

How Much Is Enough?

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Abstract

Recent debates in the United States have pitted the fiscal imperative of rationalizing the budget against the social narrative that society has an obligation to take care of its service members and veterans. This civil-military disconnect is a result of the structural necessity in so-called liberal market economies (LME) to focus significant portions of their military compensation on benefits, in addition to pay. These benefits—for example, health care, childcare, education, and retirement—are not broadly provided to all citizens in LMEs and constitute attractive recruiting incentives. However, it is difficult to control their costs and difficult to limit or remove them once implemented. Thus, the United States is caught in a benefits trap with challenging civil-military and policy implications.



In late 2014, the *Military Times* published a series of stories titled “America’s Military: A Force Adrift” in which it reported polling results from service members, veterans, and their family members showing plunging morale, feelings that society does not appreciate service members’ sacrifices, and fears that compensation will not keep pace with needs.¹ These results came hard on the heels of several public debates about the options the military had to cut its budget in line with the requirements of the 2011 Budget Control Act—from which aircraft systems to retire to whether to end the current food subsidy military families receive through the commissary system.² Budget experts such as Todd Harrison of the Center for Strategic and Budgetary Assessments and Cindy Williams of the Massachusetts Institute of Technology (MIT)

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have indicated that military personnel costs are rising at an unsustainable rate.³ Three secretaries of defense and two chairmen of the Joint Chiefs of Staff, as well as most of their service chiefs, have pleaded with Congress to bring military personnel costs under control.⁴ However, the backlash from veterans' groups, military retirees, and other groups representing the interests of military personnel and their dependents has been strong.⁵ Congress has shown no interest in any of the suggested reforms that could even bear the appearance of cuts.⁶ In January 2015, the Military Compensation and Retirement Modernization Commission (MCRMC) published its final report, wherein it expressly argued that the fundamental structure of the compensation system and the level of benefits should be protected.⁷

All of this indicates a problem. On one hand, the United States has a fairly solid consensus among experts and senior military and civilian officials that military compensation costs are skyrocketing and unsustainable. On the other hand, the country has military personnel, dependents, and veterans who feel they are not being adequately compensated and that threats to their pay and benefits represent a violation of the social contract made between the military and society. While it goes without saying that pay and benefits are not the only reasons people join the military, it is also clear that people thinking of joining the military must consider both the material and the nonmaterial costs and benefits of service.

Since very few members of Congress are willing to tackle the task of reconciling defense costs with the budget, the United States is faced with the urgent need to reevaluate the civil-military contract. In the context of a wider discussion about the social contract Americans want to make for themselves and their children, it is crucial to determine how we are to fulfill our promises to those who have served and are serving, continue to recruit high-quality personnel, encourage the right people to stay in service, help those who do not stay to transition into the labor market, and ensure that those who are serving now get the training and equipment they need to do their jobs. This article attempts to contextualize the problem and suggests a cause for this disconnect, while highlighting current efforts to improve the situation.⁸

Labor Market Structure and Military Personnel Policy

There is some evidence indicating that labor market structure affects military personnel policies and human resources management.⁹ In my previous research, I observed that comparative economists have identified two basic labor market equilibria: those with high labor turnover and low levels of vocational skills training and, conversely, those with low labor turnover and high levels of vocational skills training. The first is the equilibrium predicted by classical liberal economics—as explicated most fully in Gary Becker’s *Human Capital*.¹⁰ In a labor market free from government regulation, firms can hire and fire at will, and employees can leave at will, making it irrational for the firm to invest in training employees in any skills that could be useful to other firms. If the employees want to make themselves attractive, they must invest their own resources in skills training. Under this equilibrium, it is also irrational for firms to invest in firm-specific skills training—that is, skills that are valuable only to that firm, such as standard operating procedures—because the employee may leave at any time and the resources invested in training would be wasted.

Scholars discovered the second equilibrium when they noticed that many firms *did* engage in vocational skills training but did so only under less-than-pure market conditions—for example, where government regulation made it more difficult to fire employees or more difficult to leave employment.¹¹ I have previously argued that militaries require both moderate levels of personnel turnover and significant levels of vocational and firm-specific skills training—a situation that would require off-equilibrium behavior from the military as employer no matter which labor market structure surrounded it. This implied that militaries located in different labor market contexts would face distinct problems of recruiting, retaining, managing, and separating personnel. In effect, militaries would be unable to act like private firms and would have to engage in some market-inefficient behavior in order to manage their personnel appropriately. I showed, though with a very limited sample of countries, that the mode of contracting personnel, the mode of assigning personnel to occupational specialties, and the types and availability of nonspecialty-related further training appear to vary with labor market type. Although no hypotheses relating to recruiting or retention were tested, my analysis suggested that the apparent differences were likely to lead to a situation in which less regulated labor markets with

high turnover and low skills training—such as so-called liberal market economies (LME)—would find it easier to recruit high-quality personnel but harder to retain them. Conversely, more regulated labor markets with low turnover and high skills training—so-called coordinated market economies (CME)—would have more difficulty attracting high-quality recruits but less trouble retaining them. Indeed, the implication is that militaries in CMEs may have difficulty getting rid of their employees, in general, whereas militaries in LMEs are likely to suffer from the “lemon problem,” wherein the least capable employees want to stay and the most capable have strong material incentives to leave.

LMEs such as the United States are likely to have an easier time re-recruiting high-quality personnel than the more highly regulated CMEs such as Germany are. This is true because a more flexible labor market allows people who spend a medium term in the military to be able to transition laterally into another career, while the less flexible labor market penalizes any time spent outside of one’s chosen career path and/or on firm-specific training from a nonpermanent employer. Furthermore, the structure of unemployment protection in CMEs is such that unemployment may be more attractive than employment in a temporary job, whereas in LMEs, some job is almost always preferable to unemployment. What was not discussed in my earlier work is that other differences in the larger socioeconomic structure of these two market types may also contribute to recruiting and retention problems. In particular, the role of employer-provided benefits differs significantly across these two market types.

The Benefits Trap

One reason militaries would have trouble recruiting high-quality personnel in CMEs is that potential employees could get skills training, job security, and a close-to-median wage from almost *any* decent employer. Militaries in LMEs, on the other hand, could offer training and job security that most other employers could not promise in the low-regulation environment. Additionally, there are a number of other benefits that matter to employees in LMEs that simply do not figure into employees’ calculus in most CMEs. The cost of higher education, for example, is generally higher in LMEs than in CMEs.¹² Thus, militaries in LMEs have the option of offering tuition assistance as a recruiting incentive,

and such militaries can structure the benefit to shape retention patterns, too. Public pension benefits are more generous in CMEs than in their more liberal counterpart, so that LMEs have the option of offering generous pension benefits to recruit and to shape retention.¹³ Childcare is more likely to be more generously publicly subsidized in CMEs than in LMEs, allowing LME militaries to attract people with the offer of a benefit that may be more difficult to find with other employers.¹⁴ Finally, although health care is generally subsidized throughout the developed world, the United States is an exception, and the military offers a health care system that is far more generously subsidized than what is available to most American employees.¹⁵

In short, in CMEs, benefits such as health care, childcare, access to higher education, and pensions are provided fairly evenly to all, whereas in LMEs, access to such benefits is more limited and highly dependent on the employer.¹⁶ A military that can provide these benefits—and that, indeed, considers them necessary to readiness—will be a very attractive employer in an LME but will look just like most other employers in a CME.¹⁷ Furthermore, in LMEs, these benefits are also not generally available to citizens except through their employers, so the military cannot rely on an existing national infrastructure. This implies that militaries in LMEs will be constrained to offer benefits as a significant part of their compensation packages, and the benefits may cost more in LMEs due to the lack of infrastructure.

This constraint on LME militaries is both an advantage and a disadvantage. On one hand, the situation provides more options and thus more flexibility in recruiting and, to a certain extent, retention. Thus, it may contribute to LME militaries' ability to attract high-quality recruits. On the other hand, benefits, once conferred and justified as being necessary to the functioning of the force, are difficult to take away or modify, and their costs are difficult to control. Thus, while the government can and does control military base pay, it is much harder to tackle the costs of benefits when they rise, and service members are more likely to feel that the civil-military contract is being abrogated when benefits are the focus of cuts. Therefore, LME militaries may find themselves in a benefits trap, where they have used these incentives to recruit and shape their force but are unable to fine tune incentives when it is necessary to downsize. This is especially true because these benefits are significantly different from what the employee could expect from another employer,

making the benefits particularly salient to the employee. Thus, the employee is more likely to mobilize in defense of the benefits than in defense of pay. If it is the case that militaries in LMEs have to rely more heavily on benefits, we have clues to both the skyrocketing costs of military personnel in the United States and to their feeling that any changes to these benefits represent a betrayal.

Current Efforts to Improve

Deborah Clay-Mendez has noted that, because of the system of in-kind benefits, “one unintended consequence is that military personnel have become unnecessarily costly relative to non-military personnel. This reduces the level of military capability that the United States can provide for any given level of resources and provides an incentive for decision-makers to rely on civilians and contractors even when military ‘boots on the ground’ would be more effective.”¹⁸ Former Secretary of Defense William Perry, relating the conclusions of the Quadrennial Defense Review Independent Panel in 2010, recommended that the services begin thinking of converting future benefits into more up-front cash.¹⁹ However, several studies have indicated that military personnel would prefer cash in hand only over some, not all, of their in-kind benefits. For example, Craig C. Pinder argues that pay appears to be an ambivalent factor in job satisfaction or dissatisfaction.²⁰ Additionally, a 2012 survey by the Center for Strategic and Budgetary Assessments (CSBA) in cooperation with TrueChoice Solutions found that performance-based bonuses were not a popular idea among service members: “In our study, opinions of such a bonus varied most significantly by age groups, with younger service members, ages 18 to 29, preferring it more than older ones. But that young age group valued it at only a fraction of what it would cost to implement. And the 50-and-older age group actually considered it equivalent to a pay cut. This suggests that, contrary to the recommendations of independent panels and scores of experts, a performance-based bonus would not be a good use of resources.”²¹

The same CSBA survey found that service members do not value child, youth, and school services as much as it costs to provide them; instead, they value commissaries and exchanges *over* what it costs to provide such services.²² Harrison notes, “the preferences of junior personnel—the short-term, non-career volunteers that make an all-volunteer

force possible—are significantly different than the career personnel the compensation system was designed for before the transition to an all-volunteer force. Keeping an all-volunteer force viable without fundamentally reforming the compensation system has proven costly and it is, ultimately, unsustainable.”²³

Finally, there is the issue of readiness. In-kind benefits really began in the early modern period as a way to ensure that the money spent on the military was going to the things service members actually needed, such as food, kit, and serviceable clothing, rather than alcohol, prostitutes, and other luxuries.²⁴ To a certain extent, this is still a concern. Militaries are aware that good health, financial security, childcare, and so forth are important readiness factors. Militaries are also aware that young people are not as good at responsible use of their finances as older, more seasoned people are.²⁵ It may indeed make sense for the military to provide certain benefits in kind instead of cash payments, but the state should carefully review which in-kind benefits truly contribute to readiness and which benefits could be usefully commuted to more flexible cash payments.

The MCRMC has made a number of recommendations on how to make the provision of benefits more efficient, and there appears to be hope that the military may adopt some of those recommendations. The Obama administration has signaled endorsement of some recommendations and contingent approval of others.²⁶ Additionally, the House Armed Services Committee voted overwhelmingly to approve the adoption of a “blended” retirement system.²⁷ If realized, this change would probably result in some savings to the government (at least, the MCRMC believes it will) and improved recruiting and human resources management. The MCRMC’s detailed modeling indicates that removing the “cliff” vesting system will not result in a significant degradation of the armed forces’ ability to retain personnel; in fact, it may help the services to become more flexible in encouraging some people to leave and in targeting retention bonuses at others. One issue that remains to be addressed is the possibility of increasing the age at which these benefits begin to be paid out. This would require revisiting the current assumption that military retirement pay is not in fact a pension but something more akin to retainer pay, entitling the government to recall retirees to service.

A second recommendation that has the support of the Obama administration but has not yet been addressed by Congress is some reform to the education benefits enjoyed by service members. The MCRMC has recommended sunsetting the old Montgomery GI Bill in favor of the post-9/11 version and raising the requirement for transfer of benefits to dependents from six years of service with an obligation for four more years to ten years of service with an obligation of two more. They also recommended limiting some other forms of tuition assistance to those programs that contribute to service members' professional development. So long as the United States maintains its traditional system of high-cost post-secondary education, this will remain a key benefit the military can offer, but it will also either increase in cost or decrease in worth over time, as the costs of higher education skyrocket.

Another area in which the MCRMC expected to find savings was in consolidating the commissary and exchange systems into a single Defense Resale System, but this has found little support from the administration or Congress.²⁸ The resistance to change here is curious, since there would be essentially no cost to the main stakeholders. Although the MCRMC found that it would be more economical to do away with the commissary system altogether, after polling many service members, veterans, and dependents, the MCRMC concluded that users value the commissary benefit far above its cost. Thus, it made more sense to look for efficiencies within the system, and this was the crux of their recommendation. It is not entirely clear why neither Congress nor the administration has endorsed this reform.

One area mentioned above, where the MCRMC had recommendations but where it was unlikely the government would find a cost savings, was in the provision of childcare. The MCRMC satisfied itself with recommending that the normal restrictive rules respecting minor military construction be relaxed for the building and refurbishing of childcare facilities, as this was a crucial force-readiness issue. The president signaled his support for this recommendation.

One recommendation that appears to have little support from the administration or Congress is reforming the military health care system. Health care for active and retired military personnel and their dependents is one of the biggest chunks of military personnel spending. In a 2014 report, the Congressional Budget Office noted that

the cost of providing that care has increased rapidly as a share of the defense budget over the past decade, out-pacing growth in the economy, growth in per capita health care spending in the United States, and growth in funding for DoD's base budget. . . . Between 2000 and 2012, funding for military health care increased by 130 percent, over and above the effects of overall inflation in the economy. In 2000, funding for health care accounted for about 6 percent of DoD's [Department of Defense] base budget; by 2012, that share had reached nearly 10 percent.²⁹

Part of this spending is because most military retirees prefer to stay on the military's health insurance plan (TRICARE) instead of choosing private insurance.³⁰ The United States, of course, has a general problem with the skyrocketing costs of health care; one overlooked consequence of our reliance on employer-provided insurance and lack of a standardized national system is a potentially unsustainable burden on the military budget.

In short, the problems we are having with the military budget cannot be fixed without fixing the larger problems—primarily regarding the costs of health care and higher education, in general. Even with downsizing, the military will need to attract high-quality personnel, and society will need to fulfill its obligations to care for retirees and dependents. That means the military will need to offer and pay for substantial benefits. Unless the United States can get those costs under control for everyone, it will have difficulty getting them under control for the military.

Conclusions

Militaries cannot behave exactly like private firms. It is more difficult for militaries to adjust their compensation policies to fluctuating market forces, because of the services' needs to moderate the rate of labor turnover—neither at-will nor lifetime job security—and to invest a significant amount in training their personnel in both vocational and firm-specific skills. In the context of an LME, the job security offered by the military may be attractive, but the unattractive fact that one cannot simply leave the service at will may also offset such an incentive. Many important benefits are dependent on an individual's employment status, and the military is competing for high-quality individuals who will be looking at how their job prospects compare both in terms of how attractive the work is and how appealing the compensation is. In an LME, the military must offer those benefits.

Militaries in other developed, democratic, market-based economies face some of the same problems as the United States, but many of those militaries experience those problems to a significantly lesser extent, because they have systems in which many important benefits are provided to all citizens, regardless of employment status. This helps in several ways. First, it creates economies of scale, where national infrastructure exists to provide health care or education at low cost and does not need to be created by the government just for the military. Second, it means the military cannot or need not provide generous benefits to attract recruits; it can concentrate more on cash pay and quality of work/life issues.

The nature of the labor market in the United States necessitates that the military offer all these benefits, which many other employers—including the federal government with respect to its civilian employees—do not offer. This is due to the combination of the fact that the military needs to compete for high-quality individuals and that Americans feel a sense of moral obligation to take care of those who have served in the military in a way that is different from the way we feel obligated to take care of other public servants or other people who do dangerous and difficult jobs. It is clear that these benefits, once instituted, are politically nearly impossible to reduce or eliminate—or even limit in terms of their growth. Part of the reason for this is that the government cannot always benefit from an economy of scale that would result from having a national structure for these benefits. Additionally, the government in a low-regulation context cannot limit the growth in how much these services cost. ~~Because the US government is difficult to tax~~ Because the labor market to provide these benefits and because it cannot control their costs, it really has only four options: it could accept the situation and plan on spending significantly more on defense to cover these costs; it could significantly reduce the size of the military; it could tinker around the edges of the costs, which is essentially what all the MCRMC recommendations do; or it could move toward a social model in which these benefits are provided to all citizens. Each of these options has significant drawbacks. What we appear to be doing right now is a combination of reducing the military's size and tinkering around the edges; it remains to be seen whether that can provide a permanent fiscal solution.

The likelihood of the United States moving to a CME model is extremely low. However, the debate over the Affordable Care Act high-

lighted the fact that the United States is the only developed country in the world—whether LME or CME—that relies primarily on a system of employer-provided health insurance, and it is at least possible that Americans may eventually choose to go to a more universal system. There has also been some debate over how to rein in the costs of higher education, but no consensus seems likely to emerge any time soon.

Americans do not like to think of their military personnel as employees, and they are uncomfortable discussing military pay and benefits as a pure market transaction. In the United States, discourse about military personnel tends to emphasize service, sacrifice, and selflessness, and it seems very inappropriate—almost in bad taste—to pose the question of how much members ought to be paid in return for their selfless service and sacrifice. Even worse is the question of how much pay the nation must offer someone to induce him or her to join an organization that involves that service and sacrifice. However, this is a conversation that Americans—including the service members, veterans, retirees, and civilians—must have if they are to reform defense spending in a sustainable way. This is not just because of the absolute amounts of money involved but also because of the trade-offs necessitated by scarce resources and the need to keep the civil-military contract legitimate and widely accepted.³¹ While some may argue that the United States could easily spend more on its military to keep up with the ballooning costs of benefits, others will point out that the nature of American politics and the realities of debt will make that difficult. Within a given budget, the more citizens have to spend on pay and benefits, the less they are spending on training, equipment, and readiness, and that is an unacceptable way to treat people whose lives and limbs may depend on that training and equipment. **SSQ**

Notes

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2. Richard Sisk, "Air Force Mourns Likely Passing of A-10 Warthog," *DOD Buzz: Online Defense and Acquisition Journal*, 18 September 2013, <http://www.dodbuzz.com/2013/09/18/air-force-mourns-likely-passing-of-a-10-warthog/>; John T. Bennett, "A-10 Proponents Seek Budget Offset to Keep Attack Planes Funded, Flying," *Defense News*, 10 April 2014, <http://www.defensenews.com/article/20140410/DEFREG02/304100025/A-10-Proponents-Seek-Budget-Offset-Keep-Attack-Planes-Funded-Flying>; and Amy Bushatz, "Pentagon Proposes Plan to Gut Commissary's Budget," *Military.com* (web site), 22 January 2014, <http://www.military.com/daily-news/2014/01/22/pentagon-proposes-plan-to-gut-commissarys-budget.html>. The Budget Control Act's sequestration provisions exempted the military personnel budget, but experts insist that personnel costs are one of the most unsustainable parts of the defense budget. See Todd Harrison, "How Can We Save Money on Troops' Pay and Benefits? Let's Ask the Troops," *Washington Post*, 19 April 2013, http://www.washingtonpost.com/opinions/how-can-we-save-money-on-troops-pay-and-benefits-lets-ask-the-troops/2013/04/19/8f9f0258-a5d8-11e2-b029-8fb7e977ef71_story.html; Todd Harrison, "Defense Cuts Conundrum: Weighing the Hard Choices," *Foreign Affairs* (web site), 29 September 2013, <https://www.foreignaffairs.com/articles/united-states/2013-09-29/defense-cuts-conundrum>; Todd Harrison, "Keeping Faith with the Troops: How Congress Can Fix the Military's Compensation Problems," *Forbes*, 3 February 2015, <http://www.forbes.com/sites/toddharrison/2015/02/03/congress-military-compensation/>; Cindy Williams, "Accepting Austerity: The Right Way to Cut Defense," *Foreign Affairs* 92, no. 6 (November–December 2013): 54–64, <http://www.foreignaffairs.com/articles/140158/cindy-williams/accepting-austerity#>; and Cindy Williams, *Making Defense Affordable*, Hamilton Project Discussion Paper 2013-02 (Washington, DC: Brookings Institute, February 2013), http://www.brookings.edu/-/media/research/files/papers/2013/02/make%20defense%20affordable/thp_williamsdiscpaper.pdf.

3. Todd Harrison, *Rebalancing Military Compensation: An Evidence-Based Approach* (Washington, DC: Center for Strategic and Budgetary Assessments, 2012), <http://csbaonline.org/publications/2012/07/rebalancing-military-compensation-an-evidence-based-approach/>; Harrison "How Can We Save Money?"; Harrison "Defense Cuts Conundrum"; Williams "Accepting Austerity"; Williams *Making Defense Affordable*; Donna Miles, "QDR Panel Calls for More Force Structure Changes," *American Forces Press Service*, 4 August 2010, <http://www.defense.gov/news/newsarticle.aspx?id=60303>; and Matthew S. Goldberg, *Costs of Military Pay and Benefits in the Defense Budget* (Washington, DC: Congressional Budget Office, November 2012), http://www.cbo.gov/sites/default/files/11-14-12-MilitaryComp_0.pdf.

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8. This article will not touch on the Department of Veterans Affairs (VA) budget, which of course is where much of the cost of in-kind benefits resides. The VA covers benefits primarily for those service members who served less than the 20 years necessary to have the status of a "retiree," including health care, special pensions, education benefits, survivor benefits, disability, and some other subsidized benefits, such as home loans and life insurance. Reforming the VA is another civil-military imperative but is outside the scope of this article.

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13. OECD, *Pensions at a Glance 2014: OECD Indicators* (Paris, France: OECD Publishing, 2014), http://www.keepeek.com/Digital-Asset-Management/oecd/finance-and-investment/oecd-pensions-outlook-2014_9789264222687-en. All LMEs fell below the OECD average pension replacement rate of 54.4 percent for average earners, while only three European CMEs did. However, Japan and South Korea also fell below the average. The LME average was 41 percent, while the European CME average was 61.2 percent. (LMEs: Australia, Canada, Ireland, New Zealand, the United Kingdom, and the United States. CMEs: Austria, Belgium, Denmark, Finland, France, Germany, Iceland, Luxembourg, the Netherlands, Norway, Sweden, and Switzerland. The status of the states of Southern and Eastern Europe is still somewhat contested in the literature, so they were omitted from this calculation).

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