

Session 3: Changes in the Cost of Labor

Chair: Cindy Williams

Panelists: Carla Tighe, Don Cymrot, Casey Wardynski, and Jim Hosek

Cindy Williams introduced the session with two comments:

- Over the course of the AVF, the cost of labor has been dramatically affected, and has become much higher;
- It is important to see what has happened, what is happening, and what it means.

Carla Tighe focused on the cost of labor as a signal to decision-maker, and noted that military labor costs now make up roughly one-third of the overall budget. She noted that one would expect to see changes in the capital/labor ratio, and increases in outsourcing. The patterns should be similar to those in industry, i.e., protecting the core activities of the enterprise but outsourcing peripheral activities. Contractors would be used to handle seasonal and cyclical peaks and valleys, taking advantage of economies of scale.

The AVF appears to provide the incentives for such patterns, but experience with outsourcing over the last 30 years does not seem to bear out the expected outcomes. The A-76 database reveals that very few military positions have been subjected to study for outsourcing. In its first year, 1978, 221 positions were studied. This increased gradually to about 3,000 per year by 1989, but Congress imposed a moratorium in the early 1990s. The moratorium was later lifted, and since 1996 about 1400-1500 military billets have been studied each year for possible privatization. While the numbers did grow, the studies were very small as a percentage of the total force. This suggests that the signal was present, but weak.

Why? It is possible that the signal was received at the headquarters level, with initiatives imposed from the top down, but not really felt at the field level. Moreover, the signal may be subject to distortion on the way down. Unfortunately, **Tighe** concluded, more work needs to be done to shed further light on these possibilities. In particular, further analysis of the financial and budgetary incentives to improve efficiency would be useful.

Don Cymrot spoke of the need to confront the reasons behind the failure to reform the military retirement system. The REDUX reforms collapsed just as they were about to take hold because of a perceived fairness or equity issue, espoused even by those who were not affected by the reform. Top leadership was unwilling to counter the equity arguments, and the analytical community was caught by surprise. The opportunity for reform was lost, although there has been some progress in dealing with cliff vesting through devices such as Thrift Savings Plan (TSP) contributions, etc.

So what needs to happen in compensation? We observe lots of special pays, bonuses, etc. We need to learn the lesson of retirement—that it is difficult to change the system in ways that will raise equity issues.

There is a far larger variance in civilian pay than in military pay. Civilian pay varies by roughly 250 percent over occupations while military pay, even with SRBs, only varies by about 90

percent. We face a larger pay gap, relative to civilian pay, for new economy skills than for old economy skills.

To address the need for greater variance in military pay, **Cymrot** proposed a three-tier pay scale made up of base pay, skill-based pay, and assignment based pay. (The last could be market-based, e.g. account for locality differences as well as differences in service conditions, such as sea duty.)

The purpose of such reforms in pay would be to separate it from military rank. Lateral entrants could come in at relatively low rank, but high skill pay. The idea is to allow DoD to compete more effectively for highly-valued skills without the supervisory responsibilities implied by bringing people in at high rank.

Casey Wardynski spoke of the implications of the rising trend in military spouses' labor market participation rates for family income and the compounding difficulties imposed by the Army's location patterns. He suggested that the military compensation system implicitly assumes that military spouses do not work, and pointed out that until the mid-1980s a spouse's volunteer activities could be recorded on an officer's fitness report.

Now, however, upwards of 65 percent of military spouses participate in the labor market. The frequent shifts in location, and poor location of military bases for spousal employment (that is, the Army, Air Force and Marines have large bases in areas with weak labor markets for spouses seeking jobs) result in a finding of lower wages earned by these spouses than their civilian contemporaries.

In the future, the force is likely to be at least as married as at present and that spousal income is likely to be at least as important to the family as at present. In addition, given trends in education, levels of spousal education are likely to be even higher than at present. This trend does not bode well for retention unless spousal needs are met.

Wardynski suggested that some of the location factors that drove the current basing pattern (largely cheap land for training, or dispersed locations for SAC missile fields and airbases) probably will not be as important as they once were. The services need to explore options to decrease the effects of lost spousal income, either by reexamining their basing patterns, or, more conservatively, pursuing compensatory programs. These include preferential hiring of spouses by the military, use of employment subsidies or tax credits for contractors hiring spouses, use of private-public partnerships to create on-base industrial parks akin to the one under development at Fort Leonard Wood, or use of the Internet to expand the scope of labor demand beyond the confines of markets adjacent to military installations.

Jim Hosek's theme was making the most of the AFV, which implies the need for the efficient utilization of manpower—both in operations and the compensation of people. The challenges are to attract and keep people and to utilize them effectively.

Military/civilian wage ratios have always been computed for a particular reference group of civilians. That is, wages for officers are compared to wages for college graduates, and enlisted wages to those of high school graduates. There is probably a need for an additional level of sophistication, to include a comparison to those in the civilian labor force with some college, not

just high school. This would take better account of the large increase in post-secondary enrollment and rising returns to higher education (although these returns have risen and fallen over time).

There is a correlation between education and performance on the AFQT tests: those with four or more years of college score at the 84 level, those with some at the 65, and those with none only at the 50 level. Further, college enrollment rates have been rising. The rise in college enrollment rates is reducing the size of the traditional recruiting market, and the correlation between AFQT and educational attainment means that the traditional recruiting market is being disproportionately depleted of high quality prospects.

Another change is that many people are now pursuing higher education throughout their 20s. The returns to 4 or more years of college have risen the fastest, which serves as an inducement to persons with some college to complete their college degree. Also, wages have risen faster among IT and “knowledge-worker” occupations than other occupations. Although the increased supply of college graduates may slow down their wage growth in the future, the military cannot necessarily count on this and wait for it to occur.

These trends suggest that we need to worry about organizational issues and career paths. As Secretary Danzig indicated, we are not making efficient use of personnel.

We need to concern ourselves with the number of high quality recruits, and with retaining high tech workers. The proportion of high quality recruits has fallen from an all-time high of 72 percent in 1992 to 59 percent in 1999. This is important because high quality recruits are more proficient in performing their mission-essential tasks, and because the average AFQT of an enlisted cohort does not increase during its service career. Those in both tails (with the highest and the lowest AFQT scores) leave. Thus the best predictor of the AFQT scores of a cohort are the entering scores of that cohort.

Retention shortfalls in any occupation can hurt readiness, but high tech areas hurt most. For example, the Air Force currently doesn't have enough E-5s and E-6s to train E-3s, so by the time the current E-3's reach E-5 grade, they will not be as well trained as their predecessors.

The compensation structure also may not be cost efficient. The military departments tend to manage to profiles that are the same across 2 digit MOSs. But high quality personnel may have greater and longer proficiency increases. Higher aptitude personnel learn faster and better. The services may therefore want to lengthen careers in some areas to reduce the number of recruits needed, which would also increase the return on training investment.

The Air Force does have longer careers on average, but treats all careers the same. Hosek suggested that they should not be all the same lengths. The balance between youth and vigor and education and training may differ in different areas.

The services also may want to retain the best in each field. Reenlistment bonuses reflect only occupation, not the AFQT score. While promotion practices may help, may want to separate pay from rank to develop a system that allows you to keep, but not promote, people out of the jobs you need them in. This is an open question.

In the mid 70's there was a lot of work on the experience mix. We need more work on the relationships between AFQT, experience, education, and productivity. There is lots of ground to cover, which will require more thorough and continuous study.

The private sector has paid a lot of attention to workers, and has changed many practices accordingly. This is less true of the military. Is this all force of habit? Why isn't the senior leadership pushing this? Is an outside force like Secretary Danzig required?

DoD analysts often use static models, when a more dynamic, stochastic approach is needed. There is little information on on-the-job training. DoD in the mid-70s created the Defense Manpower Data Center to provide data. It is time for a radical look at the data holdings and files made available to researchers, and the integration of the files. Data should be made available in a usable form to all, with better ties between files.

Williams summarized the panelists' comments by noting that DoD faces a very competitive environment, but that there are some options for addressing this. One is to substitute private sector employees for military—but there are obstacles. Another is to change compensation towards a more skills-based approach, but other concerns, such as equity, can suppress support for such efforts. Comments on the labor consequences of the basing structure are well taken. And, the outside world focuses more on dollars and cents. A more flexible approach to DoD compensation policy is needed.