the results of the pay gap calculation are very sensitive to changes in that starting point; (2) do not take into account differences in the demographic composition of the civilian and military labor forces; and (3) compare military pay growth over one time period with a measure of civilian pay growth over a somewhat different period.

[16]The Employment Cost Index is a nationally representative measure of labor cost for the civilian economy and measures changes in wages and employers' costs for employee benefits.

[17]CBO, *What Does the Military "Pay Gap" Mean?* (Washington, D.C.: June 1999).

10th QRMC's Recommendation to Include Regular Military Compensation and Select Benefits When Comparing Military and Civilian Compensation Appears Reasonable

The 10th QRMC's recommendation to include regular military compensation and select benefits when comparing military and civilian compensation appears reasonable to us because it provides a more complete measure of military compensation than considering only cash compensation.[18] Given the large proportion of servicemember compensation that is comprised of in-kind and deferred benefits, the 10th QRMC emphasized that taking these additional components of compensation into account shows that servicemember compensation is generous relative to civilian compensation—more so than traditional comparisons of regular military compensation suggest.[19] The 10th QRMC also recommended that in order to maintain the standard established by the 9th QRMC's 70th percentile (which includes only regular military compensation), DOD adopt the 80th percentile as its goal for military compensation when regular military compensation and the value of some benefits, such as health care, are included in the analysis. In general, when comparing military and civilian compensation, a more complete or appropriate measure of compensation should include cash and benefits. When considering either a military or a civilian job, an individual is likely to consider the overall compensation—to include pay as well as the range and value of the benefits offered between the two options. The challenge with this approach, as mentioned previously, lies in determining how to "value" the benefits, and which benefits to include in the comparison.

Prior to issuing our report earlier this month the Deputy Under Secretary of Defense for Military Personnel Policy provided us with oral comments on a draft of the report. The Deputy Under Secretary generally agreed with our findings, noting that numerous studies have attempted to estimate the value military members place on noncash and deferred benefits and that each study has found that identifying relevant assumptions, valuing these

[18]According to senior officials in the Office of the Under Secretary of Defense for Personnel and Readiness' Directorate of Compensation, the department has not yet adopted the 10th QRMC's recommendation of including benefits in comparing military and civilian compensation, thus setting the department's overall compensation goal at the 80th percentile of comparable civilian employees.

[19]According to 2005 and 2007 GAO reports, about half of active duty compensation costs consist of benefits, as compared with about 18 percent in the private sector and about 33 percent for federal civilian employees. See GAO, *Military Personnel: DOD Needs to Improve the Transparency and Reassess the Reasonableness, Appropriateness, Affordability, and Sustainability of Its Military Compensation System*, GAO-05-798 (Washington, D.C.: July 19, 2005), and *Military Personnel: DOD Needs to Establish a Strategy and Improve Transparency over Reserve and National Guard Compensation to Manage Significant Growth in Cost*, GAO-07-828 (Washington, D.C.: June 20, 2007).

benefits, and finding appropriate benchmarks and comparisons are significant challenges. Noting the variation in the results of these studies, the Deputy Under Secretary stated that further study is necessary before DOD is willing to consider measuring and benchmarking military compensation using a measurement that incorporates benefits.

While comparisons between military and civilian compensation are important management measures, they alone do not necessarily indicate the appropriateness or adequacy of compensation. Another measure is DOD's ability to recruit and retain personnel. We have reported in the past that compensation systems are tools used for recruiting and retention purposes.[20] Similarly, in 2009, CBO stated that ultimately, the best barometer of the effectiveness of DOD's compensation system is how well the military attracts and retains high-quality, skilled personnel.[21] Since 1982, DOD has only missed its overall annual recruiting target three times—in 1998 during a period of very low unemployment, in 1999, and most recently in 2005. Given that (1) the ability to recruit and retain is a key indicator of the adequacy of compensation and (2) DOD has generally met its overall recruiting and retention goals for the past several years, it appears that regular military compensation is adequate at the 70th percentile of comparable civilian pay as well as at the 80th percentile when additional benefits are included. We note that although the services have generally met their overall recruiting goals in recent years, certain specialties, such as medical personnel, continue to experience recruiting and retention challenges. As a result, permanent, across-the-board pay increases may not be seen as the most efficient recruiting and retention mechanism. In fact, our previous work has shown that use of targeted bonuses may be more appropriate for meeting DOD's requirements for

[20]GAO, *Military Personnel: Active Duty Benefits Reflect Changing Demographics, but Opportunities Exist to Improve*, GAO-02-935 (Washington, D.C.: Sept. 18, 2002).

[21]CBO, *Statement of Matthew S. Goldberg: Long-Term Implications of the Department of Defense's Fiscal Year 2010 Budget Submission* (Washington, D.C.: Nov. 18, 2009).

selected specialties where DOD faces challenges in recruiting and retaining sufficient numbers of personnel.[22]

Concluding Observations

In closing, we note that comparisons between military and civilian compensation are important management tools—or measures—for the department to use to assess the adequacy and appropriateness of its compensation. However, such comparisons present both limitations and challenges. For example, data limitations and difficulties valuing nonmonetary benefits prevent exact comparisons between military and civilian personnel. Moreover, these comparisons represent points in time and are affected by other factors, such as the health of the economy. To illustrate, it is not clear the degree to which changes in the provision of civilian health care or retirement benefits affect the outcome of comparing military and civilian compensation. In addition, valuing military service is complicated. While serving in the military offers personal and professional rewards, such service also requires many sacrifices—for example, frequent moves and jobs that are arduous and sometimes dangerous. Ultimately, DOD's ability to recruit and retain personnel is an important indicator of the adequacy—or effectiveness—of its compensation.

Mr. Chairman, this concludes my prepared statement. I would be happy to respond to any questions that you or members of the subcommittee may have at this time.

[22]GAO, *Military Personnel: Observations Related to Reserve Compensation, Selective Reenlistment Bonuses, and Mail Delivery to Deployed Troops*, GAO-04-582T (Washington, D.C.: Mar. 24, 2004); *Military Personnel: DOD Needs More Effective Controls to Better Assess the Progress of the Selective Reenlistment Bonus Program*, GAO-04-86 (Washington, D.C.: Nov. 13, 2003); *Military Personnel: DOD Needs More Data to Address Financial and Health Care Issues Affecting Reservists*, GAO-03-1004 (Washington, D.C.: Sept. 10, 2003); and *Human Capital: Effective Use of Flexibilities Can Assist Agencies in Managing Their Workforces*, GAO-03-2 (Washington, D.C.: Dec. 6, 2002).

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