

REPORT OF
The Tenth Quadrennial
Review of Military
Compensation



EXECUTIVE SUMMARY

September 2008



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of Military Compensation**

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For Immediate Release
Office of the Press Secretary
August 2, 2005

Memorandum for the Secretary of Defense

SUBJECT: Tenth Quadrennial Review of Military Compensation

Consistent with section 1008(b) of title 37, United States Code, every 4 years the President directs a complete review of the principles and concepts of the compensation system for members of the uniformed services. You shall conduct the tenth such Quadrennial Review of Military Compensation as my Executive Agent.

The Army, Navy, Marine Corps, and Air Force in the Department of Defense; the Coast Guard in the Department of Homeland Security; the commissioned corps of the National Oceanic and Atmospheric Administration in the Department of Commerce; and the commissioned corps of the Public Health Service in the Department of Health and Human Services perform important roles in the protection of the American people and advancement of their interests at home and abroad. To continue to recruit and retain highly qualified personnel for the uniformed services as they transform themselves to meet new challenges, the departments concerned must offer, in addition to challenging and rewarding duties, compensation appropriate to the services rendered to the Nation. The departments also must apply the substantial taxpayer resources devoted to uniformed services compensation in the most effective manner possible.

In the review of the principles and concepts of the compensation system, particular attention should be paid to:

1. ensuring that personnel in the uniformed services have the abilities and experience necessary to meet the challenges expected in the future, especially with respect to the War on Terror, defense of the homeland, and public warning and health in emergencies;
2. maintaining the quality of life for members of the uniformed services and their families;
3. the potential for consolidation of special pays and bonuses into fewer, broader, and more flexible authorities and for the substantial reduction or elimination of community-specific continuation and career pays in favor of more flexible and effective compensation alternatives;
4. the potential need for enactment of broader and more flexible authorities for recruitment and retention of uniformed services personnel; and
5. the implications of changing expectations of present and potential members of the uniformed services relating to retirement.

Please ensure that the Secretaries of Commerce, Health and Human Services, and Homeland Security participate as appropriate in the conduct of the review. I look forward to reviewing your findings and recommendations in this important undertaking.

GEORGE W. BUSH

THE 10TH QRMC WISHES TO REMEMBER
TWO INDIVIDUALS WHOSE INFLUENCE AND
INSIGHT CONTRIBUTED MEASURABLY TO
ITS DELIBERATIONS.



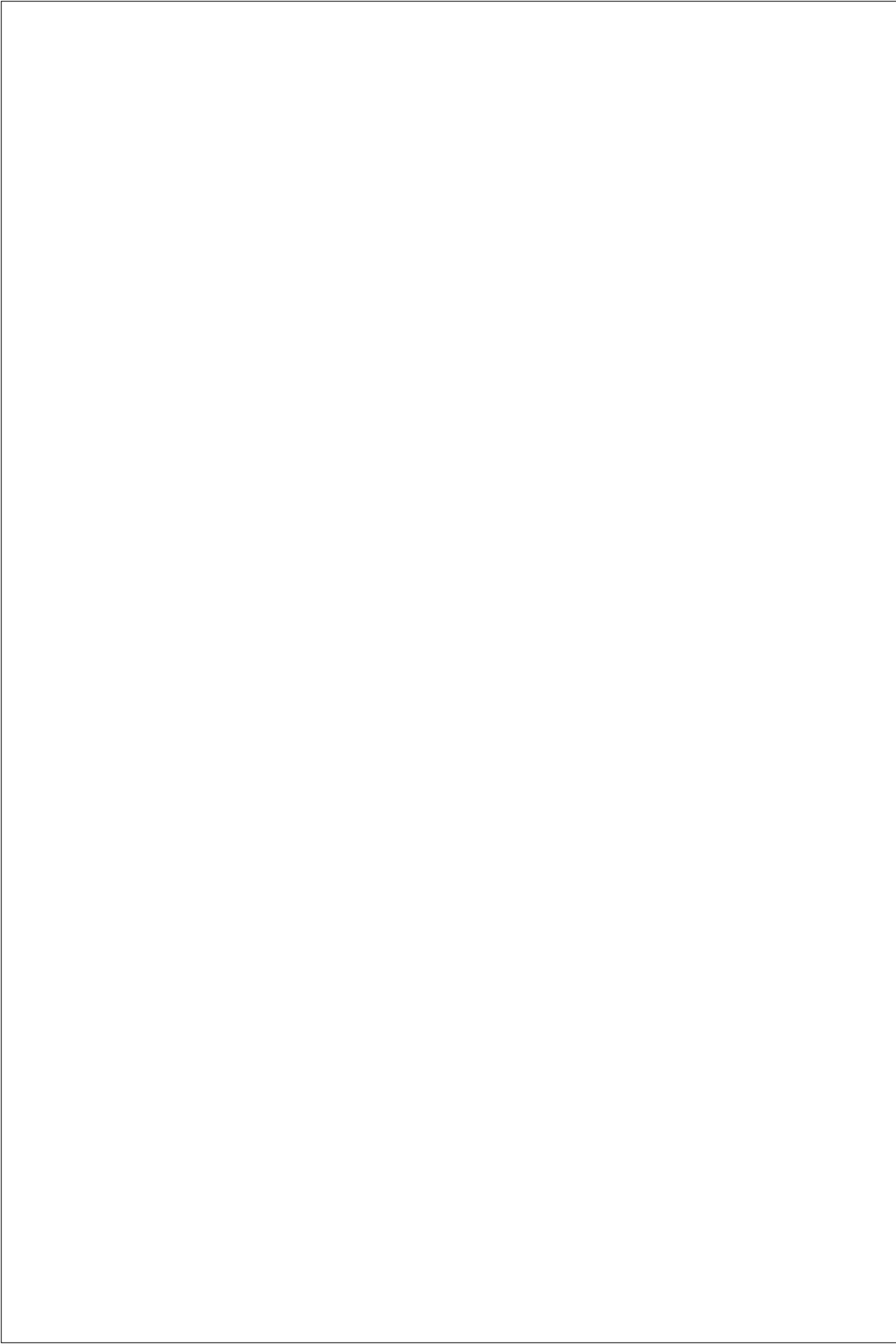
ADMIRAL DONALD L. PILLING, USN (RET.)

AS DIRECTOR OF THE DEFENSE ADVISORY COMMITTEE
ON MILITARY COMPENSATION, ADMIRAL PILLING'S
VISION OF A COMPENSATION SYSTEM WITH GREATER
FLEXIBILITY AND EQUITABILITY GUIDED THE WORK OF
THE COMMITTEE AND GREATLY INFLUENCED THE 10TH
QRMC. HIS LEGENDARY CONCERN FOR THE NEEDS OF
THE MEN AND WOMEN IN UNIFORM INFLUENCED HIS
PERSPECTIVE AND EARNED HIM GREAT RESPECT. HE
WILL BE MISSED.



Dr. GLENN GOTZ

A LEGEND IN THE AREA OF MILITARY MANPOWER AND
PERSONNEL RESEARCH, DR. GOTZ WAS A COLLEAGUE
TO MANY WHO CONTRIBUTED TO THE 10TH QRMC'S
SUPPORTING RESEARCH AND ANALYSIS. THE MODEL
DEVELOPED TO EVALUATE THE QRMC RETIREMENT
ALTERNATIVES WAS BASED ON WORK HE PIONEERED
IN THE 1980S. HIS UNTIMELY DEATH EARLY IN THE
QRMC'S STUDY WAS A SIGNIFICANT LOSS TO ALL WHO
LABOR IN THIS FIELD.



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Preface

Under federal law, every four years the President directs “a complete review of the principles and concepts of the compensation system for members of the uniformed services.”¹ The First Quadrennial Review of Military Compensation (QRMC) was convened in 1965. Since that time, eight subsequent quadrennial reviews have taken place, with the most recent—the 9th QRMC—issuing its report in 2002.

In August 2005, President George W. Bush instructed the Secretary of Defense to conduct the Tenth Quadrennial Review of Military Compensation (10th QRMC). In his charge to the Secretary, the President stated:

To continue to recruit and retain highly qualified personnel for the uniformed services as they transform themselves to meet new challenges, the departments concerned must offer, in addition to challenging and rewarding duties, compensation appropriate to the services rendered to the Nation. The departments also must apply the substantial taxpayer resources devoted to uniformed services compensation in the most effective manner possible.

Totalling over \$118 billion in 2007, military personnel costs make up 23 percent of defense spending. It is critically important that these resources are spent wisely and in ways that help the Services quickly and effectively respond to changes in mission objectives and the supply and demand for high-quality personnel. Past QRMCs have provided the Services with valuable analyses and recommendations, which have led to important improvements in the compensation system and enabled the Services to better address increasingly competitive labor markets and more effectively respond to rapidly changing operational needs. The work of the 10th QRMC furthers these efforts.

The 10th QRMC used the recently completed Defense Advisory Committee on Military Compensation (DACMC) report, published in April 2006, as the point of departure for its own assessment of the military compensation system. The DACMC was directed to

1. 37 U.S. Code, Section 1008(b).

... provide the Secretary of Defense, through the Under Secretary of Defense (Personnel and Readiness), with assistance and advice on matters pertaining to military compensation. More specifically, the Committee shall identify approaches to balance military pay and benefits in sustaining recruitment and retention of high-quality people, as well as a cost-effective and ready military force.²

During its deliberations, the DACMC focused on the following areas: the active component retirement system, pay for performance, differences in compensation by dependency status, Special and Incentive pays, the military health benefit, quality of life, and reserve compensation.

As part of its review of these same areas, the QRMC evaluated the DACMC's conclusions about the compensation system, and carefully considered each of its recommendations for change. However, while the data, analysis, and analytic framework included in the DACMC report contributed greatly to the 10th QRMC's efforts, the QRMC did not concur with all of the DACMC conclusions and recommendations. Instead, in some areas, the QRMC poses alternative recommendations—the question of strengthening the link between pay and performance being one such example. In other cases, the QRMC used the general strategies conceived by the DACMC to develop more specific recommendations focused on implementation, such as consolidation of Special and Incentive pays and retirement reform. But in the broadest philosophical terms, there is agreement between the two reviews about the crucial issues facing the compensation system and force management, as well as the key tenets for evaluating needed reforms.

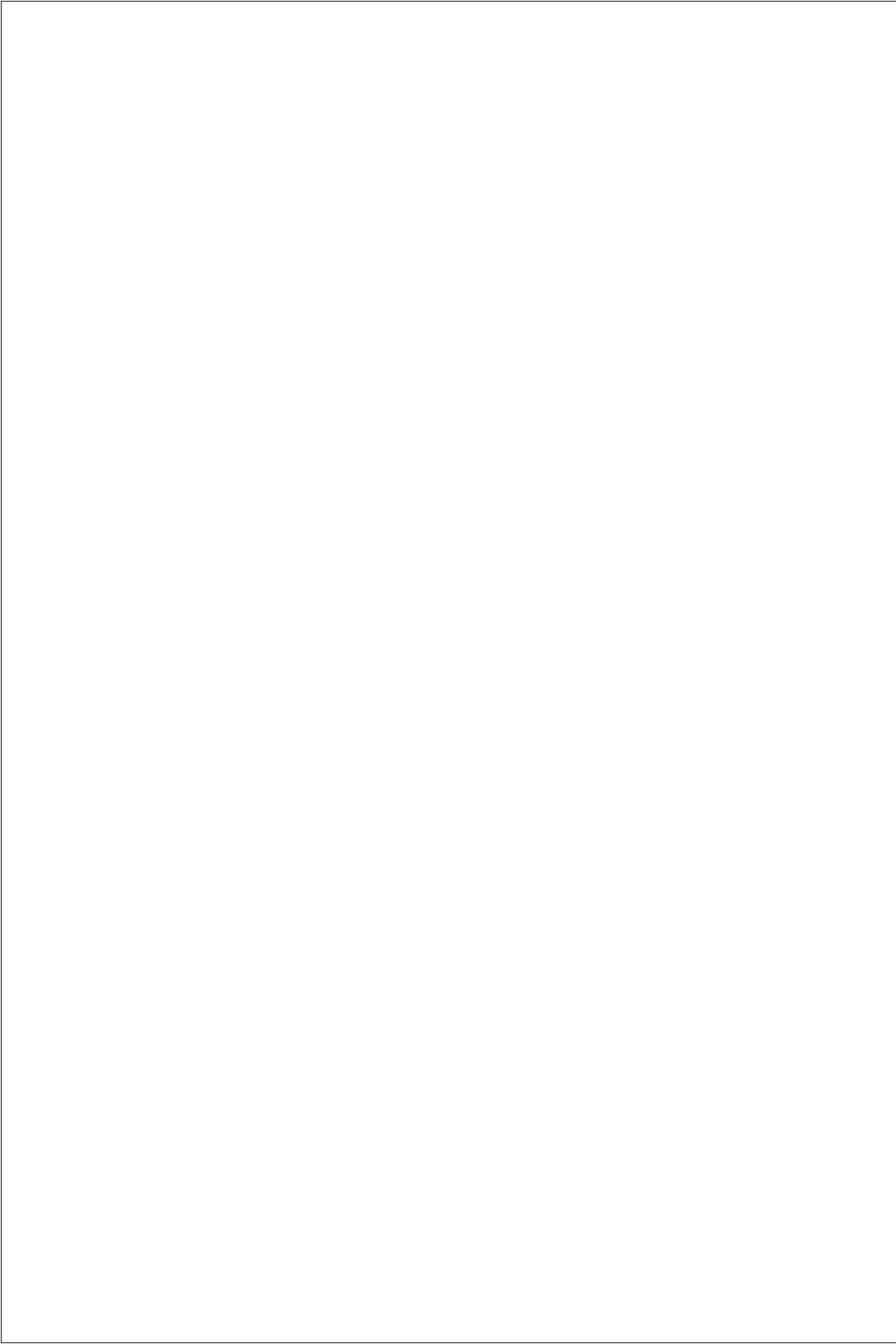
The 10th QRMC's recommendations are presented in multiple volumes. Volume 1 focuses on cash components of the military compensation system, while Volume 2 covers noncash and deferred benefits. Subsequent volumes contain research papers, sponsored by the QRMC, that address in analytic detail each of the areas covered in this review.

During the course of its deliberations, the 10th QRMC received support for many of its major recommendations. In a number of cases, steps toward implementation began before the release of this final report. Legislation supporting the consolidation of Special and Incentive pays

2. Defense Advisory Committee on Military Compensation, *The Military Compensation System: Completing the Transition to an All-Volunteer Force*, April 2006.

was included in the 2008 National Defense Authorization Act. Actions on other recommendations that did not require legislative changes have also been initiated; these include increasing the Basic Allowance for Housing rate for those without dependents (discussed in Volume 1) and negotiations regarding the use of flexible spending accounts (discussed in Volume 2).

The analyses and recommendations included in this report result from the substantial efforts of many talented and dedicated individuals, as well as a spirit of collaboration and support from the uniformed services. The rigorous analysis of complex compensation issues has resulted in a set of recommendations that will greatly improve the military compensation system in the future for both force management and the men and women in uniform.



Acknowledgments

As executive director of the Tenth Quadrennial Review of Military Compensation, I would like to thank all those who contributed their time and energy to this significant effort—from the members of the senior advisory board, to the compensation and health professionals working groups, to the extensive research staff. Over several years, these individuals, of varied backgrounds, brought expertise, experience, and innovative thinking to the compensation challenges facing the uniformed services.

Very special thanks go to the members of my immediate staff, Dr. Saul Pleeter of the Office of the Secretary of Defense; Lieutenant Colonel William Birden, USMC; Ms. Joan Byrd; and Mr. Bernard Robinson. Their dedication to this endeavor and unwavering support made my task as executive director far easier than it otherwise would have been.

I thank Dr. Curtis Gilroy, Ms. Vee Penrod, and Mr. Brad Loo, and their staffs in the Office of the Secretary of Defense, for their insight and many contributions during the course of this study. Special thanks are extended to Ms. Nina Fountain and Ms. Ann Mittermeyer of the Office of the Secretary of Defense, and to Dr. Anita Lancaster, Dr. Tim Elig, Dr. Robert Tinney, Dr. Jim Caplan, Dr. Brian Lappin, Mr. Kent Kroeger, and Ms. Kristin Williams of the Defense Manpower Data Center.

I am particularly appreciative of the continual support, encouragement, and insights of Mr. Bill Carr, Deputy Under Secretary of Defense for Military Manpower Policy; Ms. Sheila Earle, Principal Director for Military Personnel Policy; Ms. Leslie Arsht, Deputy Under Secretary of Defense for Military Community and Family Policy; and the Services' Assistant Secretaries for Manpower and Reserve Affairs. Mr. William Navas, Assistant Secretary of the Navy for Manpower and Reserve Affairs, and Ms. Anita Blair, Deputy Assistant Secretary of the Navy for Manpower and Reserve Affairs, were instrumental in our formulation of new concepts for military compensation. In addition, the wise counsel and wide latitude from The Honorable David S.C. Chu, Under Secretary of Defense for Personnel and Readiness, and The Honorable Michael Dominguez, Principal Deputy Under Secretary of Defense for Personnel and Readiness, made this work possible.

Acknowledgments

I am most grateful to Ms. Barbara Bicksler and Ms. Lisa Nolan for their dedication to the Tenth Quadrennial Review of Military Compensation. Ms. Bicksler's insights from previous QRMCs, the Defense Science Board, and the Defense Advisory Committee on Military Compensation made her an irreplaceable asset, ensuring that this review would be technically sound and policy-relevant. Thanks also to Mr. Greg Byerly for outstanding graphics design and Mr. Kevin Leonard for meticulous copy editing.

—Denny Eakle

Executive Summary

Compensation to service members is one of the largest components of the Department of Defense (DOD) budget. Its role in recruiting, retaining, and motivating the nation's uniformed service personnel also makes it one of the most crucial elements of the budget. Without adequate compensation, the nation would be unable to sustain the all-volunteer force, in the size and with the skill set needed, to support the missions called for in the national security strategy. Today's demands on the force in operational theaters around the world, competition from the private sector in recruiting and retention, and changing interests of today's youth all demand robust action on the part of the uniformed services in attracting and sustaining their workforce. A critical tool in that endeavor is the compensation system.

The Role of Military Compensation

The primary purpose of military compensation is to support defense manpower policies that in turn support the nation's defense strategy. To that end, as described above, the compensation system must attract, retain, and motivate the high-quality individuals needed to maintain a superior force that can meet the complex and challenging responsibilities facing today's uniformed services. But the system must also be structured and managed in a way that maximizes the impact and effectiveness of the substantial resources devoted to military compensation.

Flexibility in the compensation system is essential if the Services are to respond quickly and efficiently to changing staffing issues and mission objectives that reflect the realities of the high-level technology employed by today's force. In addition, compensation policies should encourage and reward top performance; promote workplace satisfaction by accommodating member preferences; and encourage service members to acquire the skills necessary to meet operational requirements. The system should also allow each Service to more effectively shape the composition of its force, in order to achieve the optimal mix of skills, experience, and seniority needed to meet its strategic objectives.

In its review of the compensation system, the Tenth Quadrennial Review of Military Compensation (QRMC) evaluated the adequacy of



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compensation provided to service members, as well as the overall cost-effectiveness and force management capacity of the system. In general, the system is extremely effective, offering a competitive compensation package that attracts and retains the high-quality individuals necessary to maintain an all-volunteer force. Moreover, force managers have access to a variety of tools, such as incentive bonuses and special pays, allowing them some flexibility to efficiently address specific staffing needs. However, the QRMC evaluation identified areas where changes to the system would improve force management capabilities, member satisfaction, and overall effectiveness.

Principles of Compensation

In directing the QRMC to carry out the President's charter, the Department of Defense instructed the review to develop "agile and flexible compensation and benefit tools to optimize force management strategies of the uniformed services." Thus, to guide its efforts, the QRMC established a set of principles that should underlie the compensation system. These principles, in essence, provided a reference point against which to test the QRMC's proposals and recommendations. Proposals that favorably support most or all of these principles would be judged to meet the goal of developing agile and flexible compensation and benefit tools, as the QRMC's guidance directed, as well as to meet the larger goal of recruiting, retaining, and motivating a highly qualified force. Further, these principles are offered not only as a benchmark for QRMC proposals, but also for future proposals and recommendations set forth by others aiming to improve the system that compensates the nation's uniformed service personnel.

The QRMC identified the following four principles as its guidelines:

1. **All-Volunteer.** Compensation policies support an all-volunteer workforce and members must perceive their compensation to be fair and equitable. Compensation incentives should support policies that guide qualified members to the assignments and locations where they are most needed in the organization while minimizing the costs to members and their families.
2. **Flexible, Responsive.** The Services must be able to quickly and effectively change compensation policies to respond to changing market conditions and Service requirements, in accordance

with human capital strategies. Acknowledging the need for coherent and consistent policies, each of the Services must have the discretionary authority to carry out its strategies and quickly address emerging problems and issues.

3. **Strategic Best Value.** Compensation policies must be aligned with other elements of the larger human capital strategies to produce the highest value—maximizing mission contribution and minimizing cost. Targeted compensation can provide cost-effective solutions to address Service-specific needs. Policies should reveal the full costs to current and future budgets, including costs that are derived from tax savings or passed to other departments or agencies.
4. **Support Achievement of Strategic Objectives and Outcomes.** Rational compensation policies support a hierarchy of strategic objectives and outcomes for successfully competing for talent, encouraging and rewarding performance, and recognizing contribution to mission. Compensation policies should reduce complexity to make linkages to objectives more direct, while making the system less difficult to manage and administer, and less difficult for personnel to understand.

These principles underpin a compensation system that must meet a wide range of essential and challenging force management goals that include recruiting and retaining sufficient numbers of high-quality and skilled individuals; encouraging and rewarding top performance throughout the force; effectively assigning personnel; promoting development of the skills necessary to meet occupational needs; and facilitating career transitions that meet both individual and force needs.

Themes of this Study

With these principles and goals as a backdrop for the QRMC's work, two themes emerged as critical drivers of system improvement: flexibility for the Services and choice for the member.

Flexibility

The compensation system should be able to respond quickly to changing force needs, operational demands, or problems in specific occupational areas. To accomplish this, force managers need the flexibility to

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adjust resources to reflect emerging issues or shifting priorities. They also need to be able to make targeted adjustments to specific problem areas. As policy makers seek to improve the compensation system, particular attention should be paid to reforms that enhance Service flexibility. Such reforms will make the system more effective, responsive, and efficient. While some flexibility exists in the current system, the QRMC's review revealed several instances in which system effectiveness and force management could be improved by increasing flexibility.

Although cash compensation is dominated by basic pay and allowances, force managers rely on some flexible pays to tackle changing staffing requirements and problems in specific occupational areas. Some of these compensation tools address short-term staffing needs, while others are used in response to more chronic manpower issues.

To address short-term recruiting challenges, force managers utilize accession bonuses, educational benefits, and shorter enlistment terms—as well as increased spending on recruiters and advertising—to attract new enlistees. Retention challenges are often handled through reenlistment bonuses. The Services rely on several special pays to address problems in specific hard-to-fill occupational areas, principally in the aviation and medical professions, where basic pay persistently lags behind private sector salaries. Rather than increase basic pay, which would inflate earnings for all service members, these special pays enable the Services to provide targeted increases to specific occupational areas where regular pay rates are too low to compete with private sector salaries.

While these compensation incentives are largely successful, certain aspects of the current system can limit their effectiveness and potential as force management tools. For example, special occupational pays often have limited flexibility. They may have upper limits on the amount of the payment, the size of the payment may be established by legislation and can only be adjusted by a change in the law, or they may be designed to only cover specific occupational areas. Further, budgets for these programs are developed more than a year in advance of execution, and once the budget is in place, funding often cannot be shifted among the different programs. Thus, when unanticipated recruiting or staffing challenges arise, the Services have to seek approval to realign their current budgets or request additional funds. While such requests are usually successful, they take time to achieve, meaning that the needed funds are often not available until several months after a problem surfaces.

The QRMC's recommendations include several proposals that would increase flexibility in the compensation system, including a proposal to consolidate the dozens of Special and Incentive (S&I) pays into several broad categories, as well as an authority to increase financial rewards to certain top performers and facilitate lateral entry of experienced individuals into the military. Recommendations for restructuring the retirement system also introduce greater flexibility into the system, providing tools to shape the profile of the force to better match mission requirements.

With added flexibility in the ability to tailor S&I pays to meet changing needs, the Services could explore other areas that potentially enhance force management capabilities, such as reforms that encourage reentry of former service members into the force or facilitate movement of personnel between the active and reserve components. Force-shaping capacity might also be improved if the Services had more flexibility in awarding incentive bonuses and testing new initiatives through pilot programs. Many such reforms have potential to make the compensation system more responsive to changing needs and mission goals.

Member Choice

A second key theme that underlies much of the QRMC's analysis is the concept of member choice—specifically, mechanisms within the compensation system that increase member choice. Certainly the demands of military operations, such as those ongoing in Afghanistan and Iraq, are such that personnel often have little control over the terms of their service; those terms are dictated by mission objectives and the personnel needs that flow from those objectives. Members frequently have little choice regarding their assignment, where they are stationed, or the frequency and duration of deployments. In some instances, however, member preferences are not inconsistent with operational requirements. In those cases, compensation policies can support member preferences by providing incentives that voluntarily steer qualified personnel to appropriate assignments. If properly designed, strategies that allow members more choice can raise job satisfaction, resulting in increased retention and productivity without damaging mission outcomes.

The Services have begun to recognize the benefits of providing members with more choices—as long as their preferences are consistent with military operational requirements. Since 2003, for example, the Navy has operated an Assignment Incentive Pay (AIP) program that allows qual-

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ified personnel to bid for certain hard-to-fill billets through sealed on-line auctions. Interested sailors bid the amount of additional pay they would want to receive in order to accept a particular open assignment. Because sailors have different preferences regarding assignments, the amount of additional pay that they might request in order to accept a specific posting will vary, with some sailors willing to take on an assignment for much less additional compensation than others might demand for the same assignment. Typically, the qualified sailor who submits the lowest bid receives the assignment.

Taking into account individual preferences can increase member satisfaction and retention. Member participation in the AIP program has increased substantially in the five years since the program began; and as of October 2007, about 8,750 jobs had been assigned through the program, with only 5 percent of those positions filled involuntarily. Providing qualified members with some choice in their assignment can also reduce costs—sailors assigned to billets they prefer require less additional pay than sailors who have been assigned to billets involuntarily. In fact, one analysis estimates that annual savings from converting all Sea Pay billets to an auction system would total more than \$100 million. The Services should explore other pays, such as reenlistment bonuses, which could potentially use an auction mechanism to incorporate member preferences into payment rates.

Member preference can also be factored into other areas of the compensation system, including benefits. Flexible benefits, such as cafeteria plans and flexible spending accounts (FSAs), for example, allow employees to make decisions about the types and levels of benefits they receive. Popular in the private sector, such plans have potential applicability in the military as well. To that end, the QRMC has included such programs in its assessment and recommends that the Services consider whether such plans are a viable option for the military.

Finally, another aspect of member choice has to do, at a fundamental level, with the enlistment and reenlistment decision. When members choose to enter into service or reenlist at the end of their service obligation, the adequacy of their compensation will be an important, and sometimes principal, factor in that decision. “Member taste” for military service is an important element in evaluating the adequacy of compensation. Providing greater member choice increases member satisfaction, which, in turn, can

have a positive impact on reenlistment decisions. Thus, changes to the compensation system that make compensation more equitable to service members, that ensure comparability with compensation in the civilian sector, or that address quality-of-life matters affecting service members and their families, can significantly impact recruiting and retention choices.

By increasing flexibility and member choice in the compensation system, the Services will be able to more readily adapt to the changing views and values of the next generation of recruits.

Elements of Compensation

Service members receive a compensation package composed of cash, as well as in-kind or noncash benefits (such as housing) and deferred benefits (such as retirement). Compensation varies by grade, years of service, geographic location, and dependency status. A recent study by the Government Accountability Office (GAO) concluded that cash payments make up approximately 48 percent of average military compensation, in-kind benefits another 21 percent, and deferred compensation 31

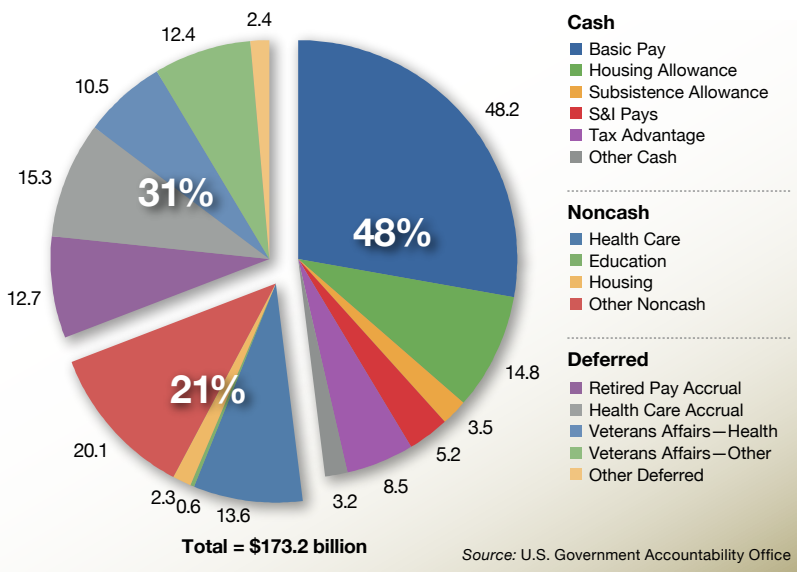


Figure ES-1. Major Components of Military Compensation, Fiscal Year 2006



percent.³ Figure ES-1 shows the major components of military compensation, which are described below.

Cash Payments

Cash compensation makes up nearly half of service member compensation. The major elements of cash compensation are basic pay and allowances for housing and subsistence. Together with the federal income tax advantage resulting from tax-exempt allowances, these elements are referred to as Regular Military Compensation (RMC). RMC is the portion of military compensation typically used in comparisons of military and civilian compensation. Cash compensation also includes special pays, bonuses, and other allowances.

- **Basic Pay.** Basic pay makes up approximately 60 percent of RMC and is paid to all personnel.⁴ Basic pay rates are based on rank and years of service, with pay increasing as service members are promoted to higher grades or accumulate additional years of service. Monthly pay amounts for each grade and year of service are provided in the basic pay table. Enlisted personnel pay grades range from E-1 for entry-level positions such as private, to E-9 for the most senior enlisted positions. Most of the enlisted force is junior, in rank E-4 and below.

The pay table is generally updated each January to reflect increases in private sector wages. By law, the annual adjustment is to be equal to the Employment Cost Index, but is often modified by Congress in response to concerns about military pay levels.⁵ From 2000 through 2006, for example, Congress authorized basic pay to increase 0.5 percentage points above the Employment Cost Index.⁶

3. U.S. Government Accountability Office, *Military Personnel: DOD Needs to Establish a Strategy and Improve Transparency over Reserve and National Guard Compensation to Manage Significant Growth in Cost*, "Appendix I: Updated Active Duty Compensation Costs," GAO-07-828 (Washington, D.C.: June 20, 2007) http://www.gao.gov/new_items/d07828.pdf.
4. For a more detailed discussion of the basic pay table, see Volume 1, Chapter 4 of the 10th QRMC report.
5. Office of the Secretary of Defense, Military Compensation, *Annual Pay Adjustment*, http://www.defenselink.mil/militarypay/pay/bp/05_annual_raise.html.
6. Congressional Budget Office, *Evaluating Military Compensation* (Washington, D.C.: June 2007).

- **Housing Allowance.** The second largest component of RMC is the Basic Allowance for Housing (BAH), a tax-exempt cash payment designed to cover housing costs of service members not living in government housing. The BAH is based on pay grade, with payments increasing as members advance to higher grades. BAH rates also vary by family status. On average, the BAH for service members without dependents is about 23 percent lower than the BAH for those members with dependents who are at the same pay grade and year of service. Because of wide variations in housing costs across the country, BAH rates also are adjusted by geographic location.
- **Subsistence Allowance.** The Basic Allowance for Subsistence (BAS) is a cash payment designed to defray the costs of service members' meals. Unlike BAH payments, BAS payments do not vary by pay grade. Instead, there is one rate for enlisted personnel (\$294.43 per month in 2008) and another for officers (\$202.76 per month in 2008). Further, because BAS payments are not intended to cover the meal costs of military dependents, rates do not vary by dependency.⁷ On average, the BAS comprises approximately 7.2 percent of enlisted RMC and 2.6 percent of officer RMC.
- **Special and Incentive Pays.** In addition to RMC, many service members also receive S&I pays. Unlike basic pay, which is paid to all service members at statutorily mandated levels, the Services can award S&I pays selectively in response to specific force management needs within limits prescribed by law. S&I pays generally are used to address staffing shortfalls in specific occupational areas, compensate members for hazardous or otherwise less desirable duty assignments, and encourage attainment and retention of valuable skills. In addition, in some occupational categories, such as certain technical and professional fields, special pays are used to ensure pay comparability with civilian sector salaries. Some of the most commonly awarded S&I pays include the Selective Reenlistment Bonus, Aviation Career Incentive Pay, Career Sea Pay, Hardship Duty Pay, and Medical Officers Variable Special Pay.

7. Office of the Secretary of Defense, Military Compensation, *Basic Allowance for Subsistence (BAS)*, <http://www.defenselink.mil/militarypay/pay/bas/index.html>.

Given the flexibility associated with S&I pays, the amount of such pays that personnel receive can vary considerably, depending on a member's occupation, assignment, and Service. On average, S&I pays for enlisted members totaled approximately \$3,000 in 2006, or 6.6 percent of total cash compensation. In the same year, S&I pays for officers averaged \$7,000, or 7.3 percent of cash compensation. While these pays can make up a significant portion of members' cash earnings in certain occupational categories, such as the health professions, they are not included in the calculation of RMC since most personnel do not receive these pays.

- **Tax Advantage.** The housing and subsistence allowances are exempt from federal and state income taxes, as well as from Social Security taxes (Federal Insurance Contributions Act, or FICA).⁸ The federal income tax advantage is included in the calculation of Regular Military Compensation. The value of the tax advantage varies depending on a member's tax bracket and number of dependents, but the Department of Defense estimates that, on average, it accounts for 6.1 percent of RMC.
- **Other Cash Payments.** Other cash payments include miscellaneous allowances, such as cost-of-living allowances.

Noncash Benefits

As Figure ES-1 shows, over 20 percent of service member compensation is composed of benefits such as health care, educational assistance, government housing, and subsistence in kind.

- **Health Care.** All service members and their dependents are eligible for comprehensive health care services through TRICARE. Health care services are primarily provided at military treatment facilities, but can also be accessed through a network of civilian health care providers. TRICARE is provided to personnel and their dependents free of charge, with service members paying neither premium contributions nor deductibles or copays.

8. FICA is the Federal Insurance Contributions Act tax for Social Security and Medicare old-age benefits.

- **Education.** The Services offer a comprehensive array of educational benefits that support members' continuing education while they are in the military and after they return to civilian life—examples include scholarship, loan repayment, and tuition assistance programs.
- **Housing.** In 2006, approximately 43 percent of military personnel lived in government quarters. The remainder of the force received a cash allowance to cover the costs of their nongovernmental housing. The value of government housing varies considerably, depending on member rank; number, age, and gender of dependents; and duty assignment. Many single service members in the junior ranks, for example, reside in barracks-style housing on base or aboard ships. In contrast, members with dependents and more senior personnel who reside in government housing typically live in larger, more valuable units, including townhouses and single-family detached homes.
- **Other Noncash Benefits.** In addition, there are a considerable number of other noncash benefits available to service members, including annual leave, commissaries, fitness facilities, exchanges, golf courses, bowling centers, libraries, and many family-oriented services.

Deferred Benefits

Approximately 30 percent of military compensation dollars cover the costs of future, or deferred, benefits, principally military retirement payments and retiree health care. While these benefits are not provided to active duty members, the accrual costs of financing such future liabilities are included in the military personnel budget.

- **Retirement Pay Accrual.** Under the current compensation system, members who serve at least 20 years in uniform receive an inflation-protected lifetime annuity immediately upon retirement. A defined benefit, the annuity provides 2.5 percent of the average of a member's "high-3" years of basic pay for each

year of service.^{9,10} While many consider the retirement benefit generous relative to private sector pensions, most members do not remain in service long enough to become eligible for retirement pay. In fact, DOD estimates indicate that less than 15 percent of the enlisted force, and 47 percent of officers, will become eligible for military retirement.¹¹

In order to cover future military retirement costs, funds are deposited annually into the Military Retirement Fund. It is important to remember, however, that while the cost of future retirement benefits per member is substantial, only a small fraction of enlisted members will ultimately receive a military retirement annuity.

In addition to the defined retirement benefit available to those who serve for 20 years, military service members also can contribute to the Thrift Savings Plan (TSP) that is also offered to federal civilian employees. Unlike the benefit offered to federal civilian employees, however, DOD does not match service members' contributions to the TSP. Thus, the principal benefit of the TSP option is that it enables personnel to contribute more dollars into a tax-deferred retirement plan than would otherwise be allowed in a typical individual retirement account.

- **Health Care Accrual.** Like their active duty counterparts, military retirees and their families are also eligible for comprehensive health care services through the TRICARE program. In 2006,

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9. Defense Advisory Committee on Military Compensation, *The Military Compensation System: Completing the Transition to an All-Volunteer Force*, April 2006.
 10. While the majority of service members receive a retirement annuity based on a member's high-3 years of basic pay, there are actually three retirement plans currently in effect. Retired pay is based upon final month's basic pay for members who entered service prior to September 8, 1980. For those who entered service after September 8, 1980 but before July 31, 1986, retired pay is computed based on the high-3 years of basic pay. Members of the uniformed services who entered service on or after August 1, 1986 have a choice of two retirement programs: 1) the high-3 retirement program or 2) REDUX and a \$30,000 Career Status Bonus at 15 years of service. REDUX is a provision of the Military Retirement Reform Act of 1986, under which members receive a reduced annuity upon retirement if they retire with less than 30 years of service.
 11. U.S. Department of Defense, *Valuation of the Military Retirement System* (Washington, D.C.: Office of the Actuary, September 30, 2003), 12.

the DOD accrual cost of funding the TRICARE for Life future liability was just over \$15 billion, or about \$10,000 per member. In comparison, the 2006 cost of providing health care services to active duty members and their families was about \$13 billion.

- **Veterans Affairs.** In addition to health care and retirement, veterans also may be eligible for other benefits administered by the Department of Veterans Affairs, including educational assistance under the Montgomery G.I. Bill, home loans, disability compensation, and vocational assistance.
- **Other Deferred Benefits.** This category includes Department of Treasury contributions to deferred benefit programs for service personnel.

Findings and Recommendations

The 10th QRMC focused its attention on seven compensation-related areas:

1. adequacy of compensation
2. special pays and bonuses
3. pay for performance
4. housing allowance
5. retirement system
6. health care
7. quality of life

The first four topics, elements of cash compensation, are addressed in Volume 1 of the QRMC's report. The latter three are covered in Volume 2 on deferred and noncash compensation. Summarized below are the 10th QRMC's key findings and recommendations.

Military Annual Compensation

In order to sustain a high-quality force in the numbers and skills needed, the uniformed services must offer a compensation package that is competitive with civilian sector wages and benefits, and recognizes the unique responsibilities and burdens of military life. The history

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of the all-volunteer force has shown that when military compensation falls relative to wages paid to civilians with comparable education and experience, recruiting and retention suffer. Thus it is critical to assess, on a regular basis, the adequacy of compensation paid to service men and women.

Traditionally, this assessment has been based on a comparison of cash compensation between the two sectors, with Regular Military Compensation serving as the measure of military cash compensation. Regular Military Compensation is composed of basic pay, the Basic Allowance for Housing, the Basic Allowance for Subsistence, and the federal income tax advantage resulting from tax-exempt allowances. But this approach leaves out several very important components of the compensation package offered to those in uniform—benefits and some tax advantages. Benefits to service members are substantially more valuable than those typically offered in the civilian sector, and members can also receive tax advantages not available in the private sector. Taking these additional components into account shows that service member compensation is much more generous relative to civilian compensation than the traditional comparison of cash pay would suggest (Figures ES-2 and ES-3).

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In fact, the average enlisted member earned approximately \$5,400 more in 2006 than his or her civilian counterpart when comparing cash compensation, but \$10,600 more when selected benefits are included in the comparison. The typical officer received an average of \$6,000 more than civilians with comparable education and experience based on traditional cash comparisons, but \$17,800 more with benefits included. Thus, the 10th QRMC concluded that a more meaningful comparison of uniformed and civilian compensation should include selected elements of in-kind and deferred benefits—elements that are tangible, generally part of civilian compensation, and widely available—as well as cash compensation. The value of the additional tax advantages and benefits included in Military Annual Compensation are 13 to 26 percent higher than Regular Military Compensation for enlisted members and 8 to 27 percent higher for officers. The QRMC believes that omitting military benefits from the comparison results in an incomplete analysis that substantially understates the value of the Services' compensation package.

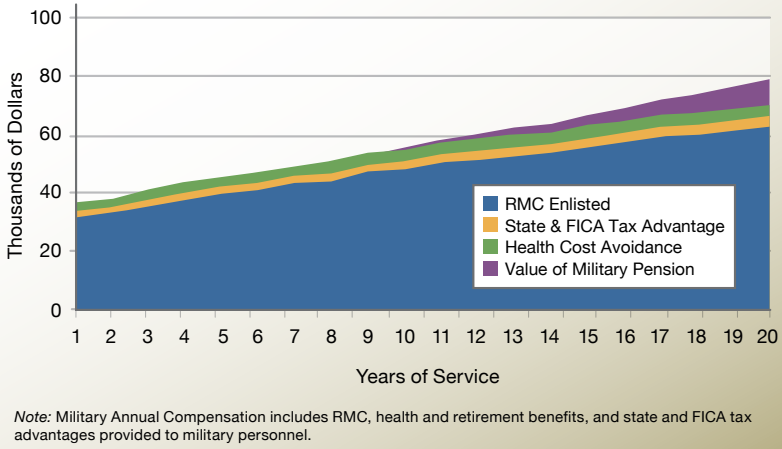


Figure ES-2. Military Annual Compensation for Enlisted Personnel, 2006

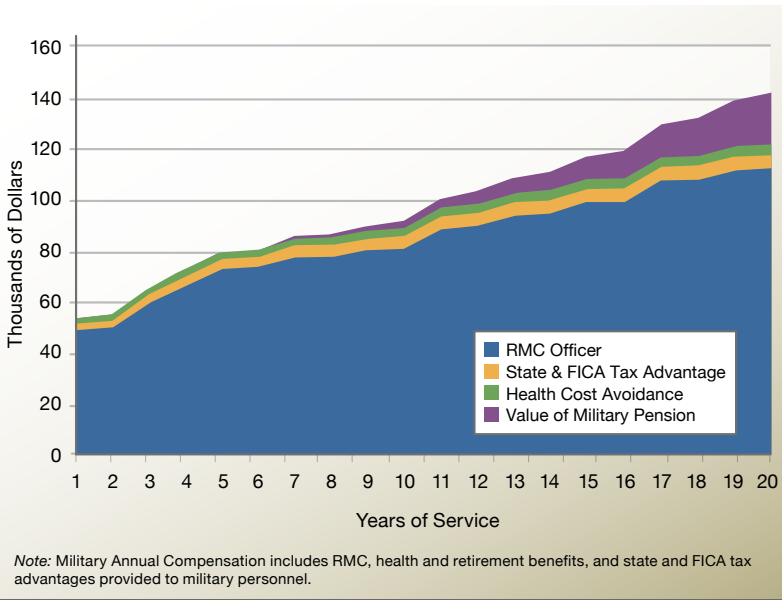


Figure ES-3. Military Annual Compensation for Officers, 2006

RECOMMENDATION

Adopt Military Annual Compensation as the basis for future pay comparisons between the uniformed services and the civilian sector.

Military Annual Compensation includes cash compensation (Regular Military Compensation) as well as health care, retirement, and the state and Social Security tax advantages. The 9th QRMC recommended that cash compensation for military personnel be comparable to the 70th percentile of compensation for civilians with similar education and experience. To maintain this same standard, Military Annual Compensation should meet the 80th percentile of comparable civilian compensation. This new measure offers both a more meaningful basis for comparing uniformed and civilian compensation as well as a tool to better explain to service members the value of their compensation—something not well understood today.

Special and Incentive Pays

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In addition to basic pay and allowances, many service members receive Special and Incentive pays. These pays are used by the Services to selectively address specific force management needs, such as staffing shortfalls in particular occupational areas, hazardous or otherwise less desirable duty assignments, and attainment and retention of valuable skills. In addition, in certain occupational categories, such as technical and professional fields, special pays are used to ensure pay comparability with civilian sector salaries. These pays offer flexibility to the compensation system not otherwise available through the basic pay table.

Despite its valued flexibility, there are several aspects that limit the effectiveness of the current S&I pay system and its potential as a force management tool. First, the large number of pays currently available makes the system unwieldy and difficult to administer and oversee. Second, the degree of flexibility among the many pays varies. Some can be used to address short- or long-term personnel issues across a range of occupations or assignments, while others are more narrowly focused, with strict statutory limits on how they are disbursed. Furthermore, these pays do not motivate personnel to top performance, as they are not, in most cases, linked to pay grade.

Consolidating the many existing pays into a smaller number of broad categories would offer a number of advantages in terms of efficiency, flexibility, and effectiveness, and would address some of the concerns with the current system. Under such a plan, a limited number of pay categories would replace the more than 60 pays that exist today. Within each category, the Services would have flexibility to allocate resources to those areas that would most effectively and efficiently meet staffing needs. S&I resources would thus be concentrated on the force's most critical staffing issues.

RECOMMENDATION

Consolidate S&I pays into eight broad categories:¹²

1. Enlisted Force Management Pay
2. Officer Force Management Pay
3. Nuclear Officer Force Management Pay
4. Aviation Officer Force Management Pay
5. Health Professions Officer Force Management Pay
6. Hazardous Duty Pay
7. Assignment or Special Duty Pay
8. Skill Incentive/Proficiency Pay

Within these categories, the Services will have the flexibility to set pay rates and eligibility criteria, and allocate resources to meet staffing needs. The proposal also authorizes the Secretary of Defense to establish eligibility criteria as warranted by changing mission needs.

It is clear that the current budget for S&I pays may be hard pressed to meet force management requirements in the future. For example, as the Army and Marine Corps increase total strength over the next few years, more recruiting and retention incentives will be required. Increasing such incentives will in turn require a larger budget for S&I pays—resources that must be obtained either by an increase in the S&I budget directly, or

12. This recommendation was enacted in the Fiscal Year 2008 National Defense Authorization Act.

through a combination of reductions from other areas of the budget and requests to Congress for supplemental funds. Neither of these latter two options is likely to provide the depth of resources required.

RECOMMENDATION

To ensure sufficient resources are available to most effectively use this more flexible system, reallocate between basic pay and S&I pays the portion of future pay raises that exceeds the Employment Cost Index. Once it is determined that the S&I pay budget is in correct proportion to other forms of cash compensation, further increases should be tied directly to increases in basic pay.

Reallocation of pay raises is not unprecedented. Previous pay raises have been allocated among various components of compensation in addition to basic pay (such as to realize increases in the housing allowance), or have been targeted to specific grades or years of service. It is important to note, however, that this recommendation assumes that pay comparability between the uniformed services and the civilian sector, which currently exists, will continue. Should that change, the entire pay raise should be applied to basic pay until pay comparability has been reestablished. Thus, DOD will have to continue to monitor military and civilian pay rates to ensure pay comparability is maintained under this allocation scheme.

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RECOMMENDATION

To ensure sufficient oversight, guidance, and coordination within this more flexible system, create an oversight committee to review the Services' S&I pay programs.

The oversight committee would have two tiers—a working group to handle the bulk of S&I pay issues that arise, and a senior oversight group to address issues that cannot be resolved by the working group. The committee would be responsible for providing clear program parameters and a consistent, rigorous, and defensible review process, while still allowing the Services greater autonomy in setting S&I pay levels and eligibility. Under this construct, the Secretary of Defense would have ultimate authority regarding policy decisions guiding S&I pay.

The new consolidated S&I pay system should become fully operational not less than three years after enactment. This time frame will give the Secretary and the Services adequate time to establish program regulations, revise budgetary systems, and prepare the force for change.

Pay for Performance

The QRMC believes that the uniformed services' compensation system should do more to recognize outstanding performance among service members and their contributions toward organizational goals and missions. Today, the Services primarily recognize performance through the promotion system, which advances service members in rank. Basic pay is calculated from a pay table based upon rank and time in service; thus a service member's compensation rises as he or she progresses to higher grades and accumulates more years of service.

When service members are promoted early, their pay is increased relative to the pay of their cohorts who are promoted a year or two later. However, due to the longevity component in the current basic pay table, the higher pay associated with an early promotion is not sustained beyond the point at which the member's on-time promotion would have occurred. The longevity component also hampers the Services' ability to offer competitive compensation to lateral entrants into the military or to individuals who leave military service and return later in their careers.

As a result, many groups have questioned whether a time-in-service table, with its dual emphasis on performance and longevity, is the best way to encourage top performance among military personnel. The most commonly considered alternative has been a time-in-grade table, in which a service member's position in a pay grade is determined by how many years he or she has been in that grade, not by how many years he or she has been in the military. Hence, under this system, a member promoted a year early to a pay grade is permanently one year further along in the pay grade as compared to those who receive due-course promotions.

This approach also has its weaknesses. The most common argument against a time-in-grade pay table is the fact that promotion speed is not always based on performance, but is sometimes due to supply and demand of personnel in a particular occupational area. Under those circumstances, the time-in-grade pay table would not be rewarding better performance and could exacerbate pay differentials that currently exist between personnel

in fast- and slow-promoting occupations. Another concern, compelling to the QRMC, is that adoption of a time-in-grade pay table would result in a major overhaul of the current pay system in order to improve compensation for a small percentage of the force.

RECOMMENDATION

Retain the current time-in-service pay table, rather than replace it with a time-in-grade pay table. Instead, adopt constructive credit to better reward service members who are promoted early and facilitate lateral entry into the force, thereby offering a means to provide service members with permanent credit for additional time in service.

The use of constructive credit would allow the Services to credit individuals with extra years of service for purposes of calculating their basic pay. This proposal is designed to give the Services flexibility within the existing pay table to reward top performance and offer competitive compensation to high-quality service members. In addition to this recommendation, the QRMC believes that the Services should consider other pay-for-performance concepts—such as credential pay and performance-based bonuses—that could strengthen the link between pay and performance.

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Basic Allowance for Housing

An integral part of the compensation system, the Basic Allowance for Housing is designed to provide military personnel in nongovernment housing with the resources necessary to live in housing comparable to their civilian counterparts. The QRMC believes that this program could be improved to make it more equitable among service members and to better meet its intended purpose. Three issues were addressed.

The first concern with BAH is the pay differential that currently exists between those with and without dependents. BAH rates vary by pay grade, geographic location, and dependency status. Thus, service members of the same rank but different dependency status receive different BAH payments, with the higher allowance paid to those with dependents. QRMC analysis showed that BAH rates for members without dependents averaged 67 percent of the rates paid to those with dependents. BAH payments for service members without dependents tend to be less than the housing expenditures of comparable civilians without dependents—a result of the fact that civilian housing expenditures do not vary significantly based on

dependency status, but rather based on age, education, and income. As a result, personnel without dependents tend to pay higher out-of-pocket costs for housing that is comparable to their civilian peers than do their counterparts with dependents.

RECOMMENDATION

Narrow the BAH dependency differential, so that all members without dependents will receive BAH payments equal to 95 percent of the “with-dependents” rate for their pay grade.

To implement this recommendation, the QRMC proposes that BAH payments to members without dependents initially be set to at least 75 percent of the with-dependents rate and increase by 5 percentage points per year over the subsequent four years.¹³

A second concern is the adequacy of government housing for single members and the implied rents charged for that housing. Partial BAH is paid to service members without dependents who live in government housing that is generally considered to be less valuable than the BAH payment they would receive if they lived in private housing—such as junior members of the force who live in barracks or aboard ships. Partial BAH payments have not been increased since first enacted in 1977.¹⁴ As a consequence, single members living on base have not received the same increased compensation as have their counterparts living in nongovernmental housing.

RECOMMENDATION

Adjust Partial BAH payments to more appropriately compensate single members in certain government quarters for their reduced standard of living. Specifically the QRMC recommends that Partial BAH be expanded to include a second component based upon the adequacy of a member’s quarters.

13. This 75 percent floor was adopted in January 2008.

14. The 1977 Department of Defense Authorization Act gave the President authority to reallocate pay raises among basic pay, the housing allowance, and the subsistence allowance whenever he determined such action to be “in the best interest of the Government.” The QRMC recommendation on partial BAH refocuses this payment on the adequacy of certain government quarters.

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The additional payments would range from 5 percent to 25 percent of BAH, with the amount of supplemental payment varying based upon actual housing conditions.

Finally, the QRMC examined the accuracy of BAH program budgetary estimates. In recent years, BAH budget estimates have woefully underestimated actual program costs. There are concerns that this inaccuracy is a result of the timing and duration of the rate-setting process—a process that begins nearly 18 months before the budget year begins. However, a review of the data suggests that the problem is with neither the rate-setting process nor the rates themselves. Rather, the primary source of error in the BAH budget has been the underestimation of the population eligible for BAH.

RECOMMENDATION

No changes are recommended in the timeline or methodology of the BAH rate-setting process. Rather, it is important for the Defense Department to continue to improve its procedures for estimating the BAH-eligible population to ensure that the BAH budget is as accurate as possible.

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Several factors skew results in estimating the size of the population eligible for BAH and adjustments to address these issues should be considered. One strategy is to take into account trends in dependency status in the population estimates. A second is to improve the forecast of and assumptions regarding reserve component members who will be mobilized and entitled to housing allowances.

Military Retirement

The military retirement benefit is a major component of military compensation, costing approximately \$13 billion per year, or over 7 percent of current active duty personnel costs. It is a noncontributory, defined benefit plan that is available immediately upon retirement to active duty military personnel who have served a minimum of 20 years. Members of the reserve components are also provided a retirement benefit after 20 years of creditable service, but reservists generally must wait until age 60 before drawing retired pay. Although the retirement system provides a substantial benefit to eligible retirees, it is important to

note that the vast majority of service members never receive a retirement payment. According to the Department of Defense, less than 15 percent of enlisted personnel and 47 percent of officers become eligible for the military retirement benefit.

Military retirement reform has been a topic of lengthy review and discussion, dating back to the 1948 Hook Commission and continuing to the present day. Concerns with the system tend to focus on three areas: the system is inequitable, inflexible, and inefficient.

The *equity argument* stems from the fact that the benefit does not vest until 20 years of service, so only a small fraction of the force ever receives retirement pay. The different treatment of reserve component members is another area of concern, particularly as their contributions to military operations have expanded over the past decade, making them an increasingly essential part of the total force.

An equally important argument involves the impact of the current system on the shape of the force and on member retention patterns, which *greatly reduces the flexibility* force managers have to influence military careers. Personnel who reach 10 to 12 years of service have a strong incentive to remain in the military for a 20-year career; similarly, the Services are reluctant to separate members after they reach 15 years of service, knowing that they will leave with no retirement benefit. Moreover, it also encourages personnel to leave at 20 years of service, once they are eligible for the benefit, even if the Services want to retain them.

This “one-size-fits-all” approach encourages all personnel to follow the same career path regardless of whether it is consistent with Service needs or appropriate for a particular occupation. It is often desirable, for example, for “youth and vigor” occupations to have shorter careers, while in certain professional fields longer careers are desirable. Because of the 20-year vesting point, it is difficult for force managers to shape careers in ways that would better match changing Service requirements.

Finally, the fact is that the current military retirement system is made up entirely of deferred compensation, *which is less efficient than current compensation*. It costs the government more to provide the retirement benefit than its value to many military personnel, primarily due to the relatively young population in the uniformed services, who tend to value cash in hand over compensation paid in the future. A retirement benefit with both cash and deferred elements would be more efficient than the

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current system of deferred benefits only—less costly to the government and of greater value to the service member.

Based on these concerns, the QRMC judged that retirement reform, leading to a more flexible, cost-effective, and equitable system, would benefit the uniformed services and service members. The underlying philosophy of the QRMC proposal was to replace some of the current system's deferred benefits with cash compensation, thus improving cost-effectiveness and introducing flexibility. The foundation of the system would be a defined benefit plan and a defined contribution plan, as well as earlier vesting. The system would also include other elements of cash compensation that force managers could vary to achieve different retention patterns.

The key elements of the QRMC retirement plan are as follows:

- **A defined benefit plan** providing retirement pay equal to 2.5 percent of high-3 annual basic pay multiplied by the number of years of service. The benefit would be payable at age 57 for those with at least 20 years of service and at 60 for those with fewer than 20 years. The plan would vest at 10 years. Members who opt to receive the defined benefit immediately upon retirement would receive a reduced benefit.
- **A defined contribution plan** under which DOD would annually contribute up to 5 percent of basic pay (the precise contribution would vary based on years of service).¹⁵ The plan would vest at 10 years of service and begin paying benefits at age 60.
- **Gate pays** payable at specified year-of-service milestones.
- **Separation pay** provided to members when they leave the military.

The defined benefit and defined contribution elements would be the same across the uniformed services. However, requirements for gate pay and separation pay are expected to vary across the Services and by occupation depending on factors such as force needs and occupational characteristics. The QRMC plan does not distinguish between reserve and

15. Specifically, the contribution rate would equal zero percent of annual basic pay for those with less than a year of service; 2 percent for members with up to two years of service; 3 percent for those with more than two but less than four years of service; 4 percent for personnel with four but less than five years of service; and 5 percent for those with five or more years of service.

active duty service members—both would have the same vesting requirement and become eligible for the defined benefit and defined contribution benefit at the same age.

This system offers many benefits. Vesting the retirement benefit at 10 years of service would substantially expand the number of personnel eligible for a retirement benefit, resulting in a more equitable system. Earlier vesting, gate pays, and separation pays would enable force managers to achieve more variation in career lengths, while continuing to allow personnel to choose how long they prefer to remain in the military. Such elements infuse flexibility into the system and would enable force managers to change the retention patterns that have long dominated the shape of the force. Further, the combination of current and deferred elements leads to greater efficiency and lower cost to the government.

This proposal, while sound in its construct, does represent a significant reform with potential for considerable impact on recruiting and retention. Thus, the QRMC believes that a field test of the reform proposal should be conducted before any system changes are implemented force wide.

RECOMMENDATION

DOD should conduct a multiyear demonstration project of the QRMC's proposed retirement benefit prior to implementing the new system force wide.

DOD should undertake a demonstration project to better ascertain the new system's actual effects on the force—including the impact on retention, costs, vesting, and other critical elements of force management. The test should include a representative sample of enlisted personnel and officers who will substitute the new retirement system for the current system. The test should run for a minimum of five years. Participation should be voluntary but participants should be drawn from all four DOD Services, the active and reserve components, as well as from diverse occupational areas in which different career lengths are desired. A test constructed along these lines would enable the Department to determine whether the proposed system is sufficiently flexible to achieve a range of different retention patterns and career lengths. Precedent for such demonstration projects exists.

Health Care

No single benefit affects more of the active duty, reserve, retired, and dependent populations than the military health care benefit. From the perspective of compensation, health care is the largest and most important noncash incentive for personnel to join and remain in military service. Other than retirement pay, it is also the most significant component of compensation for retirees and their families. Maintaining a quality military health care system is essential—both to force readiness and as a highly valued element of compensation.

The QRMC examined two aspects of military health care: system costs of the health benefit and recruiting and retaining health care professionals.

Military Health Care Benefit

Health care benefits to the military are generally provided through TRICARE. Beneficiaries can choose among three health plans: TRICARE Prime, a health maintenance organization; TRICARE Extra, a preferred-provider network; and TRICARE Standard, a point-of-sale plan. In addition, TRICARE for Life, introduced in 2001, provides a lifetime benefit for Medicare-eligible military retirees age 65 and over and their dependents. A major attribute of the military health care package is its low cost to beneficiaries—premium contributions, copayments, and deductibles that are substantially lower than typically found in civilian health plans.

Although TRICARE costs have increased in recent years along with civilian health care costs, these costs have not been passed on to beneficiaries. Active duty personnel and their families continue to pay no premium for their TRICARE Prime coverage and the premiums charged to military retirees under age 65 have remained the same since 1996. Other out-of-pocket costs, such as deductibles or copayments, have also remained fixed or have been reduced in recent years. Retirees over age 65 have experienced increased premium costs, as they are required to pay Medicare Part B premiums to participate in the TRICARE for Life program—premiums that have increased considerably.

Since the creation of TRICARE more than a decade ago, the health care benefit has continued to improve and expand. But program costs have increased significantly as well and are expected to continue to do so into the future—which constitutes a growing budgetary problem for the Department of Defense. In part, increased costs simply reflect

the skyrocketing cost of civilian sector health care purchased by the Department. They also reflect the fact that higher costs have not been passed along to beneficiaries in the form of higher premiums or out-of-pocket expenditures. Moreover, the number of military retirees continues to grow and, in fact, is a key driver in the growth of purchased care expenditures. Finally, the TRICARE system does little to encourage users to select cost-effective options for their health care.

While many groups have evaluated and recommended options for curbing the military health program's persistent cost increases, these proposals have not been adopted. The QRMC believes that the Department must take steps to mitigate the upward trend in military health care costs and makes recommendations designed to improve the equity of the military health care benefit and promote more cost-effective choices among program participants.

TRICARE Premiums for Military Retirees

Military retirees under the age of 65, who are enrolled in TRICARE Prime, are still paying the same premiums they paid in 1996, while those using TRICARE Standard/Extra pay no premiums. Yet older retirees, who are less likely to be employed and generally have lower incomes relative to their younger counterparts, are required to maintain Medicare Part B in order to qualify for TRICARE for Life—the costs of which have increased more than 85 percent since 2001. The QRMC finds this situation inherently inequitable. TRICARE fees should be fair to all retiree populations and—consistent with trends in Medicare—should cover a larger portion of health care costs and reflect beneficiaries' ability to pay.

RECOMMENDATIONS

Set TRICARE Prime premiums for single retirees under age 65 at 40 percent of the Medicare Part B premium, with the family rate set at twice the single rate, regardless of family size. Set TRICARE Standard/Extra premiums for single retirees at 15 percent of the Part B premium, with the family rate set at twice the single rate.

Link TRICARE deductibles to Medicare rates and eliminate copayments for preventative care.

Require military retirees and dependents wishing to participate in TRICARE to enroll during a designated open enrollment period.

Basing TRICARE premiums for younger retirees on the fees charged to TRICARE-for-Life beneficiaries would inject an element of equity into the health care system by treating all military retirees more consistently. Thus, retirees under age 65 would begin to pay premiums that cover a larger portion of their actual health care costs and that are adjusted to reflect health care cost increases (Tables ES-1 and ES-2). To lessen the impact of these cost increases, the QRMC recommends that the new rates be phased in over four years.

Consistent with changes in premium contributions, TRICARE deductibles and copayments should also be adjusted. The QRMC believes that the TRICARE system should be biased toward prevention, rather than treatment, and that copayments for preventative services should be eliminated. The aim is to encourage enrollees to seek out such care, improve their health status, and reduce their overall health care costs.

The QRMC also believes that participation in TRICARE should be more consistent with civilian sector practices. Establishing an open enrollment period, for example, will encourage more retirees and dependents to obtain ongoing health coverage and care, rather than episodic coverage. It will also result in more premium contributions from participants. Retirees and dependents would be required to join TRICARE during open enrollment and would be precluded from doing so at other times during the year, except in special circumstances.

Prescription Drugs

Because the pharmacy benefit has been the fastest growing component of military health care since 2000, the QRMC believes steps should be taken to lower the costs to the government of the TRICARE prescription drug benefit.

RECOMMENDATIONS

Set prescription drug fees at levels that encourage beneficiaries to choose lower-cost purchasing options.

Set prescription drug copayments under TRICARE at no more than two thirds of the average copayments faced by civilians at retail pharmacies. Prescriptions filled at military treatment facilities should continue to be dispensed at no cost.

Table ES-1. Annual TRICARE Prime Premiums Under QRMC Recommendation: 40 Percent of 2009 Medicare Part B Premium

Modified Adjusted Gross Income	Single Premium	Family Premium
Individuals: \$82,000 or below Married Couples: \$164,000 or below	\$462.70	\$925.40
Individuals: \$82,001–102,000 Married Couples: \$164,001–204,000	648.50	1,297.00
Individuals: \$102,001–153,000 Married Couples: \$204,001–306,000	927.10	1,854.20
Individuals: \$153,001–205,000 Married Couples: \$306,001–410,000	1,206.50	2,413.00
Individuals: above \$205,000 Married Couples: above \$410,000	1,485.10	2,970.20

Note: Data based on 2008 modified adjusted gross income brackets and estimated before program cost and income level increases were calculated.

Table ES-2. Annual TRICARE Standard/Extra Premiums Under QRMC Recommendation: 15 percent of 2009 Medicare Part B Premium

Modified Adjusted Gross Income	Single Premium	Family Premium
Individuals: \$82,000 or below Married Couples: \$164,000 or below	\$173.50	\$347.00
Individuals: \$82,001–102,000 Married Couples: \$164,001–204,000	243.20	486.40
Individuals: \$102,001–153,000 Married Couples: \$204,001–306,000	347.70	695.40
Individuals: \$153,001–205,000 Married Couples: \$306,001–410,000	452.40	904.80
Individuals: above \$205,000 Married Couples: above \$410,000	556.90	1,113.80

Note: Data based on 2008 modified adjusted gross income brackets and estimated before program cost and income level increases were calculated.

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TRICARE prescription drug program costs could be reduced if more beneficiaries filled their prescriptions at military treatment facilities or through the TRICARE mail order pharmacy. Today there is little incentive for beneficiaries to make more cost-effective choices, but the QRMC believes that implementing such incentives would produce significant cost savings while maintaining member benefits at current levels.

Program Funding

The cost of health care for retirees under age 65 is significant, yet the present funding methodology does not make these costs clear to decision makers. All significant and separable costs related to military retirees should be explicitly identified in the DOD budget. It makes little sense to fund health care for older retirees using accrual accounting while using a current outlays methodology for retirees under age 65.

RECOMMENDATION

Finance health care for retirees under age 65 through accrual accounting.

Changing to accrual accounting will shed light on how current manning decisions will affect future costs. When implementing this recommendation, DOD needs to make a one-time adjustment to the budget to account for the impact of the change. It is essential that other DOD accounts not be penalized in order to make this transition.

TRICARE Reimbursement

Access to civilian health care providers, outside the military treatment facilities, is an important aspect of the military health care benefit. If such access is limited, the value of the benefit declines. TRICARE reimbursement rates are, in general, much lower than those normally paid by private insurers. Lower reimbursement rates in turn result in fewer providers willing to serve the TRICARE population. Dependents and retirees could, as a result, face an ever-shrinking pool of providers who are willing to treat them.

RECOMMENDATION

Periodically evaluate TRICARE reimbursement rates to guarantee sufficient provider access so that appropriate care is available.

DOD has the authority to establish higher rates in geographic areas and for those specialties where access to providers becomes and remains a problem. The Department should be more aggressive in exercising this authority. Congress, as well, should take action to prevent gaps between TRICARE and private sector reimbursement rates from increasing.

Health Care Professionals

Essential to the military health care system is a corps of experienced health care professionals capable of providing a full range of general and specialized care. Because health care professionals have attractive and lucrative career opportunities in the private sector, recruiting and retaining them into the military has long been a challenge, but personnel shortfalls in these professions have increased in recent years. While there are many programs in place—such as scholarship programs, accession bonuses, and special pays—the military services have increasingly struggled to meet requirements for uniformed medical personnel, even as requirements have fallen.

As a result of these trends, Congress asked the QRMC in 2007 to examine compensation issues pertaining to uniformed medical personnel in DOD.

In its evaluation, the QRMC identified a number of factors contributing to the current shortages of military health care professionals. Part of the challenge stems from high demand for health care professionals in the civilian sector, creating a more competitive market and higher salaries. The military work environment, which in some cases compares unfavorably to conditions enjoyed in the civilian sector, also has an impact on recruiting and retention in this occupational area. In addition, changing demographics of medical and dental school students create challenges for the uniformed services: more students are from affluent families, reducing the attractiveness of financial assistance; more students are women, who are less inclined to serve in uniform; and the percentage of students who are not U.S. citizens, and therefore ineligible to become commissioned officers, is on the rise.

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The QRMC developed a series of recommendations to respond to these factors and aid the uniformed services in filling requirements for personnel in these fields. They are designed to make existing recruiting and retention tools more attractive to health care professionals considering military service and to promote recruiting opportunities in previously untapped markets.

Health Professionals Scholarship Program

The Health Professionals Scholarship Program (HPSP) is the most widely used program for recruiting physicians and dentists. The program pays tuition, books, fees, and a monthly stipend in exchange for a commitment to military service—typically four years for physicians and dentists. Despite the substantial financial assistance available under this program, it is attracting fewer recruits. In part, this simply reflects the challenges of the recruiting environment described above, but the QRMC believes that part of the problem may be due to weaknesses in the program itself that discourage participation. The QRMC believes that changes could be made to help make the HPSP program more attractive to medical and dental students considering military service.

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RECOMMENDATIONS

Give HPSP participants access to TRICARE Reserve Select, or, if coming directly from active duty, allow them to retain their active duty TRICARE coverage.

Provide a Basic Allowance for Housing to HPSP students.

Cover the costs of all required equipment at medical and dental schools.

Expand HPSP to cover the costs of additional training requirements for U.S. citizens who attend foreign medical schools. The Services should also offer residency slots to certified foreign medical school graduates.

Together these recommendations can help offset additional expenses of medical school not currently covered under HPSP and enhance the value of the HPSP benefit. HPSP students only have limited access to the military's health care system. Health care coverage, particularly family

coverage, is expensive and difficult for HPSP students to afford on their monthly stipend. Defraying health care costs can serve as an additional incentive. Similarly, providing a housing allowance and resources to cover all equipment costs will help offset expenses in areas where the cost of living is high and many students still struggle to make ends meet. In addition, doctors educated in foreign medical schools, once fully certified to practice in the United States, represent a potentially valuable source of military physicians. Offering them access to HPSP in exchange for a service commitment could help DOD tap into this market.

Nurses

Like the civilian sector, the military is finding it increasingly difficult to recruit and retain the nurses necessary to meet force management needs. Targeting new markets could help the Services expand their nursing inventories.

RECOMMENDATIONS

The Services should expand their recruiting pool to include registered nurses with associate degrees.

To encourage military nurses without Bachelor of Science Nursing (BSN) degrees to complete their four-year degrees, the Services should create programs that enable nurses to earn their degrees while in the military, and subsequently compete for commissions as O-1s.

The Services should offer nurse training to currently serving officers or enlisted personnel.

Today, the military nurse corps is reluctant to recruit nurses who do not have BSN degrees. However, the QRMC could find no evidence that the quality of care and leadership provided by non-BSN nurses is significantly different. Tapping into this market could substantially alleviate current nursing shortages without sacrificing quality of care. Furthermore, the Services could offer training opportunities to help nurses without BSN degrees complete the requirements. In addition, programs that provide nurse training to currently serving enlisted personnel should be expanded.

All Health Professionals

A final set of recommendations pertaining to health care professionals is designed to maximize contributions from existing military personnel—both health care personnel and other service members who are available for retraining.

RECOMMENDATIONS

DOD should ask Congress to raise the mandatory retirement age for health professionals from 62 to 68.

Where appropriate, expand current programs that train enlisted personnel as physician assistants to also cover training in other medical areas.

The Services should use an auction mechanism to induce health care personnel to volunteer for specific hard-to-fill billets.

Allow non-citizen health care professionals, who are licensed to practice in the United States, to enlist in the military and apply for expedited citizenship.

DOD should use the inter-Service transfer bonus program to encourage surplus health professionals to transfer to a Service where their skills are needed.

In general, health professionals are subject to mandatory retirement at age 62. The QRMC believes that health professionals between the ages of 62 and 68 can still make valuable contributions to the military health care system and should be allowed to remain in service for longer careers, thus expanding the pool of qualified professionals.

Tapping into existing military personnel is another potentially valuable source of health professionals. The Services should explore whether existing physician assistant training programs for current personnel could be expanded to other medical fields as a way of increasing health care personnel.

As with the rest of the military, the burdens of deployment have fallen on military health professionals. Instituting a bidding system for duty assignments would be one way to offer health professionals more control over their assignments and the deployment process, thus helping to offset the less flexible nature of the military work environment.

Many health care professionals practicing in the United States are not U.S. citizens. The QRMC believes that military service may be an attractive opportunity for some foreign-born health professionals, particularly if military service provides them access to an expedited citizenship program. If a health care professional who enters the military under such an initiative fails to complete his or her contract, there is a five-year window under federal law in which the citizenship may be revoked—a provision the Services could invoke if circumstances warranted.

Quality of Life Programs

The military services offer a wide array of quality of life programs. Many of these programs can be described as morale, welfare, and recreation programs, which include programs such as commissaries, exchanges, fitness centers, and libraries—typically located on military installations. DOD also offers an array of community and family support services designed to help families cope with the hardships sometimes associated with military service, as well as with other issues that can confront both military and civilian families—programs such as marriage and family counseling, child care services, youth/adolescent programs, and financial counseling.

Quality of life benefits represent a significant portion of service members' compensation. Yet despite this substantial investment, it is not clear how much quality of life programs promote force management goals or whether the dollars invested are being used as efficiently or effectively as possible, or in ways that maximize member choice. Furthermore, it is unclear whether programs developed decades ago to support families of a conscript military are as relevant and valuable to the all-volunteer force of the 21st century. Moreover, while service members and their families may appreciate these benefits, survey data show that their value is often underestimated—thus diminishing their effectiveness as a recruiting and retention incentive. In light of all this, the Services need to take a different approach to quality of life benefits—an approach where they structure, use, and evaluate quality of life programs as *valuable elements of the military compensation package*.

While sophisticated tools exist to evaluate how various pays and allowances influence recruiting, retention, and readiness, no such analysis exists for quality of life benefits. The cost of the programs is not well understood, nor is consistent and comprehensive utilization data available. Without

this data, which needs to be developed, it is difficult to evaluate the effectiveness of the quality of life programs and whether they are contributing to force management goals. It is also difficult to measure the impact of the benefit, and to target and structure program resources accordingly.

A critical part of treating the quality of life benefit as part of compensation is educating military personnel about the benefit so that they appreciate its value and understand that it is, in fact, compensation. In contrast to cash compensation, it is difficult for members to quantify the worth of the in-kind benefits they receive—such as the savings associated with shopping in a commissary or the value of military child care services.

As it turns out, nearly half of all service members believe that benefits cost DOD less than 25 cents per dollar that they earn, when in fact the costs to the Department are over 40 cents per dollar earned. A consequence of this misunderstanding is that more than half of service members think it is easy to find a civilian job with comparable salary and benefits—although analysis indicates that military compensation of both enlisted personnel and officers is significantly higher than compensation paid to comparable civilians, even without including retirement, health care, and quality of life benefits in the calculations. Whether service member perceptions are accurate or not, these perceptions do affect members' continuation plans. Thus, if service members do not consider quality of life services as part of their compensation package, nor appreciate the value of these services, they will have little impact as continuation incentives.

RECOMMENDATIONS

The Services should develop a more comprehensive system to educate personnel on an ongoing basis about the variety of quality of life programs available to service members, the value of those programs, and the fact that they represent a substantial component of military compensation.

The Department of Defense should conduct periodic reviews of its quality of life programs to assess their ongoing role and effectiveness as compensation tools.

DOD officials have indicated that educating personnel about their compensation package has not been a department-wide priority. Nor has the Department ever undertaken a comprehensive effort to inform service

members about the value of military compensation compared to compensation in the civilian sector. To maximize the impact of quality of life resources on force management goals and member reenlistment decisions, service members and their families need to more fully appreciate the true value of quality of life benefits and how those benefits compare to civilian sector compensation. The Services need to develop accessible and easy-to-understand ways to communicate this information through education programs that are conducted throughout a service member's career. Armed with a better understanding of the value of their compensation, potential recruits and service members will be able to make more informed decisions about joining or staying in the military.

While there is a general sense among force managers that personnel and their families appreciate quality of life services and possibly factor these benefits into their continuation decisions, there is no hard data to quantify their impact on either recruiting or retention. The QRMC believes that an analysis of the recruiting, retention, and readiness impacts of specific programs needs to be conducted to guide decision makers in allocating resources among programs. In addition, DOD needs to develop more sophisticated survey tools to better measure member preferences and satisfaction regarding quality of life benefits. Better data will enable DOD to more efficiently and effectively allocate resources devoted to quality of life programs—to make investments that are based on the actual needs of military families and focused on areas of greatest return to the Services.

Flexible Spending Accounts

In the civilian sector, there has been a growing trend toward flexible benefits that give employees more say over the types of benefits and levels of coverage in their compensation package—enabling them to tailor their benefit plans to specific needs. Flexible spending accounts are one of the most common flexible benefit programs. Employees place pretax income, up to specified annual caps, into these accounts to cover costs of specific goods or services, such as medical or dependent care—the two most frequently used flexible spending accounts. Funds are placed into the accounts, typically through payroll deductions, and must be used within a specified period or they are lost to the employee. Because they use pretax income, flexible spending accounts enable employees to increase their purchasing power.

RECOMMENDATION

The Services should adopt dependent care and health care flexible spending accounts for uniformed service members.

The QRMC believes that offering these types of flexible spending accounts to service members will enable them to increase their purchasing power to buy benefits that meet their particular needs, preferences, and circumstances. The main benefit to employees is the ability to shelter income from taxation. However, the accounts do carry some risk in that employees forfeit any unspent funds at the end of the use period. Hence, such accounts make the most sense for employees who have a good idea of their medical and dependent care expenses for the coming year.

Flexible spending accounts for medical and dependent care are available to federal employees. These programs could be easily applied in the military setting. In order for flexible spending accounts to be workable in a military context, the federal rules governing the accounts—specifically, those policies regulating forfeiture of unused funds—will have to be modified to acknowledge the unique and often uncertain nature of military service, particularly deployments and relocation to a new assignment.

To that end, the QRMC recommends that the law governing flexible spending accounts be modified to provide deployed or transferred military personnel with the authority to both modify their contribution plan and carry forward unused dollars into the first full year following a transfer or return from deployment. The QRMC does not believe it would be fair for members to be financially penalized for personnel actions outside of their control.

Dependent Education

Given the frequent changes of station that are a reality of military life, maintaining quality education and smooth transitions for their children is a critical priority for military parents and a goal shared by DOD. While most children of military personnel stationed in the United States attend local civilian schools, there are a few areas where concern about the quality of local schools makes parents of school-aged children reluctant to accept assignments. Personnel in those locations often send their children to private school or home school them—alternatives that have

financial impacts on members and their families. To mitigate such situations, consideration needs to be given to providing military families with more attractive alternatives for educating their children.

RECOMMENDATIONS

In designated parts of the country, DOD, in cooperation with the Department of Education, should institute a voucher program in which military parents could choose the school on which to spend the Impact Aid dollars associated with their child.

Parents should be allowed to form charter schools at military installations, similar to civilian charter schools currently operating under state laws.

Congress needs to fully fund Impact Aid associated with the children of uniformed service members, and transition to a current-year enrollment basis for distribution of the funds.

The QRMC recommends that in implementing a voucher program, DOD begin with a pilot program in which federal funds currently provided to public schools for military dependents—called Impact Aid—instead be given to parents in the form of vouchers to be used at the school of their choice. The voucher option would be offered at a limited number of locations considered to have less desirable designated public schools, potentially making these assignments more palatable and ultimately improving retention and readiness. Since the voucher amount under this proposal would equal the amount already being spent on each child through the Impact Aid program, it would not increase total federal spending, aside from some administrative costs.

Charter schools operated at military installations could offer yet another education option for military children. Like civilian charter schools, military charter schools would be considered part of the local system and funded in the same manner. In areas with substandard local schools, charter schools would offer another option to parents in addition to private school or home schooling. In implementing such a program, rules governing waiting lists would have to be modified to give highest priority to the children of military personnel.

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Finally, Impact Aid does not fully compensate schools for the additional costs associated with educating children of service members. As military populations shift over the coming years through base closures and realignment decisions, Impact Aid funding needs to be more timely and robust. Thus, the QRMC believes that Congress should provide sufficient appropriations to fully fund Impact Aid associated with dependent children.

Child Care

The Department of Defense operates the largest employer-sponsored child care program in the United States, spending approximately \$530 million annually to provide services to the children of military personnel. The two main government-sponsored options for care are child development centers and family child care programs. After-school care is also available for older children through school-age care.

It is unclear, however, whether this substantial investment in child care has a significant or cost-effective impact on key force management goals such as recruitment, retention, or readiness. In fact, there is little analysis of the program's effectiveness and it is well documented that many service members significantly underestimate the program's value, which can exceed \$10,000 per child annually. Nor is it clear that the child care benefit—which is available to only a fraction of the force—is being utilized as efficiently and equitably as possible in order to maximize the benefit to personnel. Wait list policies, for example, do not appear to give priority to personnel most in need of child care services and centers have limited hours, offering little help to members who work nights and weekends.

The QRMC believes that many of the concerns with military child care arise from the fact that DOD does not manage its child care program as an element of the military compensation package; instead, most of the management focus on the program has revolved around improving the quality of care. Although an important objective, this contrasts sharply with the approach to child care benefits in the private sector. Thus, the QRMC recommends three reforms that would improve the effectiveness, equity, and efficiency of the child care benefit, as well as expand services to cover more members.

RECOMMENDATIONS

The Services should prioritize allocation of child care slots based on force management needs.

DOD should implement a voucher program to help service members pay for child care costs.

DOD should increase its investment in family child care.

To have the maximum impact on force management needs and readiness, the child care benefit should be targeted to those personnel most valued by the Services, and to those members most in need of child care assistance in order to meet their service obligations. In peacetime, priority should be given to personnel serving in skill areas with high temporary duty time, or to service members in occupational areas that are highly valued by the Services or that are experiencing critical shortages. During wartime, priority should be given to families of deployed service members.

The QRMC recommends that DOD implement a pilot program to evaluate different program designs that could supplement or replace the current in-kind child care benefits with vouchers that personnel could apply towards the cost of child care. Part of this evaluation would need to consider the likely impact of a voucher program on the child development centers and family child care providers. Depending on its structure, a voucher program could offer a number of improvements to the current system: financial assistance to families who currently receive no child care benefit, a benefit with more tangible value to service members, and greater choice for service members and their families.

Like a voucher program, increased financial support to family child care providers would enhance the effectiveness and efficiency of the child care benefit, as well as expand families' access to services. To fund such an effort, DOD could request additional appropriations or reallocate resources currently assigned to child development centers. Even though an increased investment in family child care offers many advantages—particularly the ability to leverage the lower cost of care to expand services to more families—the system would still be predominantly offered on military installations. As such, it would not improve access or convenience to the many personnel who live off base and who prefer child care options

closer to home. Thus, DOD should also consider whether greater utilization of private sector providers offers any advantages over the current child care network, which is dominated by DOD-operated facilities.

Commissaries

DOD operates approximately 280 commissaries worldwide. Commissaries are one of the most costly quality of life benefits offered to military personnel, with DOD spending approximately \$1.2 billion each year to support the system. DOD estimates that commissaries save service members roughly 30 percent on their groceries and household supply purchases compared to regular retail stores. Like the other quality of life benefits discussed in this report, the commissary benefit is also a component of military compensation. As such, DOD should evaluate whether commissaries improve recruiting and retention, and whether they do so in an efficient, rational, and cost-effective manner.

In that context, however, the commissary is an interesting benefit because not only does it serve the practical purpose of providing goods at reduced cost, it also plays a central role in military life. Many service members would view attempts to reduce commissary activities as DOD abandoning its commitment to quality of life. Thus, force morale and satisfaction need to be considered in evaluating the commissary benefit.

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RECOMMENDATION

DOD should seek to develop relationships with national and regional grocery chains to provide discounts to service members.

In areas in the continental United States where off-base alternatives are available, this proposal would offer several advantages—including convenient shopping for members who live off base, and greater accessibility to reduced pricing for reservists and retirees who do not live in proximity to an installation. In addition, these other shopping alternatives would reduce the pressure to build larger commissaries since members living off base would be more likely to avail themselves of shopping opportunities close to home.

Overseas Cost-of-Living Allowance

The overseas cost-of-living allowance (COLA) is intended to ensure that military personnel assigned to overseas duty locations are not financially disadvantaged by such an assignment. To that end, the COLA provides

additional compensation to offset higher costs of food, transportation, recreation, and similar expenditures. The COLA rate-setting process uses a “market basket” approach with the allowance based on the differential between the cost of a typical basket of goods and services purchased at an overseas location and the cost of the same items in the continental United States. The COLA varies based on a variety of factors: product availability, changes in overseas prices relative to prices in the United States, and fluctuations in the monetary exchange rate.

The QRMC evaluated the current rate-setting process and found that the methodology is sound and mirrors best practices in the private sector. COLA rate changes clearly reflect economic trends. There are two changes, however, that the QRMC believes would provide additional improvements in the overall COLA process.

RECOMMENDATIONS

Rates for the overseas cost-of-living allowance should be based on the size of commissaries and exchanges located at each overseas site to prevent shifts in shopping patterns alone from causing changes in COLA rates.

DOD and the Services should develop a clearer explanation of how COLA rates are established and educate personnel on this benefit before they arrive at a new overseas duty station. In addition, DOD should publish frequent updates of the change in the cost of the U.S. market basket, so that members have appropriate expectations regarding changes in the cost-of-living allowance.

Service members overseas face different shopping choices than members in the United States. In the United States, commissary and exchange prices tend to move in tandem with prices in civilian establishments. This linkage does not exist in overseas locations. When off-base prices rise, members assigned overseas tend to shift their purchases away from the local economy and toward commissaries and exchanges. In locations where the on-base establishments are smaller, the ability to shift purchasing patterns is more limited. Linking adjustments to the size of the commissaries and exchanges will achieve more consistency across COLA programs. It would also bring to an end the current practice of effectively penalizing members for shifting shopping patterns in response to prices in the local economy.

As with many quality of life benefits, a significant issue with the current COLA system appears to be a lack of understanding about the purpose of the allowance, how it is calculated, and how it changes over time. The QRMC believes the Department should invest in a professionally prepared, tested presentation of the allowance that it can make available to service members and their families. In addition, by publishing quarterly changes in the U.S. cost of living allowance, members should be able to better anticipate changes in the overseas allowance.

Conclusion

As described previously, two themes dominated the deliberations of the 10th QRMC and serve as critical drivers of system improvement: flexibility for the uniformed services and choice for the service member. This concluding section evaluates how well the QRMC recommendations advance these important principles.

- It is well documented that if the uniformed services are to be an “employer of choice” they must offer competitive compensation. **Military Annual Compensation** is a new measure for comparing service member compensation to that in the civilian sector—a measure that takes into account benefits and some tax advantages that are important components of the compensation package. In fact, using this more meaningful basis for comparing compensation shows that service member compensation is more generous relative to civilian compensation than traditional comparisons suggest.

If service members are better able to understand the value of their compensation package relative to civilian compensation then they are able to make more informed *choices* at the time of their initial enlistment and, even more so, at various reenlistment points. Military Annual Compensation is a useful tool to better explain to service members the value of their compensation and, thus, informs *member choice*.

- **S&I pay consolidation** offers the Services greater *flexibility* in responding to changing mission needs. Consolidating more than 60 pays into eight pay categories, without the statutory restrictions that encumber many pays today, will allow force managers

to more rapidly respond to changes in personnel supply and demand. Further, with the ability to allocate resources to those areas most in demand, as the needs arise, staffing challenges can be met in a more efficient, effective, and timely way.

Simplifying the S&I pay structure also enhances *member choice*, in a fashion similar to the adoption of Military Annual Compensation, in that members will be able to better understand the purpose of the special pays and bonuses that they receive. With fewer S&I pay categories, the linkage between S&I payments and the purpose of those payments becomes much clearer. Service members who understand the purpose of Skill Incentive/Proficiency Pay, for example, can make more informed *choices* about obtaining a credential, such as proficiency in a foreign language.

Increasing the size of the S&I pay budget also contributes to *flexibility* for the uniformed services, offering greater opportunity to use special pays and bonuses to shape the force. Even the design of the oversight committee considered flexibility at the fore—balancing the need for some degree of oversight, guidance, and coordination with the desire to allow the uniformed services to have greater autonomy in setting S&I pay levels and eligibility.

- Similarly, the concept of **constructive credit**, as a mechanism for better rewarding early promotions and facilitating lateral entry or reentry into the force, offers additional *force-shaping flexibility* to the Services. In a competitive labor market, the “best and the brightest” often have many opportunities for employment, with high-quality service members lured by potentially more lucrative private sector opportunities. By offering those who are promoted early a permanent increase in pay (as compared to their counterparts who are promoted in due course), the Services have an additional tool by which to link pay and performance, which in turn improves force-shaping capabilities through better retention.

Moreover, certain skills are difficult to grow and retain in the Service environment. The flexibility to bring in specialists midcareer, at an appropriate level of pay, is also important—something that applies as well to individuals who leave military

service and later wish to reenter. Constructive credit allows the Services to more appropriately compensate such individuals. With more *flexible* tools, the Services are freer to recruit individuals in midcareer from the civilian sector to fill gaps in personnel requirements.

- Reducing the **Basic Allowance for Housing rate differential** between those with and without dependents improves *member choice*. By narrowing the differential, members without dependents have a greater choice in housing—able to live in housing more like their civilian peers without the out-of-pocket expenses they now often face. Further, compensation in effect increases through a more equitable payment structure for members.

Recommended **adjustments to partial BAH** more appropriately compensate single members in certain government quarters for their reduced standard of living—a change that is not only more equitable but also serves as an increase in compensation to many junior members of the force. Compensation that meets or exceeds opportunities in the civilian sector puts the Services in a more advantageous position when members face reenlistment decisions.

- The **military retirement benefit** is a major component of military compensation. But the system as it exists today, with its 20-year vesting point, is often criticized as inequitable, inflexible, and inefficient. Few members earn the benefit, it leads to very rigid career patterns, and it is less efficient than cash compensation. The QRMC proposal, with early vesting and a mix of both deferred and cash components, mitigates these concerns. The proposal offers greater *flexibility* to force managers to use elements of the retirement benefit to shape the force in response to changing requirements, and *greater choice* to the member to plan a career that meets individual needs and preferences.

The elements of the QRMC proposal that enhance *flexibility* and *choice* are its earlier vesting at 10 years of service, a portable defined contribution plan that also vests at 10 years, gate pays payable at specified years-of-service milestones, and separation pay provided to members when they end their service. Gate pays and separation pay are designed to vary, so that force managers can set the criteria for receipt of these pays to shape career

lengths in different specialties or for the force in general, and to adjust these levers as Service requirements shift in response to national security missions. Thus, career lengths can vary according to specialty, with “youth and vigor” careers designed to be shorter, compared to some professional and technical careers where longer careers are advantageous. These diverse career lengths will also provide managers with more *flexibility* to vary assignment length to match force needs.

From the perspective of the member, the 10-year vesting point creates many *more choices for career lengths*. By reforming the “20-years-or-nothing” system with one that vests earlier and includes variable gate and separation pays, service members would have more options regarding how long they might serve, which could increase reenlistment rates early in a career. Knowing that a member could serve between 10 and 20 years and still receive retirement benefits may be an incentive to many service members to reenlist a second or third time, even if they are not interested in serving a full career in uniform. The Services would benefit because they would have a greater return from their training investment in the member, and the service members would benefit because they would have greater *choice* in tailoring their service careers.

Better aligning the active and reserve retirement systems also enhances *member choice* and can serve as an incentive for members to stay in uniform after an active duty career, or even for a member to move between active and reserve status multiple times during the course of a career. Furthermore, since most service members value cash compensation more than future compensation—or deferred benefits—the cash elements of the system are more highly valued and can serve as attractive recruiting and retention incentives. Relying on a more efficient mix of current and deferred compensation enables the uniformed services to deliver a more cost-effective retirement benefit that provides enhanced value to both members and the military at no additional cost.

- The **military health care** program provides benefits to active duty, reserve, retired, and dependent populations. It is highly valued by members and their families and is critical to force

readiness. A number of the QRMC recommendations serve to infuse greater equity into the program and promote more cost-effective *choices* among program participants. Recommendations to better align premiums and deductibles with costs and to link these payments to retirees' ability to pay will establish a more equitable system, as well as help ensure that benefits to members are sustained into the future, even as national health care costs continue to rise. This ultimately sustains the value of the benefit as an element of compensation, which is important to force managers in the context of recruiting and retention.

Changes in copayments and deductibles also encourage increased utilization of cost-effective care. They provide incentives for participants to *choose* low-cost prescription drug providers, for example, and to seek preventative care, which improves healthfulness and in turn lowers health care costs—both to the individual and to the health care provider. They enable members to consider health care *choices* in a new light. Ensuring that TRICARE reimbursement rates are in line with private insurer rates serves to ensure adequate *member choice* in health care providers—both general care physicians as well as specialists. If access to health care is limited, it could have a negative impact on recruiting, retention, and readiness—affecting both the member and the uniformed services.

- **Health care professionals** are the core of the military health benefit—those individuals who provide care to members, retirees, and families. The QRMC recommends a wide range of options to provide force managers with additional tools and *flexibility* to more effectively recruit and retain health professionals during a period of intense competition with the private sector. Recommended changes to the Health Professionals Scholarship Program—to help offset the high costs of medical school—are designed to make the program more attractive to medical and dental students considering uniformed service.

Likewise, recommendations for recruiting and retaining nurses are designed to enable the Services to target new markets as a source of personnel to expand nursing inventories, including military personnel currently serving in other occupations. A

final set of recommendations is designed to maximize contributions from existing personnel—enabling longer careers, additional training, creative use of bonuses, and other mechanisms. Making existing recruiting and retention tools more attractive to health care professionals enhances force manager *flexibility* in this challenging career market.

- Many of the recommendations to enhance **quality of life programs** also expand *member choice*. Flexible spending accounts, voucher programs for dependent education and child care services, and commissary alternatives are several examples of how quality of life benefits can be modified to provide members with more choice. Recommendations to better educate personnel about the value of quality of life benefits compared to civilian compensation opportunities would help individuals make more informed career *choices* regarding enlistment and reenlistment. Some of these changes could also provide the Services with more *flexibility* to leverage and adapt quality of life resources in ways that better meet the diverse and evolving needs of military families in the 21st century.

While service members and their families appreciate and often rely on quality of life benefits, the in-kind nature of these benefits makes them less efficient than cash benefits and less valuable to some members. Offering flexible spending accounts to cover health and dependent care costs would give service members the *choice* of using a portion of their pretax income to cover health or dependent care costs. The QRMC's dependent care proposals would also enhance *choice* for members by providing—initially via pilot programs—school vouchers and charter school authority to military parents unhappy with local school options. Similarly, recommended changes to the military child care benefit would broaden accessibility and provider options to serve more families more effectively. Exploring partnerships with retail grocery chains could provide additional and more convenient shopping *choices* for military personnel, particularly those not living on or near a military installation. These proposed changes would also give force managers the *flexibility* to vary and adjust quality of life resources to meet diverse needs, preferences, and circumstances.

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It is also essential for both service members and force managers to change their thinking about quality of life benefits. These programs are valuable elements of compensation. However, their impact on critical force objectives such as recruiting, retention, and readiness will be diminished if members do not appreciate their true value and if managers do not consider them as part of their compensation “tool kit.” To address these concerns, the QRMC recommends that DOD implement an educational initiative to improve member understanding regarding the value of quality of life benefits, and also urges force managers to utilize and evaluate quality of life benefits as elements of compensation.

The recommendations put forward by the 10th QRMC are not intended to radically change the current compensation system used by the uniformed services. Rather, they offer select innovations in policy and practice that would lead to improved responsiveness in the system, ensure fair and equitable compensation, improve the link between pay and performance, and enhance recruiting and retention—all goals that will sustain and strengthen the all-volunteer force. Together these recommendations add to the suite of tools available to force managers, enabling them to more efficiently and effectively respond to changes in personnel needs—increasingly important as the Services work to respond to the demands of today’s national security environment.

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Glossary

AIP	Assignment Incentive Pay
BAH	Basic Allowance for Housing
BAS	Basic Allowance for Subsistence
BSN	Bachelor of Science Nursing
COLA	cost-of-living allowance
DOD	Department of Defense
FICA	Federal Insurance Contributions Act
FSA	flexible spending account
GAO	Government Accountability Office
HPSP	Health Professionals Scholarship Program
QRMC	Quadrennial Review of Military Compensation
RMC	Regular Military Compensation
S&I	Special and Incentive
TSP	Thrift Savings Plan



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