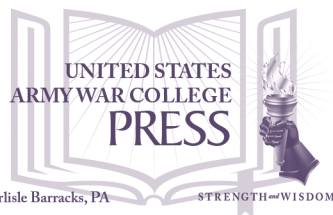


Officer Corps Strategy Monograph Series

Volume 8



PAID TO PERFORM: ALIGNING TOTAL MILITARY COMPENSATION WITH TALENT MANAGEMENT

Roy A. Wallace

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Andrew O. Hall

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and
U.S. Army War College Press**

**PAID TO PERFORM:
Aligning Total Military Compensation
With Talent Management**

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June 2015

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This volume is the 8th in a series of monographs on officer talent management.

7. *Creating an Effective Regional Alignment Strategy for the U.S. Army*, November 2014, authored by Major Raven Bukowski, Major John Childress, Lieutenant Colonel (Ret) Michael J. Colarusso, Lieutenant Colonel David S. Lyle.

6. *Towards a U.S. Army Officer Corps Strategy for Success: Employing Talent*, May 2010, authored by Colonel Casey Wardynski, Lieutenant Colonel David S. Lyle, and Lieutenant Colonel (Ret) Michael J. Colarusso.

5. *Towards a U.S. Army Officer Corps Strategy for Success: Developing Talent*, March 2010, authored by Colonel Casey Wardynski, Lieutenant Colonel David S. Lyle, and Lieutenant Colonel (Ret) Michael J. Colarusso.

4. *Accessing Talent: The Foundation of a U.S. Army Officer Corps Strategy*, February 2010, authored by Colonel Casey Wardynski, Lieutenant Colonel David S. Lyle, and Lieutenant Colonel (Ret) Michael J. Colarusso.

3. *Towards a U.S. Army Officer Corps Strategy for Success: Retaining Talent*, January 2010, authored by Colonel Casey Wardynski, Lieutenant Colonel David S. Lyle, and Lieutenant Colonel (Ret) Michael J. Colarusso.

2. *Talent: Implications for a U.S. Army Officer Corps Strategy*, November 2009, authored by Colonel Casey Wardynski, Lieutenant Colonel David S. Lyle, and Lieutenant Colonel (Ret) Michael J. Colarusso.

1. *Towards a U.S. Army Officer Corps Strategy for Success: A Proposed Human Capital Model Focused upon Talent*, April 2009, authored by Colonel Casey Wardynski, Lieutenant Colonel David S. Lyle, and Lieutenant Colonel (Ret) Michael J. Colarusso.

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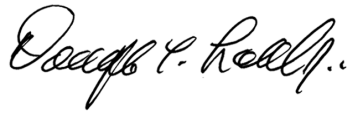
FOREWORD

The United States finds itself at a profound inflection point. Since World War II, its national security threats have tended to accumulate rather than diminish. While U.S. military capabilities remain more advanced than that of any other state, an increasingly interconnected global economy has allowed potential adversaries to shrink the technological lead currently enjoyed by America's Armed Forces. Additionally, U.S. economic power has declined relative to that of other nations, steadily narrowing its defense spending advantage. Meanwhile, increasing Federal budget austerity has focused Congress upon reigning in defense costs, particularly in the personnel realm.

The authors of this monograph believe that talent management—the science of creating a higher performing, more productive, and more satisfied workforce—is critical to dealing with these national security challenges. They argue that, instead of making across-the-board cuts to service member pay and benefits, Congress should allow the Department of Defense to implement an integrated talent and compensation management redesign, creating a far more operationally effective and fiscally efficient “force of the future.” They posit that this is possible, however, only if the entire military compensation system is overhauled: basic pay, pensions, and retirement; incentive and special pays; nonmonetary compensation; etc.

Given the increasing threats and declining budgetary resources described, and as several other recent compensation redesign proposals have been less

comprehensive in scope, aligning total military compensation with talent management efforts merits close attention by government and military leaders alike.

A handwritten signature in black ink, reading "Douglas C. Lovelace, Jr." in a cursive script.

DOUGLAS C. LOVELACE, JR.
Director
Strategic Studies Institute and
U.S. Army War College Press

SUMMARY

Transforming the U.S. military's personnel management system is critical to long-run American national security interests, particularly as increasingly capable peer adversaries emerge. Talent management—the science of creating a higher performing, more productive, and more satisfied workforce—is critical to confronting these threats, particularly in an austere fiscal environment. This transformation cannot take place in a vacuum, however. As an extensive body of labor economics literature makes clear, total compensation management is an integral part of talent management. As the military changes the way it accesses, retains, develops, and employs its people, so, too, must it change the ways in which it compensates them. However, the current compensation system, rooted in industrial-era labor management practices, has outlived its usefulness. It is not linked to defined organizational outcomes, rests upon an ineffectual evaluation system, and does little to incentivize performance. Designed to complement an “up or out” personnel system that treats people as interchangeable parts, it has been rendered obsolete by dramatic changes in the American labor market, fiscal constraints, technological advances, and the changing nature of information age work.

Using the Army's Officer Corps as a case study upon which a wider compensation model can be built, we propose a system that thoughtfully integrates redesigned basic pays and pensions, “monetizes” nonpay benefits, and provides additional performance incentives in critical positions demanding organizational productivity.

How can we reward . . . and promote people not simply on the basis of when they joined, but . . . on the basis of their performance and talent? How can we be that kind of organization?

Secretary of Defense Ashton Carter¹

**PAID TO PERFORM:
Aligning Total Military Compensation
With Talent Management**

**INTRODUCTION – The Case for a Complete
Compensation Overhaul**

That the pay of the Officers and privates be as follows:
a captain at 20 dollars per month; a lieutenant at 13
1/3 dollars; a serjeant [sic] at 8 dollars; a corporal at
7 1/3 dollars; drummer or trumpeter at 7 1/3 dollars;
privates at 6 2/3 dollars; to find their own arms and
clothes.

Resolution of the Continental Congress,
June 14, 1775²

Congress has debated military compensation rates since the inception of the U.S. Armed Forces. What is different today, however, is the impetus for debate. While budgetary concerns still appear to dominate, the issue at hand is not really a fiscal one but a national security one. As peer competitors operate ever closer to the defense technology frontier due to rapid economic development and globalization, the U.S. military's long-held advantage in physical capital and equipment is waning. This is why human capital investment is more critical than ever before. Equipment does not learn, grow, or innovate—individuals and organizations do.

To ensure the Armed Forces retain and extend their global people advantage, the Department of Defense (DoD) is gradually reworking the military's woefully outmoded, industrial-era personnel system to help create a "force of the future." As new talent management practices emerge, sound compensation

management principles must undergird them. Modern economic theory holds that thoughtfully designed total compensation is integral to maintaining a highly productive workforce. The military's current compensation system, however, is an artifact of a bygone era.³ As a result, it is not linked to defined organizational outcomes, rests upon an ineffectual evaluation system, and does little to incentivize performance.

This is particularly problematic for Active Duty commissioned officers, who (in collaboration with the service secretaries) lead program and policy development for the rest of the Armed Forces—Guard and Reserve, warrant and enlisted. Because they possess such a significant span of control, we have focused our analysis accordingly—getting active component officer talent and compensation management right is a precondition to wider implementation.

Recently, several beltway think tanks and “blue ribbon panel-type” commissions have made military compensation redesign proposals, most notably the Military Compensation and Retirement Modernization Commission (MCRMC).⁴ While each proposal has merit, collectively they tend to focus upon “run-away” pension and health care components, with little or no consideration given to restructuring basic pay (military salary). For example, the MCRMC made the following assessment of the current basic pay table system:

The basic pay table provides simplicity, equity, and transparency, and the targeted changes to the pay tables in 2000-2001 proved valuable during the 13 years of war. The system of allowances is appropriate and strikes the correct balance between Service member compensation and financial assistance for expenses.⁵

Perhaps this hands-off approach is because basic pay is considered sacrosanct, particularly while service members remain in harm's way around the globe—"shoot if you must this old grey pension, but spare your military's basic pay." More likely (and despite protestations to the contrary) it is because the MCRMC and several other proposals seem focused upon cost savings rather than national security—a "spend less" rather than "spend better" approach.

Salary, however, is the **centerpiece** of any workforce pay and benefits structure. Trying to overhaul the military's antiquated compensation management system without fine-tuning basic pay is akin to servicing an engine without checking the oil. Carrying the analogy a bit further, the military is a high performance machine fueled by a talented mix of Soldiers, Sailors, Airmen and Marines. Overhauling its "compensation engine" **can** lower operating costs, but only as a happy by-product of improving **performance**. Because talent management creates a higher performing workforce, it should be the first tool applied to any compensation system overhaul, to include all of its components: basic, performance and incentive pays, pensions and retirement benefits—the works.

Unlike the MCRMC, we find the current basic pay table problematic. Its central design principle is to march officers along lock-step career paths, "up" a graduated pay scale and "out" the door, typically at 20 years of service.⁶ In a 21st century context, however, "up or out" personnel management is not a good thing. Just like the rest of the America's skilled labor force, today's officers are healthier, live longer, and are lifelong learners. As several recent labor studies suggest, the 40s and 50s are often a worker's most productive years. Thanks to the military's antiquated evaluation, promotion, and compensation systems, however,

a great number of officers with high-demand talents will be out of uniform by then, poached by the private sector, mistakenly culled at mid-career, or lured into retirement by generous pension benefits that kick in too early.⁷

A particular flaw in the current officer basic pay table is the timing and magnitude of scheduled pay increases, which largely ignore changes in officers' "opportunity costs" (the compensation that they could command outside of the military) across a typical career timeline. For example, the largest officer pay increases occur during Active Duty service obligation periods and flatten **afterwards**, just when officers are **more** vulnerable to private sector poaching. Furthermore, the overarching officer compensation system fails to leverage thoughtfully a host of nonmonetary compensation benefits that individuals value but that have little or no budgetary implications (duty and location preference, continuing education, status, job satisfaction, family stability, etc.).

Today's military compensation system assumes that employees value all benefits equally (with cash valued above all). This assumption is forced upon the services because they do not truly know their officers — what each wants and the value he or she ascribes to it. In economic parlance, this is called an "information asymmetry," and it creates significant disadvantages to the Government during wage contract negotiations. If the military hopes to compete with the private sector for talent, it must better integrate noncash benefits into any total compensation management redesign, just as Southwest, Google, General Electric, Proctor & Gamble, and Microsoft do. That is why its compensation management system must be built upon a talent management approach that recognizes and unleashes

the unique skills, knowledge, and behaviors of every service member.

In the following pages, we propose such a system, one attuned to presidential guidance while remaining mindful of sound economic theory, military labor demands, and national security considerations. While not its *raison d'être*, our proposal does yield cost savings, a by-product of efficient design. It also provides greater flexibility in response to external labor market conditions, leverages readily available monetary and nonmonetary compensation sources, and includes performance incentives to enhance workforce productivity. Again, while our recommendations apply specifically to officer compensation, their guiding principles generalize to the entire military workforce. Of note, our total compensation management redesign also incorporates a pension overhaul proposal known as the "10-15-55" plan.⁸ This is critical, as pensions **are** compensation, albeit of a deferred nature.

BACKGROUND – Talent Management as a Compensation Change Framework

There is no such thing as a 'good man.' 'Good for what?' is the question.

Peter Drucker⁹

While we have explained why any new compensation system must rest upon talent management principles, some readers may not yet understand why the world's most formidable military is shifting to this new approach.¹⁰ The answer is reasonably straightforward—national security demands it. Talent management develops, employs, and rewards a multiplicity of abilities across an entire workforce rather than focusing upon a narrow distribution of perceived high performers. A deep and broad talent inventory is the single best way to mitigate the risks of an uncertain threat environment and an increasingly competitive labor market.

In the last 40 years, American labor market demands have shifted to support an ever changing economy with fundamentally different work requirements. No longer focused upon physical labor, the high-tech, service-centric, information age economy that emerged in the 1980s demands a far higher share of "knowledge workers," people who add value and increase productivity through creative thinking and innovation. The relatively limited supply of these workers has also made talent poaching standard practice in the labor market. The era of the "organization man," when bosses unilaterally made employment decisions, is over. Today's knowledge workers are not content to stay with one employer for 40 years. They value steady employability far more than steady em-

ployment, and they are willing to change jobs often to secure greater rewards. Faced with this high-demand, high-churn, high-skill labor market, employers had to change their personnel practices or perish. The firms that continued to thrive were usually those that turned to talent management.

The military has been subject to the same information age forces as the American private sector. Gone are the days when victory hinged exclusively upon masses of men charging across the battlefield behind interchangeable combat arms officers. In today's far more complex operating environment, the services need and create knowledge workers as well. Unlike the private sector, however, military manpower management practices have seen little innovation since World War II. That is now changing, however. The Armed Forces are finally beginning to innovate in the personnel arena, applying many of the same talent management techniques that have made their corporate cousins hypercompetitive in a dynamic global environment, and the current defense secretary seems intent upon accelerating this shift.¹¹

The services should benchmark from civilian firms very carefully, however, as they differ from them in a critical way. The profession of arms is built upon trust. It relies upon an internal labor market, with little ability to poach executive talent to perform most core functions. After all, directing the measured and ethical application of deadly force is not something Dell or Pfizer does. This limits lateral entry into the military's mid- or senior-officer positions. It also means that the military must pay far closer attention to its junior officers, the feedstock for its mid- and senior-level leadership. These unique workforce characteristics make the need for a modern, flexible compensation man-

agement system even more critical to the military's Officer Corps than it is to the private sector.

Figure 1 highlights the four critical components of an officer talent-management model: new **accessions**, targeted **retention**, appropriate **development**, and effective **employment** of **talent**, all supported by an extremely granular evaluation system.¹² These components are complementary rather than linear—they occur simultaneously and are of equal importance. In the Army's case, they also apply across the three phases of a 30-year officer career—the initial junior grade or “apprenticeship” phase, the mid-career or full “practitioner” phase, and the late-career “senior leader” phase.

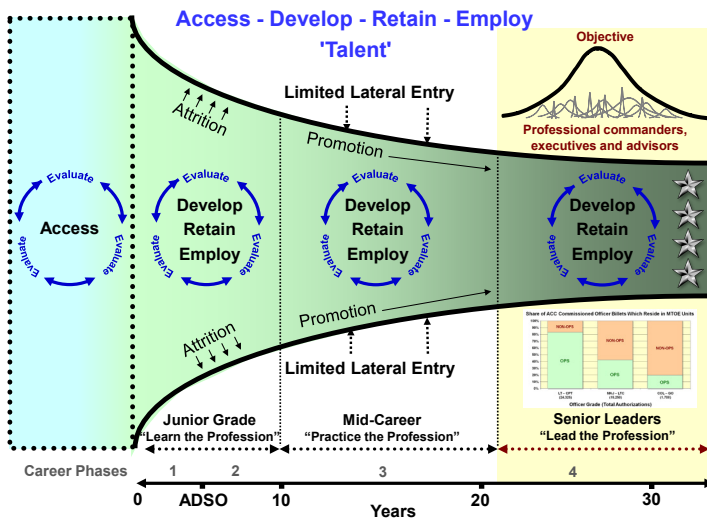


Figure 1. The Officer Talent Management Model.

This model is shaped by several factors. As previously mentioned, the military by necessity has limited lateral entry into its mid- and senior-career ranks,

which makes retention more critical, particularly among officers completing their initial Active Duty Service Obligation (ADSO). Additionally, as officers move into their mid- and senior-career phases, the bulk of the jobs awaiting them demand “enterprise leadership” talents, the nonoperational or “business side” of the Armed Forces. Policy; force management; budgeting; research and development; strategy and doctrine; acquisitions and procurement; foreign relations; domestic politics; accountability to Congress; joint, combined, and interagency coordination; public affairs and outreach; and a myriad number of other talents are needed to lead one of the nation’s most complex and critical organizations.

Given these realities, a talent-driven officer career timeline must incorporate extremely comprehensive, “whole person” assessments, going well beyond each officer’s tactical or operational acumen (after all, it’s impossible to negotiate unique compensation contracts with officers if their unique talents remain hidden). As Figure 2 indicates, these “Individual Development and Employment Assessments” (IDEAs) are so critical to ensuring the optimal development and employment of each person that we recommend executing one at the beginning of each officer career phase (with additional “azimuth check” assessments at 15, 24, and 27 years of service [YoS] to determine whether an officer’s particular talents remain relevant to constantly evolving service demands).

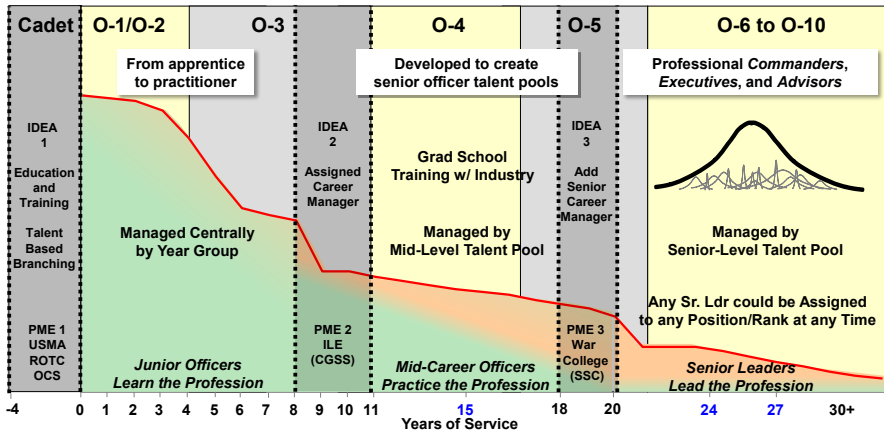


Figure 2. A Talent-driven Army Officer Career Timeline.

For example, each of the commissioning sources (whether the service academies, reserve officer training corps [ROTC], or officer candidate school [OCS]) provides a powerful IDEA opportunity. For 3 to 47 months, future officers are immersed in rigorous training and educational environments that can reveal extremely granular talent information, provided the right assessment tools are employed. This information can be used to match each individual with his or her optimal occupational specialty, but even more importantly, it establishes a cognitive and noncognitive talent baseline for each officer entering the service.¹³

Army officers currently spend their apprenticeship years (O-1 to O-3) being “on-boarded” into the profession via tactical and operational assignments, a solid practice that we recommend continuing. Before entering mid-career as O-4s, however, officers pass through two gates on an industrial-era personnel assembly line: an O-4 promotion board and a resident

Command and General Staff School (CGSS) board. Both are convened at Department of the Army-level by well-intentioned people with very little talent information. Relying upon generic and inflated efficiency reports, their unenviable duty is to evaluate the career potential of hundreds of young officers whom they have never met.

CGSS is a 44-week, intermediate officer educational requirement administered by the Command and General Staff College (CGSC) at Fort Leavenworth, Kansas. It matriculates roughly 50 percent of all officers selected for promotion to O-4 (the remainder taking the course via satellite school/distance learning modules). Much like the commissioning sources, CGSS is an excellent time and place for IDEAs but these can only occur with accompanying adjustments to officer management policies. One adjustment would be to link O-4 promotion to CGSS completion (thus eliminating a promotion board). To do this, however, CGSS must first become a far more rigorous and intellectually demanding environment, one that “screens, vets and culls” **all** potential field grade officers, not just half of them.

First, the CGSC must gain discretion over its staff school admissions from the Department of the Army.¹⁴ Unlike the challenge facing other graduate school admissions departments, these applicants are not strangers — their comprehensive military performance histories and corresponding talent inventories should inform any admissions decision. Before extending admissions offers to prospective students, however, the college should **also** consider previous academic performance and a demonstrated ability to perform at the graduate level (captured via transcripts, writing samples, Graduate Record Examinations [GRE], etc.).

This is critical because CGSS graduates will be less concerned with tactical operations and increasingly involved in institutional/enterprise management as they enter the mid- and senior-officer ranks.

What we are suggesting, then, is that all company grade officers desiring promotion to major would apply to CGSS. Some would opt out by not applying, and, as “screening” suggests, not all of those who apply would gain entry. The acceptance rate would be pegged to overarching mid-grade officer demand (likely in the 70-80 percent range). While those denied admission could be retained at the service’s discretion, the vast majority would be involuntarily separated (although, per our compensation redesign, with a very generous pension benefit, which we introduce later in this monograph).

Once accepted to CGSS, officers would enter an extremely rigorous vetting environment. For 44 weeks, they would be put through their intellectual paces. Far from “taking a knee,” the school experience would challenge officers across the spectrum of field grade talent demands, with new evaluative mechanisms and performance management experts cataloguing levels of each. Those meeting baseline requirements for field grade service would be sorted into the appropriate talent pools at the end of the program, but to be clear, 100 percent graduation rates would fall by the wayside. The rigors of the course would cull a further 20% - 30% of enrolled students (again, contingent upon force requirements).

This new methodology better aligns officer talents against demands by leveraging economic principles proven to increase productivity and job satisfaction. It ends the practice of selecting people for promotion and then shunting half of them into nonresident course-

work, an onerous additional duty that simultaneously denies them the benefits of instructor, evaluator, and peer interaction. It eliminates a negative signal (“you are less worthy of human capital investment than your peers”) and replaces it with a meaningful credential: CGSS graduation. Because graduates will complete a rigorous course that screens, vets, and culls perhaps a third of their peers, the CGSS diploma will signal that they possess field grade talents truly in demand. This is why promotion to O-4 will be concurrent with graduation – no promotion board is necessary.

There are additional benefits as well. For example, providing Leavenworth with admissions authority will increase its relevance and accountability for graduation outcomes. Because officer assignments from mid-career forward are increasingly nonoperational, a carefully redesigned CGSS curriculum will better prepare each graduating class to meet those demands. Last and most important, however, this talent-driven methodology will provide a 9-month, round-the-clock talent evaluation opportunity that ensures terrific assessment fidelity for each and every officer, certainly more accurate than the seconds spent on each by legacy promotion boards. This will allow officers to be sorted into the right talent pools at graduation and managed by their talent potential rather than by year group. This will continue for the rest of their careers, giving the services the flexibility to place the right officer in the right job, regardless of rank or time in service.

Leveraging extremely rigorous professional military education to conduct deep individual assessments at commissioning and mid-career would repeat a final time at the senior service college level: all mid-career officers desiring promotion to O-6 would ap-

ply; not all would be accepted; the respective colleges would make the admissions decision; successful graduates would become O-6s, etc. This final, penetrating talent assessment would ensure that those entering the senior officer cohort were appropriately matched to the strategic, enterprise level management duties awaiting the vast majority of them. As with mid-career officers, the removal of year group management constraints would truly liberate talent, providing the services' human resource professionals the assignment flexibility demanded by the speed of change in the information age. This flexibility, however, requires an equally modern and flexible compensation component.

Total Compensation Redesign – Assumptions and Principles.

A modern employee compensation scheme must do several things: identify desired organizational outcomes; assess the degree to which workers are meeting those outcomes; and directly link compensation to both. Unfortunately, today's military compensation is not linked to defined organizational outcomes; it rests upon an ineffectual evaluation system and does little to incentivize productivity. It also ties compensation more directly to **time in service** rather than **manner of performance**, quite out of step with the professional military ethic.

Our total compensation redesign proposal will help redress these problems. It rests upon some important assumptions: that the military possesses sufficient ability to assess global threats and establish national security objectives in accordance with guidance from the U.S. Government; that the Government seeks

the most efficient and effective expenditure of defense dollars; and, as already discussed, that a talent management approach must be integral to compensation redesign. Given these, as well as presidential guidance, relevant labor economic theories, and today's modern data management capabilities, we have identified five redesign principles with which a talent-driven military compensation system must adhere. They provide a framework with which to identify and correct flaws in the current system:

1. **Cost Effective:** Enhances national security at the lowest cost to taxpayers without shortchanging service members.

2. **Competitive and Equitable:** Attracts and retains the right talent with tailored compensation.

3. **Flexible:** Supports the ability of the U.S. Armed Forces to adapt to change.

4. **Performance Driven:** Links individual performance to both service values and required outcomes.

5. **Supportable and Executable:** Easy to comprehend and relatively simple to implement—garners sufficient support from critical stakeholders.

Principle #1 — Cost Effective

Our men and women will always be our greatest strength, and they deserve the best possible support we can provide. However, as leaders, we all must exercise good stewardship over the resources entrusted to the Department, including competitive pay and compensation consistent with a ready and modern force.

General Martin Dempsey,
Chairman of the Joint Chiefs of Staff¹⁵

Basic Pay Table Redesign.

In a fiscally unconstrained environment, the Armed Forces could compete in the labor market at any wage level. Reality, however, requires the uniformed services' compensation system to balance national defense against some very real resource constraints.¹⁶ While the DoD fields the most capable military in the world, it must remain an excellent steward of taxpayer funds, even during perilous national security conditions or armed conflict. Using active component officers as an example, however, it is clear that fiscal stewardship of payroll dollars can certainly be improved.

Consider Figure 3, which displays officer base pay increases over the course of a 30-year career, expressed as a percentage of base pay at the previous rank.¹⁷ The largest pay raise (36 percent) occurs upon promotion to O-3, the culmination of several generous raises during an officer's initial ADSO. Meanwhile, pay increases over the next 5 to 6 years of **non**-obligated service are relatively small (5 percent each).

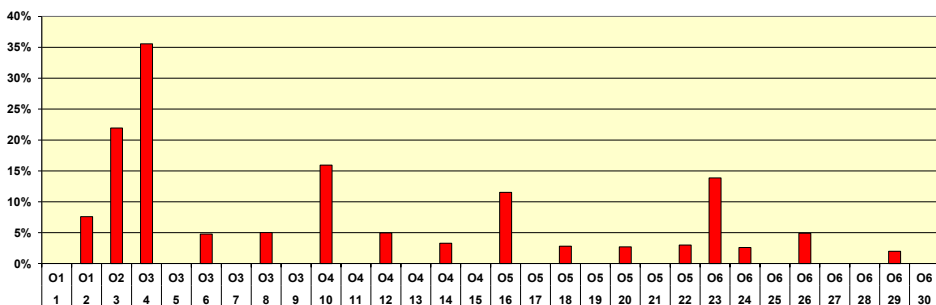


Figure 3. Overpaying Junior Officers, Underpaying Mid-Career Officers: Pay Increases as a Percentage of Previous Base Pay (2014).

This is quite inefficient because junior officers serving their initial 4- to 5-year ADSO are in effect “repaying” the services for college tuition assistance and/or guaranteed employment and benefits upon graduation.¹⁸ During this time, their outside employment options are virtually nonexistent, due both to their contractual service obligation and relative lack of experience. As a result, steep wage increases at the very beginning of an officer’s career amounts to overpayment—the Armed Forces are paying someone to stay who has no option **but** to stay. Doing so expends hundreds of millions of payroll dollars annually that could be used more effectively later.¹⁹

For example, from their 5th to 9th years of service, most officers accumulate significant command experience, a highly valued private sector commodity. At this career point, most officers are in their mid- to late-20s, a prime age to enter the mid-executive ranks in private firms that are assiduously trying to poach them. In other words, officers have far higher military

service opportunity costs as senior O-3s than they will at any other point in a 30-year career. To prevent talent leakage, **this** is the time to significantly ramp up basic pay, but the dollars are not available because they were paid out far earlier (and thus longer) than necessary. In short, the current compensation system fails to accurately gauge the market value of officer talent, thus overpaying new officers and underpaying more seasoned ones.

This can be easily remedied. As Figure 4 demonstrates, we propose modest pay increases during the early years of obligated service: 5 percent at the end of years 1 and 2 and another 10 percent upon promotion to O-3. A 35 percent pay increase would follow at year 5, when officers are more experienced, free of their ADSOs, and thus most vulnerable to talent poaching. Two more 10 percent pay raises would follow at years 8 and 10.

From the 11th year of service onward, however, full talent management would replace year group management, thus eliminating time-in-service pay raises. While monthly base pay for O-4s and O-5s would remain constant (with the occasional cost of living adjustment), additional base pay increases would be linked to significant accomplishments. Further variations in pay would be driven by observed performance differentials, job degree of difficulty, and realization of desired outcomes—in other words, productivity pay.

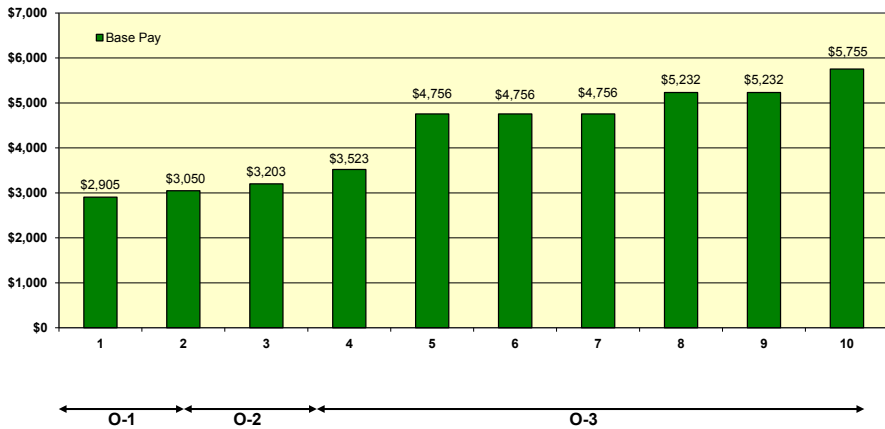


Figure 4. Monthly Base Pay Redesign for Company Grade Officers.

Two examples help illustrate the “basic-plus-performance” pay rates proposed in Figure 5. In the first, graduation from a mid-career staff college such as the Army’s CGSS near the 11th year of service would bring a very healthy 31 percent (\$1,800) monthly basic pay increase. Variable performance pay could increase this amount by an average of \$214 (some officers would earn more, others less). In the second example, another generous base pay increase (33 percent or \$2,500) would kick in near the 21st year of service after completion of a competitively selected senior service college program. At this career point, variable performance pay could increase an officer’s monthly income by an average of \$304.²⁰

YoS	Current	Proposed	% of Current
1	\$ 2,905	\$ 2,905	100%
2	\$ 3,126	\$ 3,050	98%
3	\$ 3,812	\$ 3,203	84%
4	\$ 5,168	\$ 3,523	68%
5	\$ 5,168	\$ 4,756	92%
6	\$ 5,415	\$ 4,756	88%
7	\$ 5,415	\$ 4,756	88%
8	\$ 5,687	\$ 5,232	92%
9	\$ 5,687	\$ 5,232	92%
10	\$ 6,593	\$ 5,755	87%
11	\$ 6,593	\$ 7,770	118%
12	\$ 6,921	\$ 7,770	112%
13	\$ 6,921	\$ 7,770	112%
14	\$ 7,150	\$ 7,770	109%
15	\$ 7,150	\$ 7,770	109%
16	\$ 7,974	\$ 7,770	97%
17	\$ 7,974	\$ 7,770	97%
18	\$ 8,199	\$ 7,770	95%
19	\$ 8,199	\$ 7,770	95%
20	\$ 8,422	\$ 7,770	92%
21	\$ 8,422	\$ 10,360	123%
22	\$ 8,676	\$ 10,360	119%
23	\$ 9,878	\$ 10,360	105%
24	\$ 10,135	\$ 10,360	102%
25	\$ 10,135	\$ 10,360	102%
26	\$ 10,632	\$ 10,360	97%
27	\$ 10,632	\$ 10,360	97%
28	\$ 10,632	\$ 10,360	97%
29	\$ 10,844	\$ 10,360	96%
30	\$ 10,844	\$ 10,360	96%

Figure 5. Proposed Officer Pay Redesign.

To be clear, this **redistribution** (versus wholesale cutting) of salary results in a small reduction in total officer base pay during the first one-third of a typical career. As the chart shows, however, by mid-career, base pay recovers to 118 percent of the current rate, placing field grade officers solidly in the upper quartile of American earners, a highly competitive salary. This is **prior to** the inclusion of any tax-free special pays or allowances, as well as the various other types of nonmonetary compensation, which officers value. In short, any concerns regarding the ability of the proposed pay changes to meet officers' financial needs are unfounded.

A larger question, however, is whether grandfathered implementation of these basic pay adjustments would still attract and retain appropriately talented officers for the Armed Forces. To explore this, consider Figure 6, which illustrates the negative impact of current Army officer management practices, using scholastic assessment test (SAT) scores as a talent proxy. The SAT is useful in this regard because it measures high-demand information age officer talents (problem solving, communications, comprehension and analytical ability, mathematical intelligence, etc.).

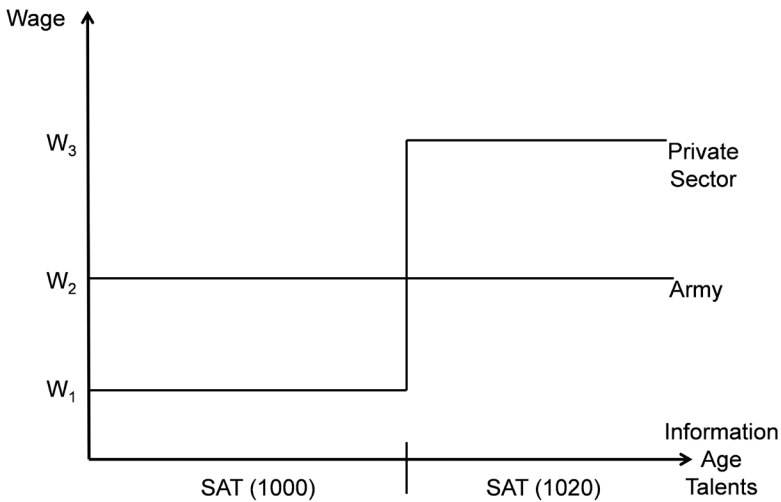


Figure 6. Separating Equilibrium (with Army Officer SAT Scores as Talent Proxy).

As Figure 6 indicates, today all officers earn fixed wage W_2 , regardless of talent level (SAT score), in large part because the services lack mechanisms to accurately identify or measure talents. Savvy private sector competitors, meanwhile, make a much greater effort to find, differentiate, and employ high-demand talents, adjusting individual wage contracts as required. In this example, they offer W_1 to individuals falling below a critical talent threshold (1,000 SAT) and W_3 to employees who are above the critical threshold (SAT above 1,020).

Theoretically, these differing wage contract approaches should induce a sorting effect. Individuals possessing critical talents (SAT of 1,020) would choose the private sector employer offering wages at W_3 , while those below this talent threshold would reject

the private sector's W1 wages in favor of the Army's W2 offer. Actual data bear out the theory – this is exactly what happens today. The average SAT score of Army officers separating before their 8th year of service is indeed 20 points higher than those who remain in service.²¹ This suggests that increasing overall officer retention with targeted pay raises **after** an officer's initial ADSO will slow information age talent flight, giving the military greater discretion over which officers it chooses to retain.²² In other words, the pay table redesign proposed in Figure 5 will better protect the services from talent poaching and low retention while saving money.²³

Very importantly, however, mid-career officers would receive another significant compensatory benefit at year 10: 50 percent vesting in all Government 401K contributions (baseline plus Government matching of personal contributions), with 100 percent vesting at year 15. This 401K is part of a newly proposed pension system (the **10-15-55** plan), part of our total compensation redesign.

Pension and Retirement Redesign – The MCRMC Report versus the 10-15-55 Plan.

While speaking to troops at Fort Drum, New York, Secretary of Defense Ashton Carter recently said that:

... I'm looking very hard right now at blended retirement plans that would be similar to the 401(k) mechanism that is widespread in civil society. Because 80 percent of our troops leave service before 20 years [of service] are up. . . . And in the current system, if they leave before 20 years, they leave with nothing.²⁴

He is right. Military pensions are one of the few remaining defined benefit programs in the United States today. In the case of officers, the current 20-year cliff-vested pension plan was enacted in the Officer Personnel Act of 1947 and retained by the Defense Officer Personnel Management Act of 1980. It provided a way to off-board officers to maintain flow rates in an “up or out” promotion system. In other words, today’s pension plan is tied directly to the industrial era personnel system of which it is a part. As the services transition from personnel management to talent management, the existing pension system should also be re-evaluated as part of a larger compensation overhaul.

That re-evaluation has been ongoing, with no final decisions yet taken. For example, in 2011 the Defense Business Board (DBB) presented a report to the DoD, citing a fiscal imperative to reduce pension costs. Because the suggestions in the report focused largely upon cost cutting, it was met with hostility by several veterans’ advocacy groups, members of Congress, and the wider military community, which viewed the proposals as breaking faith with service members and potentially damaging to the continued recruitment and retention of talented people. In the wake of the DBB report, the 2013 National Defense Authorization Act (NDAA) directed the establishment of an MCRMC to provide the President and Congress with specific recommendations to “modernize” uniformed services pay and benefits. The MCRMC report (February 2015) is now dominating the compensation debate.

During its initial deliberations, the MCRMC consulted with Army economists and manpower analysts who had published a comprehensive pension and retirement redesign proposal known as the 10-15-55 plan.²⁵ While the Commission’s final report echoes a

key aspect of the Army plan — creating a hybrid defined contribution and defined benefit pension system — it is markedly different in detail. For example, the Commission’s pension and retirement plan calls for vesting in matching government 401K contributions after just 2 years of service, while all Active Duty service members are still subject to a contractual service obligation. This is likely to flatten retention, with high opportunity-cost service members viewing the cash as a separation incentive. Unnecessary retention continuation pays are another feature of the MCRMC pension plan and a further departure from the 10-15-55 proposal. There are other differences as well, resulting in very different total program costs.²⁶

Much like today’s basic pay tables, the MCRMC pension proposal falls short in the timing, amount, and application of benefits. As written, it is antithetical to effective and efficient compensation management. The 10-15-55 plan, however, is a viable alternative to the MCRMC recommendations. As Figure 7 shows, it calls for the services to begin contributing 5 percent of an officer’s pay to a 401K upon commissioning. Officers could then contribute up to an additional 5 percent pay with a dollar-for-dollar match from the military. While officers would own their personal contributions, they would have to serve through 10 years to vest in 50 percent of the matching military contributions.

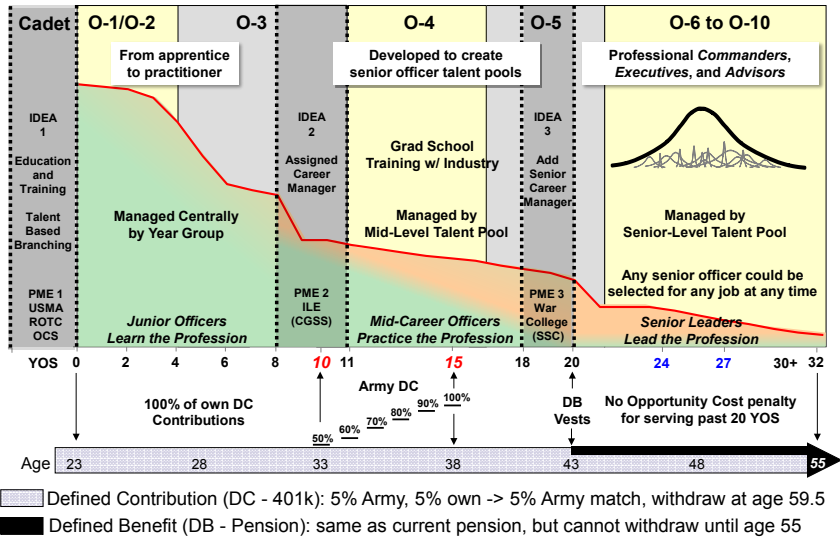


Figure 7. The 10-15-55 Pension Plan Aligned with Talent-Driven Career Timeline.

For each of the next 5 years, officers would vest in an additional 10 percent of those matching contributions until vesting in the full 401K value at 15 years. From there forward, officers would receive the full amount of both their personal and military contributions (plus interest) and could begin drawing on the 401K at age 59 1/2. In addition to the 401K component, officers serving to 20 years would be eligible for the same defined benefit pension program of today but would not begin receiving payments until age 55.

This delay creates three powerful benefits. First, it more than offsets the costs of the 401K payouts provided to officers separating between 10 and 20 years of service (in fact, the Army alone would save over \$2B per annual commissioned cohort when compared to the current pension system). Second, it no longer en-

courages officers to retire at 20 years to “avoid working for less than half pay” when retirement eligible.²⁷ Third (and as we mentioned earlier), recent studies indicate that skilled worker productivity continues to rise into the mid-50s. The military services would retain this productivity instead of watching it migrate to the private sector.

There are several other benefits associated with the 10-15-55 proposal. It aligns tightly with the talent management paradigm proposed in this monograph, targeting retention incentives where officer attrition is historically highest. The 401K component provides retirement benefits to officers not selected for staff or senior service college or to mid-career officers involuntarily separated from service. In short, it provides retirement benefits to a significantly greater share of officers than the current program, rewarding those who serve extended careers in uniform. While the 10-15-55 proposal represents a 27 percent cut in 20-year retirement benefits compared to the current system, it actually offers greater potential benefit to 30-year retirees and substantially reduces financial risk for **all** service members by ensuring **each** leaves the military with some pension benefit (compared to the mere 17 percent who receive pension benefits today).

Taken together, these basic pay and pension redesign components will create a far more cost-effective total compensation system than the one currently in place. They will enhance retention, reward productivity and performance, provide pension benefits to officers separating before retirement (all at lower cost to the taxpayer), and can easily compete with the very best private sector compensation plans.

Principle #2 – Competitive and Equitable

. . . fairness and the market are two completely different things. Fairness is paying everyone the same. . . . The market is all about matching [talent] supply and demand and trying to tailor compensation to get and retain the best people you can. . .

— Professor Matthew Bidwell,
The Wharton School²⁸

A sound compensation system closely considers labor market trends. It then attracts the right talent by providing competitive and equitable pay, benefits, and the other rewards from which employees derive “utility” – the satisfaction of their unique needs and desires. As Figure 8 suggests, an officer’s utility derives from a combination of tangible compensation and intrinsic rewards, each informed by the special nature of military service.

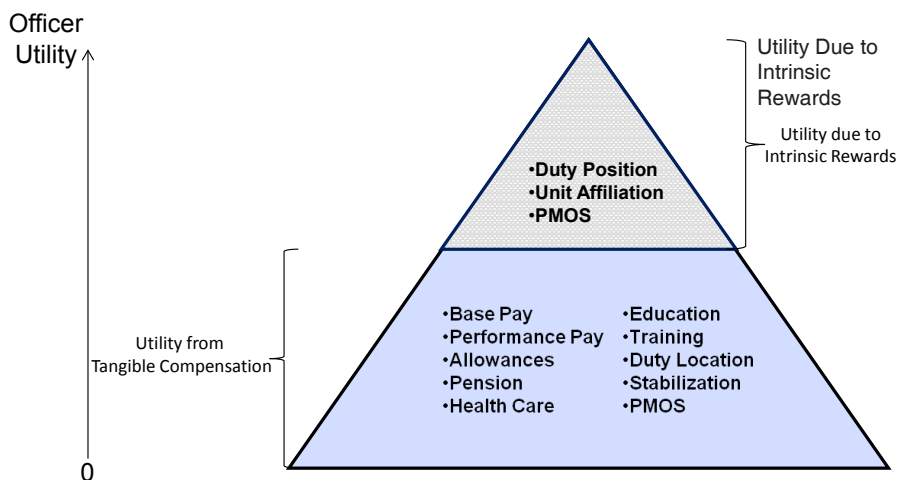


Figure 8. Components of a Total Compensation System.

The word “equitable” is a conscious choice on our part. By equitable, we do not mean “identical,” but rather “just” compensation, tailored to each officer’s duties, responsibilities, desires, credentials, and performance.²⁹ The targeted, personalized pay and benefits we are suggesting are possible because a heterogeneous workforce has heterogeneous talents (which, in turn, shape preferences). This talent diversity causes each individual to place different value upon particular rewards, pushing universally applied notions of “fairness” somewhat into the background. For example, an officer who values a chance to attend graduate school more than receiving the duty posting of his or her choice will not feel it “unfair” if a colleague receives that benefit, and vice versa. In other words, if “fairness” equals **identical** compensation (as it does in the current pay table system), then it is hard to be fair when individuals with different talents derive utility from different things.

At the moment, all officers of the same rank and year receive identical basic pay and allowances (conditional upon duty location). In the name of both “fairness” and administrative ease, this single wage contract system also provides officers similar access to most nonmonetary benefits despite widely varying performance, responsibilities, talents, and replacement costs. In effect, some officers are being overpaid and others underpaid — and they know it.

This generic treatment occurs because today’s personnel management system neither knows nor sufficiently values the unique attributes of each officer. The coming talent management approach, however, will compile comprehensive, accurate, granular, and timely assessment information for every individual. This data will provide an upper boundary for total

compensation negotiations, giving the services a more accurate valuation of each officer while allowing them to better satisfy each officer’s desires.

As Figure 9 indicates, performance pay, education, assignment considerations, and training are all compensation “levers” that the military can manipulate to increase service utility to each officer, creating a more equitable total compensation package that goes well beyond direct pay and pension benefits (and, in many cases, require no additional outlay of dollars by the Government).³⁰ These methods are simple and involve little administrative overhead. Additionally, tailoring these benefits to each officer can create substantial talent and compensation management efficiencies.³¹

Monetary Compensation	Non-Monetary Compensation
• Incentive / Special Pays: Aviation, Hazardous Duty, Submarine Duty, Sea Pay, Family Separation Allowance • Location Pay: Basic Allowance for Housing, Cost of Living Allowance • Performance Incentives • Leave and Pass Policies • Retirement Savings: TSP and SDP • Tuition Assistance / Loan Repayment	• Resident Civilian Graduate Educational Opportunities • Professional Certifications • Training with Industry • Assignment Considerations: Duty Location, Unit Choice, Position • Service Specific: Professional Military Education, Skills Training

Figure 9. Total Officer Compensation “Levers.”

Some initial efforts in this direction have already been made, and with good results. An example is the Army’s “post of choice” or “PADSO” program,

which grants newly commissioned lieutenants their preferred initial assignment location in exchange for 3 additional years of obligated active service. Not all officers value this nonmonetary benefit, but for those who do, PADS0 provides the Army with a powerful yet costless compensation lever that creates a more satisfied and trusting employee while harvesting additional man-years of service.

Figure 10 illustrates the way in which this approach fundamentally changes officer wage negotiations. In the legacy system, tangible compensation limited to base pay and allowances simply may not match the opportunities a particular officer foregoes by remaining in the service. In the system we are proposing, however, the addition of preferred duty location, graduate school, or other nonmonetary incentives sufficiently increases the utility of the officer's total compensation, exceeding that of his or her best outside option **without** increasing salary.

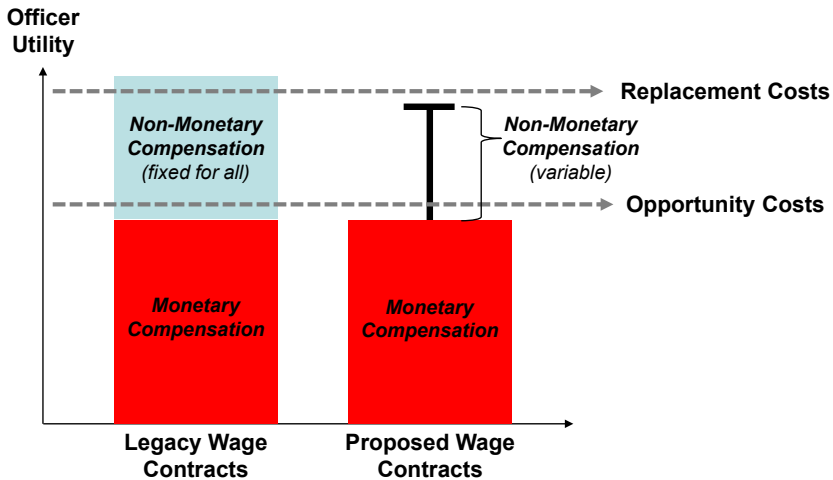


Figure 10. Negotiating Total Officer Compensation.

The DoD can reinforce the productivity-enhancing effects of tailored total compensation by offering targeted performance pays to mid-career officers.³² These could be used to reward individuals for outstanding performance (i.e., productivity) in certain critical assignments, to counter labor market competition for certain high demand, low density talents (fixed wing aviators, for example), or in lieu of nonmonetary compensation.

To demonstrate the feasibility of this concept, consider the sample pay structure at Figure 11, where performance pay is layered upon a stable mid-career officer base pay rate (with occasional cost of living adjustments as required). Unhitching mid-career pay hikes from time-in-service creates a healthy payroll fund from which to disburse targeted performance pays. In the Army alone, for example, it would free up approximately \$3.8 million per month for targeted performance pay.³³

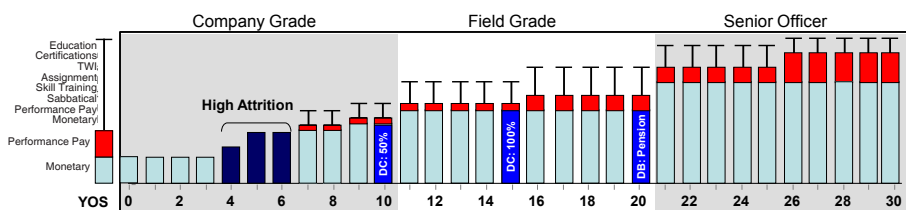


Figure 11. Total Officer Compensation – Base Pay and Allowances Combined with Performance Pay and Nonmonetary Benefits.

As illustrated in Figure 5, successful CGSS graduates would actually receive a higher base salary from 11-15 years of service than they do now, keeping them

solidly in the middle-class income quintile that society demands for selfless public servants in a high-risk profession.³⁴ Layered upon that benefit would be a defined contribution plan with matching government contributions, with full vesting taking place by the 15th year of service. Layered on top of **that**, officers could receive several of the nonmonetary benefits described in Figure 9.

The Army, for example, has been able to negotiate officer tuition rates at some of the country's most prestigious graduate schools for a fraction of what the public pays. If it communicates the value of this benefit to an officer (on average an additional \$400,000 in lifetime earnings for the officer, at a government cost of just \$10,000-\$15,000), it can easily outcompete the private sector employer trying to poach officers with a \$10,000-\$20,000 a year pay raise.³⁵ Rather than paying a retention bonus to keep an officer (100 percent economic rent), a graduate school investment increases officer productivity, entails an additional service obligation, and thus is "paid for" by the officer, all while providing a productivity return on the Government's small upfront investment.

The final piece of the layered compensation illustrated by Figure 11 is the performance pay described earlier. Performance pay is **targeted**, not evenly distributed among all employees – if it was, it would not be performance pay. Pentagon decisionmakers must devise precise methods of application, but as an example, if 20 percent of all mid-career officer jobs were deemed extremely difficult and/or critical to national defense, officers matched against those jobs (**and** who delivered desired organizational outcomes) would receive an annual performance pay bump of up to \$6,434, a handsome 7 percent pay increase.

Again, this is just an illustrative example. Care must be exercised when implementing any performance pay system because monetary compensation influences extrinsically and intrinsically motivated tasks differently. Performance pay has a “price effect” on extrinsically motivated tasks: the more the person is paid, the more effort the person exerts. Conversely, however, performance pay may cause a “crowding-out effect” on intrinsically motivated tasks: the additional wages cheapen the utility gained from performing these tasks, leading to lower productivity.³⁶ This is why we continuously emphasize “monetizing” the intrinsic rewards officers already value and from which they derive utility: duty type, location, etc.³⁷ The larger point, however, is that performance pays can be used without increasing overall payroll costs and provide the services with greater flexibility to counter dynamic shifts in labor market conditions.

Principle #3 — Flexible

More flexible compensation systems can improve government's ability to attract, recruit, and retain employees with high-demand skills. . . . Compensation systems that base salaries on post [i.e., position] rather than on skills and increase all salaries at the same time may not be in a position to facilitate that flexibility.

Rolf Alter, Organization of
Economic Cooperation and Development³⁸

Constantly evolving threats, technological change, and labor market competition demand that the U.S. military maintains and values both organizational and functional flexibility. Such flexibility is a product of many factors. A critical one is the ability to make dynamic workforce adjustments in response to any situation. This is exceedingly hard to do with an inflexible, static compensation system.

A case in point — recent fiscal pressures in the United States resulted in sequestration, requiring the military (particularly the Army and the Marines) to significantly cut the number of people in uniform. Less than a decade before, the global war on terror required just the opposite — a rapid expansion of the Armed Forces. Russia's recent military muscle flexing and increasing military expenditures are now causing the United States to reconsider its Landpower downsizing, and a future rapid Army/Marine Corps expansion is entirely possible. These expansions and contractions have been the central challenge to military workforce management since the United States transitioned to an All-Volunteer Force in the mid-1970s and are likely to remain so for the foreseeable future. Unfortunately, the current compensation system is tied to an indus-

trial labor management model that focuses the Armed Forces not upon “talent” when rapidly expanding or contracting, but on “quantity.”

Consider military officers recently subjected to involuntary separation boards (by year group). The current personnel and compensation management systems provided no useful way for board members to discern which officers might best meet current and future workforce talent demands. With no way to “see” talent due to extremely generic and inflated evaluation systems, the boards focused not upon talent but instead upon derogatory information (often in the farthest reaches of a personnel file, e.g., a driving under the influence [DUI] as an O-1) to justify an officer’s separation, despite years of exemplary service.

We are not for a moment downplaying the seriousness of something like a DUI, but if it was not cause for immediate separation at the time it occurred, then the officer was told in effect that “your performance from here out is what matters.” In many documented cases, however, it was not. It is hard to know how many talented network security experts, Russian linguists, Middle Eastern political scientists, or mechanical engineers were culled in this way. Under the compensation system redesign we are proposing, targeted performance pays would have helped focus boards upon those officers who were actually achieving desired organizational outcomes, not those guilty of a quite troubling yet one-time lapse in judgment.

In addition to expanding or contracting existing organizations and functions as demanded by the times, the military must also redesign, consolidate, or eliminate legacy organizations, something it is notoriously slow to do (the Army eliminated its horse cavalry in 1950, the Navy struck its last battleship in 2006). A modern compensation system enables dynamic

change. As new technologies allow the military to “do more with less,” the nature of work will change—fewer pilots, turret gunners, and tank crewmen; more remote or autonomous combat systems, etc.

Navy Secretary Ray Mabus recently said that the F-35 Joint Strike Fighter “. . . should be, and almost certainly will be, the last manned strike fighter aircraft the Department of the Navy will ever buy or fly.”³⁹ As a result, the military will not only need fewer people, but people with different work talents. A flexible compensation system would allow pilots and commanders to transition from “operators” to “technical experts,” enjoying long careers not truncated by rapidly vanishing opportunities to lead a charge, engage in a dogfight, sink enemy ships, or lead ever larger organizations for ever shorter periods of time.

Consider the recent creation of the Army’s Cyber Command and Cyber branches. Building a bench of officers capable of defeating cyber threats demands specific talents currently in low Army supply but in high demand across the country. A flexible compensation system would provide the Army with the ability to access, retain, develop, and employ the uniquely talented people critical to this mission with competitive incentive or performance pay. Currently, however, there is no provision for cyber “incentive pay,” and it may be slow in coming due to the nonmarket driven inflexibility of the current pay system. Meanwhile, some Army officers are receiving incentive pay, but unfortunately it is based upon perceived labor market competition identified in 1974. Army aviators are still “paid to stay,” even though today there is no real demand for their piloting skills in the private sector. Regardless, 41 years of Aviation Career Incentive Pay (ACIP) has eradicated its incentive value. It is now

viewed as an entitlement, and, under the current pay system, it is very unlikely to change.⁴⁰

With the compensation redesign proposals we have presented in this monograph, however, the services would gain all manner of flexibility. They could rapidly off-board personnel whose talents were no longer in demand, while rewarding their service with a generous, portable pension benefit. They could layer nonmonetary benefits on top of salary to tailor wage contracts to each individual, especially those well-suited to transition from legacy work to new duties. Finally, they could quickly adjust performance and incentive pays in response to prevailing demands and labor market conditions.

This last point is particularly important. Labor markets matter. In times when a specific talent is scarce, the military must tailor compensation contracts to increase the pay or program rewards associated with the talent. If the Armed Forces find themselves with an abundance of officers with low demand skills, wage contracts should reflect this, particularly in austere times. The rich performance data gained by linking talent and compensation management will ensure officers are paid to perform instead of merely paid to age.

Principle #4 — Performance Driven

[Young officers are] paying attention to the talent management revolution going on around us. Inspired by the thoroughly American creed of opportunity, equality, and freedom to pursue individual gifts—they watch their corporate peers rising past others based on merit, not merely when they joined the firm. Or they see opportunities to master a profession without worrying about an ‘up or out’ system which assumes everyone must be groomed for the highest possible rank. They wonder why they can’t do the same, in service to their country.

Vice Admiral J. Kevin Moran,
Chief of Naval Personnel⁴¹

In the United States, many Federal, state, and local government agencies have experimented with performance pay to improve performance outcomes. While some have been successful, many others have not. A common problem underlies most failures—an obvious disconnect between talent assessments and compensation.⁴² In fact, a robust body of labor and organizational research suggests that closely tailoring wage contracts to individual talents is the single best way for organizations to increase both individual and organizational performance. Figure 12 illustrates this linkage.

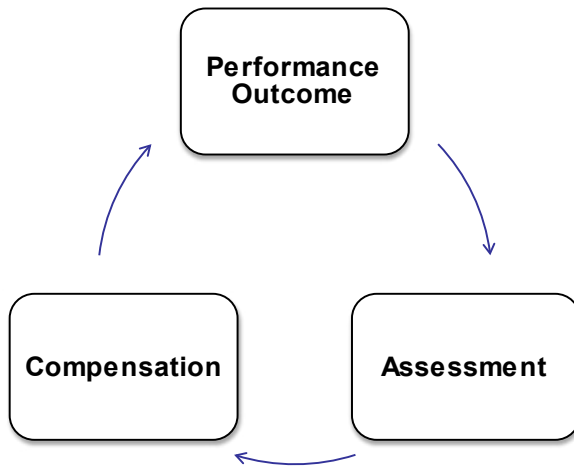


Figure 12. A Performance-Driven Compensation Cycle.

The key to achieving this, however, is a talent management system. Because today's military has not yet completed its transition from industrial era personnel management to information age talent management, its current compensation system cannot maximize productivity—it lacks accurate, granular talent assessments. This breaks the link between performance outcomes and compensation that is so critical to effective and efficient organizations. Consider that at any given moment (among those of the same rank and service), some officers today are achieving requisite performance outcomes, some are vastly exceeding them, and some are falling short, yet each is being paid identically. This rewards the underachiever, encourages status quo effort, and can lower the productivity of those previously exceeding performance expectations. In other words, the current compensation system **lowers** average productivity.

Figure 13 models these performance effects in terms of a generic performance metric (P) in the current wage system. In this example, a single Army captain assigned to Fort Hood, Texas, receives her base salary and allowances (point A) for as long as she performs at a requisite threshold level ($P_{\min,O-3}$). She receives no additional compensation, however, even when realizing organizational outcomes that far outstrip those of her peers and even more senior officers (past point B).⁴³ As she and others begin to notice this, it creates a disincentive to exceed the performance threshold associated with point A because today's officer compensation contracts cannot respond dynamically.⁴⁴ This is because the current personnel and compensation management systems neither continuously nor accurately assess officer talents.

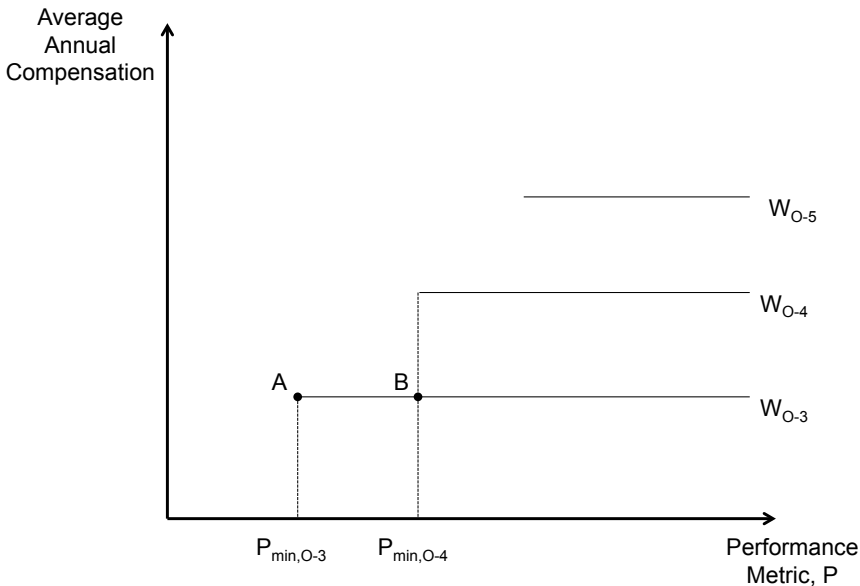


Figure 13. Performance and the Current Officer Wage Contract.

For comparison purposes, Figure 14 illustrates the potential productivity impacts of the variable compensation model we are suggesting. In the current system, the military might observe “pooling” around a requisite level of performance (point A), but in the officer talent management system the military is moving toward, the dynamic linkage between compensation and performance can incentivize desired behaviors.

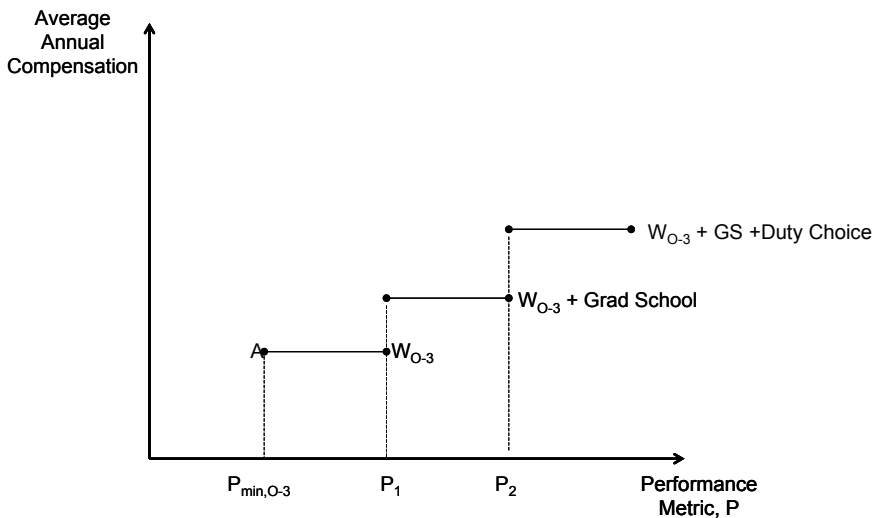


Figure 14. Performance and the Variable Compensation Contract.

For example, an officer performing at P_1 (exceeding requisite outcomes) could prompt an offer of fully funded resident graduate school. A duty assignment of choice could follow if he or she performed at P_2 . In other words, an approach aligning variable compensation with performance, buttressed by an understandable, defensible, and rational talent assessment system, would gradually increase organizational

productivity via “sorting” and “incentive” effects.⁴⁵ In other words, organizational productivity would rise as officers sought jobs aligned with their talents, simultaneously increasing their potential to earn performance pay.

As discussed previously, in the officer talent management system that the military is moving toward, the services will conduct extremely comprehensive assessments of each officer (the labor supply) at key intervals, identifying talents and talent gaps, and revealing whether desired outcomes are being realized. These assessments will yield the individually tailored wage contracts described here. Importantly, however, the military must also identify desired work outcomes and performance metrics for each of its officer positions (the labor demand). The more accurately the Armed Forces can align talents with demands, the more efficient each individual wage contract will be.

Principle #5 — Supportable and Executable

If you want to succeed, get some enemies.

Thomas Edison⁴⁶

Looking back, the universal adaptation of electricity seems inevitable. Not so from the vantage point of 1879. As Thomas Edison learned firsthand, implementing any paradigm-shifting innovation requires widespread support. Powerful, entrenched interest groups often combine to squash disruptive upstarts. So it was in Edison's case. Private gas light utilities devoted substantial resources to blocking the launch of his electric service. Gas lighting was a mature, profitable, and well-established industry with robust infrastructure, franchises, and manufacturing facilities. The increasing quality, reliability, and availability of gas light had won society over. Gas light was the norm, a superior and convenient alternative to cooking fires, whale oil lamps, or paraffin. Its position seemed unassailable.

With no power infrastructure in place, Edison faced a tough, uphill slog — why invest in electric light when gas was already meeting the public's light, heat, and cooking needs? What problem would electricity solve? Edison had to convince people that, while shifting to electricity would initially be hard, the return on investment would be well worth it. He emphasized electricity's obvious advantages over gas light — lower cost, increased safety, the ability to power electric motors, and the relative ease with which it could reach still-dark rural America. As we know, Edison prevailed by presenting a compelling case for change, one sharpened in response to his opponents. He presented

a comprehensive vision of electricity's future. It could do everything gas could do and more for many more people and at far lower cost. Electricity opened the door to new possibilities.

As the DoD builds its case for talent-based workforce and compensation management transformations, Edison's battle against the entrenched gas utilities is instructive. Yes, the current military personnel and compensation management systems work. Yes, they provide a functioning service. But talent management, much like electricity, can do much more and at lower cost. The customers (service men and women) seem convinced, the stockholders (taxpayers) would certainly welcome it, but the corporation (DoD) must still gain the support of its Board of Directors (Congress). As Congress considers personnel and compensation reform, the question before it is a simple one—"Do you prefer gas light or electric light?" The good news is that Congress has **demand**ed a new way of doing business and is therefore receptive to change. How it responds to the DoD's proposals, however, will be shaped by both public and service member sentiments.

According to a Gallup Poll, 74 percent of Americans have a "great deal" or "quite a lot" of faith in the military, making it the country's most trusted institution.⁴⁷ That is not a blank check, however. In wartime, taxpayers grade the defense establishment on its ability to protect our shores, so it is little surprise that, after almost 15 years of warfare, the military garners high marks. In peacetime, however, the evaluative criteria shift—"Keep us safe, but do not spend \$600 on a toilet seat or a ball-peen hammer." To preserve the public's trust and support, particularly in austere times, the military must become increasingly effective

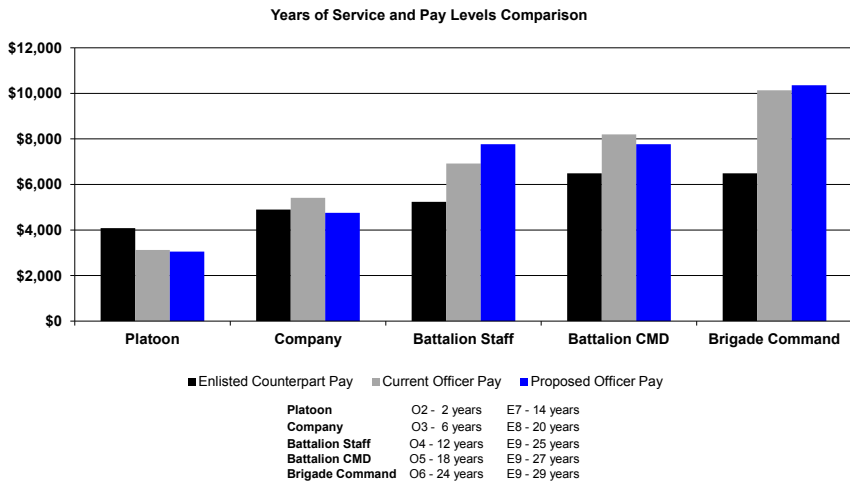
and cost efficient. Talent management, accompanied by carefully crafted total compensation reform, will deliver this. It will reassure the public that the military is not just another bloated bureaucratic agency—it fights well, but it does an even better job of sufficiently compensating American sons and daughters without being inefficient or wasteful.

Service member perceptions of any new compensation management system are equally important. In the case of officers, compensation must attract the right individuals to the right jobs by adequately accounting for the internal and external valuation of the talents required to support the military mission. Furthermore, the compensation system must reinforce the link between individual performance and organizational goals. It must also take care not to subvert the professional military ethic or undermine trust, the lifeblood of the military profession.

The officer compensation management redesign we are proposing is so different from today's system that one might wonder whether it can actually gain support among all critical stakeholders. One way policymakers can soften implementation impact is via grandfathering, giving already serving men and women the option to stay with the old system or move to the new. Another way to garner support is to demonstrate the new system's competitiveness in the American labor market. A third is to make clear that the vast majority of service people will gain a portable pension benefit. A fourth is to emphasize that officers will more or less remain in the same middle class income quintiles they occupy today. A fifth is to enumerate total cost savings to the Government.

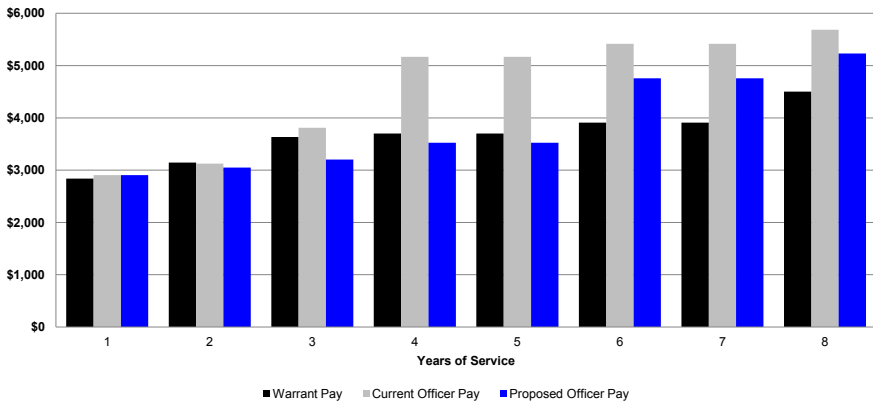
Perhaps the best way to assuage concerns over a seemingly foreign compensation system, however, is by pointing out that **it is not that foreign after all**. In fact, much of what we prescribe is consistent with the DoD's current approach to enlisted pay. For example, the military often retains select noncommissioned officers (NCOs, E-6, and E-7) for additional service, even though they have not advanced to the next rank per typical career timelines. The enlisted compensation and career management systems do not prevent this—"up or out" is not gospel in their world. Additionally, the military uses a broad mix of nonmonetary and monetary compensation to retain NCOs with specific talents, a practice that officer talent management will emulate.

While on the subject of enlisted pay practices, another possible objection to the officer compensation redesign we are proposing is that it will create friction between officers and NCOs due to changed earnings differentials. Figure 15 lays such concerns to rest. As it illustrates, rifle platoon leaders today are typically in their 1st to 3rd year of service. Their platoon sergeant, meanwhile, likely has 10 or more years of service under his belt. Under the current system, the NCO's experience commands a wage premium—he outearns his commissioned counterpart. As shown, that would still be the case in our proposed pay table redesign. In fact, the general trend of officers making less or a comparable amount to their enlisted counterparts as junior officers but more as mid-career officers holds quite nicely in our proposal.



**Figure 15. Legacy of Proposed Officer Pay
Versus Enlisted Pay.**

The same is true of officer versus warrant officer base pay. As Figure 16 shows, commissioned and warrant base pays today closely correlate through 3 years of service. In our proposed officer basic pay table restructuring, warrant pay would actually out-strip commissioned pay until 6 years of service, where the current pay differential between them would resume. There is nothing to indicate that this would negatively impact cohesion between the two officer cohorts.



**Figure 16. Legacy of Proposed Officer Pay
Versus Warrant Officer Pay.**

Even if certain stakeholders resist the total compensation redesign framework we propose, we believe a reasonable majority will support it as a vast improvement over the current system. Holdouts should eventually accept it as their “best bad choice” because no other proposal is as efficacious, while the status quo is fiscally unsustainable. To be clear, however, what we proposed here is an eminently **good** choice for the country and its service people. In fact, even if we were not operating in a time of fiscal austerity, we would still make these recommendations because they improve national security by helping usher in talent management.

CONCLUSIONS

The dogmas of the quiet past are inadequate to the stormy present. The occasion is piled high with difficulty, and we must rise with the occasion.

Abraham Lincoln⁴⁸

Abraham Lincoln understood that status quo thinking would not, could not, save the Union from disintegration. Early in the Civil War, he recognized that the contest would forever change the role of the Federal Government in American life. Defeating the Confederacy would require: a nationally planned and executed strategy; the transformation of the U.S. Armed Forces from a frontier constabulary and muddy water Navy into a formidable, modern combination of land and sea power; military leaders who could ruthlessly prosecute the strategy (Ulysses Grant and David Farragut); and continuity of that leadership until the South succumbed.

We are not equating the need for compensation reform with the Civil War. Much like that conflict, however, the issue has profound national security implications and will encounter devoted, motivated opponents. Success requires a thoughtful strategy, the staunch support of both military and civilian leaders, and a stable leadership team within the DoD to develop and implement change over several years. The DoD will also need to transform its human resource management organizations and practices to successfully lead change, something that can and must be done.

Most of the nonmonetary compensation elements we highlighted are already granted at the discretion of the individual military services. Some have joint

implications and require leadership at the DoD level, but the changes can be made somewhat easily once stakeholders understand the reasons and benefits of doing so. Other change components will take longer to implement, particularly the base pay restructuring, performance pays, and pension redesign we suggested. Eliminating the pertinent outdated laws found in the United States Code requires congressional and presidential approval, no mean feat given the level of legislative gridlock currently permeating government. Over the past several years, several proposed law changes aimed at adjusting Active Duty compensation elements have failed to transit the legislative process. If improperly communicated, any new change effort is likely to encounter the same fate, swamped by opponents even before they understand the benefits of the proposal.

The first step to avoiding this fate is to clarify to all why this proposal is being made. This time, compensation redesign is ancillary to the adoption of a new people management paradigm—talent management. Yes, it saves money, and, yes, it does so by eliminating overpayment (and underpayment) of benefits through better design and adherence to sound economic principles. Its purpose, however, is not to save money but to enhance national security; and to access, develop, employ, and retain a peerless body of officers who can lead the services to victory over any opponent.

The second requirement is to do the necessary analytical spade work **prior** to implementation. The services must conduct a penetrating reassessment of their organizational goals (labor demand) and required performance outcomes in key jobs (labor supply). This analysis will lay the groundwork for building the layered, dynamic, and targeted pays described in this

monograph, as well as for the professional military education curricula redesign truly needed to prepare officers for the “force of the future.”

The timing may be right to incorporate this workforce analysis into the 12th *Quadrennial Review of Military Compensation* due in 2016.⁴⁹ Upon its completion, the services can then pilot proposed changes with small segments of its officer workforce, refining and scaling changes to incorporate lessons learned. As it does so, a third and final non-negotiable for successful compensation redesign implementation is grandfathering. The military must stipulate that no serving member will ever endure a pay reduction during implementation.

If carefully implemented, the total compensation management redesign proposed here, including the proposed pension system overhaul, will allow the military to increase average productivity by revealing and rewarding talents that are in demand, something the current system simply cannot do. It will also provide the payroll flexibility needed to ensure the Armed Forces can rapidly adjust to both emerging threats and labor market competition by thoughtfully managing talent.

ENDNOTES

1. Remarks by Secretary of Defense Ashton Carter to Troops in Fort Drum, New York, March 30, 2015, available from www.defense.gov/Transcripts/Transcript.aspx?TranscriptID=5606.

2. See www.history.army.mil/books/revwar/ss/revdoc.htm.

3. Today’s military compensation system reflects the slow evolution of the U.S. Armed Forces from a conscription model to a professional, All-Volunteer Force. Pay compression, limited lateral entry, health care, education benefits, defined-benefit pen-

sion, and other features of the current system were developed incrementally rather than holistically.

4. The MCRMC was established by the National Defense Authorization Act (NDAA) for fiscal year (FY) 2013 to provide the President of the United States and the Congress specific recommendations to modernize pay and benefits of the uniformed services. For the MCRMC full report, see www.mcrmc.gov/public/docs/report/MCRMC-FinalReport-29JAN15-HI.pdf.

5. *Ibid.* p. 2.

6. One of the lessons learned from World War II was that officer management in the interwar years (particularly in the Army) stifled advancement and development. All officers were ranked by seniority on a single list, advancing only upon the death, resignation, or retirement of a more senior officer. On the eve of World War II, the War and Navy Departments therefore possessed a high percentage of very old senior officers unsuited for modern combat and a large number of middle-aged lieutenants and captains who had never commanded above the company level. To remedy this, the services adopted today's "up or out" officer management system in 1947.

7. For a comprehensive literature review, see Jan C. van Ours and Lenny Stoelddraijer, *Age, Wage and Productivity*, Bonn, Germany: Institute for the Study of Labor (IZA), February 2010, available from <http://ftp.iza.org/dp4765.pdf>.

8. For an even more detailed discussion of the 10-15-55 plan, see Roy A. Wallace, David S. Lyle, and John Z. Smith, *A Framework for Restructuring the Military Retirement System*, Carlisle, PA: Strategic Studies Institute, U.S. Army War College, 2013.

9. Peter F. Drucker, *The Effective Executive*, New York: Harper and Row, 1966, pp. 72-73.

10. For a thorough discussion of talent management in a military context, see Michael J. Colarusso and David S. Lyle, *Senior Officer Talent Management: Fostering Institutional Adaptability*, Carlisle, PA: Strategic Studies Institute, U.S. Army War College, 2014.

11. Andrew Tilghman, "Carter: Toss Vintage Personnel Systems." *Military Times*, April 12, 2015, available from www.militarytimes.com/story/military/pentagon/2015/04/12/carter-social-media/25513773/.

12. While a myriad number of administrative actions are part of workforce management (for example, transitioning fired or retired workers), these are transactional rather than **transformational** in nature—they do not shift the production possibilities of an organization outward. Culling workers who are a poor fit for the organization is integral to talent management as a subset of robust evaluations, but transitioning these workers out of the organization is not. It is a necessary business expense, but it is not a **talent management** function. This is not to say that transactional functions have no impact upon talent management—in this case, providing too generous a transition benefit could harm retention by encouraging high opportunity-cost workers to leave.

13. Talent-based branching has been in operation at the United States Military Academy (USMA) since the fall of 2012. Cadets receive feedback regarding their own talent strengths and weaknesses based on three different perspectives: 1) cognitive and noncognitive assessments, 2) supervising officer evaluations, and 3) cadet file reviews. Cadets use this information to determine the branches in which they might be best suited to serve. Branching administrators use the cadet talent assessments and the talent requirements from the various branches to provide best-fit branch recommendations to cadets, based on the development of composite "branch scores" for each cadet. A final branching board validates branch assignments to ensure that the cadets' talents meet the specific talent requirements of the Army's basic branches. For a more detailed discussion of this process, see Sarah Heckel, David Lyle, and William Skimmyhorn, "Talent-Based Branching: Improving Occupation Matches in the U.S. Army" (forthcoming).

14. This is already taking place in a military educational context—the service academies have discretion over the bulk of their admissions.

15. General Martin Dempsey, Chairman of the Joint Chiefs of Staff, remarks to the Senate Armed Services Committee, May 6, 2014.

16. According to Army Chief of Staff Ray Odierno,

The cost of a soldier has doubled since 2001; it's going to almost double again by 2025. We can't go on like this, so we have to come up with [new] compensation packages.

See Walter Pincus, "Personnel Costs are a Growing Threat to Defense, Military Leaders Tell Congress," *The Washington Post*, November 13, 2013.

17. Source: Military Pay Tables, Washington, DC: Defense Finance and Accounting Services, January 1, 2014, which are used for all analysis pertaining to the current compensation system.

18. ADSOs differ by commissioning source. For example, Service Academy graduates incur an initial 5-year ADSO upon graduation and commissioning, whereas ROTC scholars incur a 4-year ADSO.

19. These pay table adjustments will reduce annual Army officer payroll outlays by approximately \$144.5 million. Savings calculations are for Active Duty, Army Competitive Category (ACC) officers only and are based upon the 2014 Defense Finance and Accounting Services military pay table. Properly aligning pay increases with an officer's rising labor market value will also increase retention, bringing additional savings in officer recruiting and transition costs.

20. Figure 5 represents one possible structure for the performance payments. It allocates a specific amount of available monthly performance pay. To determine the amounts represented in the table, we established mid-career and senior officer basic pay rates based upon income distribution rates found in the 2012 American Community Survey. When doing so, we considered only employed American workers of similar age and educational background. We also omitted professional degree holders (doctors, lawyers, veterinarians) and entertainers (athletes, actors, etc.) and truncated the sample at \$30,000 in annual income and above at \$200,000. We then selected an average monthly performance pay amount that would move an officer to the next highest quintile in the income distribution. For example, the \$214 average monthly incentive for O-4s and O-5s moves them from the 72nd

to the 75th percentile of the distribution for annual income. The \$304 average monthly incentive for O-6s moves them from the 83rd to the 85th percentile.

21. Source is the Total Army Personnel Data Base, USMA data, and U.S. Army Cadet Corps data for scholarship officers from year groups 2001-05.

22. The SAT is designed to measure the probability for academic achievement at the undergraduate level. A superior performer on the SAT likely possesses a particular talent distribution: problem solving, critical thinking, communication, etc. These talents are in high demand in the Officer Corps and are likely to remain so, making the SAT a good proxy for measuring desired officer talents. It is not the only measure of talent, nor are the talents it assesses the only ones sought by the Armed Forces in their officers.

23. The net impact of these changes is a savings of just under \$30,500 per 30-year officer career, based on the proposed officer career timeline. This is the net present value (NPV) of pay differences between the current and proposed systems, discounted to today using a rate of 2.5 percent. Most of the savings in this model occur due to the reduced base pay for company grade officers. The total savings through the 10th year of service amount to \$73,150 per officer (NPV). However, subsequent increases in field grade pay substantially reduce this amount.

24. Remarks by Secretary of Defense Ashton Carter to Troops in Fort Drum, New York.

25. For a complete discussion of the 10-15-55 plan, see Wallace, Lyle, and Smith, *A Framework for Restructuring the Military Retirement System*.

26. While the Commission's blended defined benefit and defined contribution concept is sound, the specific elements of the proposal cannot produce the financial outcomes suggested in its report. For example, the Commission argues (p. 10) that its retirement redesign proposal ". . . reduces annual DoD budgetary costs and Federal outlays, in FY 2016 constant dollars, by \$1.9 billion and \$4.7 billion, respectively, after full implementation."

Our analysis, however, indicates that costs will actually rise. We reached this conclusion by conducting a basic cohort analysis of the Army's Active Duty enlisted and officer populations (a cohort is defined by the total number of officers or enlisted service members with the same service entry year). As a baseline, we projected the total retirement program costs for cohort members who retire at 20 Years of Service (YoS) under the current defined benefit (DB) system, approximately \$850 million. Assuming the same cohort retention behavior through 20 YoS (a key assumption in RAND's Dynamic Retention Model, which informs the MCRMC report), and applying the Commission's blended Defined Contribution/Defined Benefit/Continuation Pay plan, total retirement program costs would rise to \$1.3 billion in 2015 dollars, an increase of more than half a billion dollars per cohort. Our analysis rests largely upon the same modeling assumptions used by the MCRMC. Key differences: for the enlisted cohort, we used a retirement age of 42 (which actually lowered the MCRMC's proposal costs). For both cohorts, we used average cohort sizes and separation-by-YoS figures from 2006-10; assumed wage growth continues at 1 percent annual growth rate, creating a negative real growth rate but reflecting current policy; used a government discount rate of 4 percent to calculate NPV of programs to the Government (rather than the individual); and assumed all noncommissioned officers (NCOs) and officers remaining on Active Duty at 16 YoS received continuation pay multipliers per the respective examples found on pp. 33 and 34 of MCRMC report. Extrapolating from this analysis, the Commission's retirement program proposal would likely cost the Government in excess of \$1 billion more per cohort across all services than the current pension system.

27. In other words, officers could theoretically retire at 20 years of service and immediately receive half of their salary as part of their pension in addition to working a job outside of the military that pays exactly the same (or more) as they would receive by remaining on Active Duty. By staying in, they forgo the 50 percent pension payout, essentially reducing their compensation by half.

28. "Balancing the Pay Scale: 'Fair vs. Unfair'," *Knowledge@Wharton*, May 22, 2013, available from knowledge.wharton.upenn.edu/article/balancing-the-pay-scale-fair-vs-unfair/.

29. For further discussion of the possible efficiencies from offering choice in selection of nonmonetary compensation packages, see Peter J. Coughlan, William R. Gates, and Noah Myung, "One Size Does Not Fit All: Personalized Compensation Incentives In Military Compensation," *Defense and Security Analysis*, 2014, pp. 1-19.

30. These levers are currently administered using one of four criteria: 1) time in service; 2) binary – i.e., jump pay is a uniform lump sum paid to any service member on "jump status"; 3) universal access; or 4), a combination of 1 and 2.

31. The military must exercise caution when including other nonmonetary compensation programs in contract negotiations. Noticeably absent from our options list are several universal benefits: health care, childcare, recreational, commissary and Post/Base Exchange access. The military should not tailor these benefits to individuals because it owns the infrastructure for each, indicating underlying economies of scale. In other words, if service members were permitted to "opt out" of these, a threshold level of participation might be crossed, below which provisioning costs would actually be higher than they are today with universal participation. Additionally, the military should never "monetize" benefits that increase utility through recognition or status, such as awards. This simply erodes the value of the award to the organization and the service member, reducing its utility and thus its appeal as part of any total compensation package.

32. While the military could offer performance pay to O-3s, we caution against it at this early point in their career timeline. By offering monetary incentives in lieu of or in addition to graduate school, functional area transfer, or training with industry, the military risks giving money to officers for retention payoffs at the risk of undermining the long-term development of its talent pool. Instead, the military should leverage the many nonmonetary human capital development levers at its disposal to retain O-3 talents in demand.

33. Based upon a projection of 17,500 officers in the combined O-4 and O-5 ranks.

34. Source for national income distribution data is the 2012 American Community Survey.

35. Jennifer Cheeseman Day and Eric C. Newburger, *The Big Payoff: Educational Attainment and Synthetic Estimates of Work-Life Earnings*, Washington, DC, U.S. Department of the Census, July 2002, p. 4.

36. See Weibel *et al.*, "Pay for Performance in the Public Sector-Benefits and (Hidden) Costs," *Journal of Public Administration Research and Theory*, Vol. 20, No. 2, 2010, pp. 387-412.

37. To assess the viability of using performance pay to enhance performance for certain military tasks, the Army's Combine Arms Center (CAC) and Office of Economic and Manpower Analysis (OEMA) will conduct a vignette study with officers enrolled in CGSS at Fort Leavenworth, Kansas. Careful implementation of the proposed compensation plan across the military will require similar piloting across grades and specialties to account for cultural and market differences.

38. Organisation for Economic Cooperation and Development (OECD), *Public Sector Compensation in Times of Austerity*, Paris, France: OECD Publishing, 2012, p. 10, available from [dx.doi.org/10.1787/9789264177758-en](https://doi.org/10.1787/9789264177758-en).

39. Secretary of the Navy Ray Mabus, remarks presented at the 2015 Sea-Air-Space Symposium, April 15, 2015, available from navylive.dodlive.mil/2015/04/15/secnavs-prepared-remarks-at-sea-air-space-2015/.

40. ACIP is a prime example of how the services must tailor their performance and incentive pays. The Army contends that exposure to hazard is not the basis for this substantial pay differential, a position borne out by the fact that many aviators in a nonflight status receive it during their careers, and many Army officers perform equally hazardous and complex duties, yet receive no incentive pay. Congress required ACIP be tied to fluctuating private labor market demands for rotary wing pilots. Since its inception in 1974, however, ACIP has continued virtually unchanged, its pay rates tied more closely to the pilot incentive pays offered by the Navy and Air Force. The bulk of **those** pilots, how-

ever, are commissioned officers flying fixed wing jet aircraft. Multiple analyses indicate there is continuous and substantial labor market competition for jet pilots. There is no evidence, however, that substantial labor market competition exists for rotary wing aviators. While we are not arguing that ACIP be ended, we are suggesting that incentive pays should have a legitimate market basis and be adjusted, reallocated, or eliminated when no longer justified. If not, they eventually lose their incentive power and are instead perceived as an entitlement.

41. Available from thehill.com/blogs/congress-blog/homeland-security/213529-talent-and-national-security.

42. See Paula Ingraham. "Of Pigs in Pokes and Policy Diffusion: Another Look at Pay-for-Performance," *Public Administration Review*, Vol. 53, No. 4, 1993, pp. 348-356.

43. Even the link between high performance and early promotion in the current personnel system provides lackluster compensation incentives. If the captain in our example was promoted below the zone to O-4, she would receive higher pay than her original cohort peers—for all of 9 months (in effect, a \$5,786.10 bonus). Meanwhile, her professional developmental timeline has just been truncated by a year, a tough tradeoff for so meager a benefit. For example, she may no longer have time to attend graduate school, foregoing a degree whose impact on lifetime earnings would dwarf her early promotion pay raise. In other words, she has been heavily penalized by the current system for over performing.

44. To be clear, we acknowledge the unique nature of military service and the value of experience in assuming positions of greater responsibility. For example, even if the Army identified a captain who was, by any other measure, qualified to command a battalion, lack of experience as a battalion executive or operations officer would serve as strong justification for not assigning the officer to battalion command. For certain military positions, there is no substitute for experience. Performance in subordinate positions often indicates potential for success, but a responsible organization will still shape future leaders through a progression of appropriate assignments.

45. See Edward P. Lazear, "Performance Pay and Productivity," *American Economic Review*, Vol. 90, No. 5, 2000, pp. 1346-1361.

46. *Ladies Home Journal*, April 1898.

47. See Gallup Poll, "Confidence in American Institutions," 2014, available from www.gallup.com/poll/1597/Confidence-Institutions.aspx.

48. Abraham Lincoln, Second Annual Message to Congress, December 1, 1862, available from www.presidency.ucsb.edu/ws/?pid=29503.

49. Rather than simply reviewing base pay for fairness or sufficiency, the 12th Quadrennial Review of Military Compensation should use this paper to shape its analytical goals and recommended changes to compensation policy, practice, and law.

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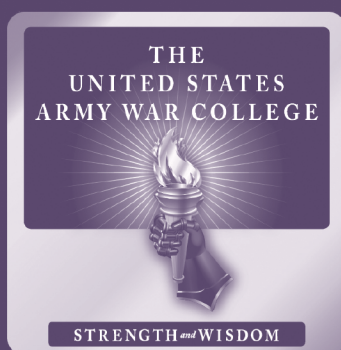
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