

Statement

DoD Personnel Issues

Honorable Robert F. Hale

Former Comptroller and Chief Financial Officer

Department of Defense

before the

Senate Armed Services Committee

December 2, 2015

I appreciate the opportunity to testify on Department of Defense (DoD) personnel issues. DoD is one of the largest employers in the United States, and the military compensation system is one of the most complex. Given this size and complexity, I cannot address all of the issues related to DoD personnel. Instead I will focus on two issues: efforts to reform and slow growth in the costs of military compensation and selected civilian personnel issues.

Reforming and Slowing Growth in Costs of Military Compensation

As a share of the total DoD budget, military compensation costs have remained roughly constant since 2000. But the constant percentages mask important shifts. As DoD budgets grew sharply after 9/11, compensation costs also grew sharply. Health care costs, especially for the new TRICARE for Life program, caused much of this growth. But substantial increases in basic pay, along with increases in basic allowance for housing to eliminate out-of-pocket costs, also fueled growth.

Past Success in Reform and Slowing Growth. After 2010 total defense budgets began to decline, and DoD faced legal limits on its total funding put in place in 2011. In response, the Department sought to slow the growth in the costs of military compensation. It made that decision, not to alter the percentage of funding devoted to compensation, but rather to maintain recruiting and retention while freeing up funds to sustain modernization and, importantly, readiness. As the military ended most of its large-scale combat operations in Iraq and Afghanistan, regaining full-spectrum readiness required added funds. Proposed compensation reforms sought to help meet readiness needs while also modernizing the compensation system and making it more effective.

Conventional wisdom holds that Congress refused most of DoD's requests for changes in laws needed to alter the military compensation system. While Congress did turn down some DoD requests, it approved a number of them and even took the lead on key issues. Examples of key enacted changes over the past five years include:

- *Health care changes.* The Administration permitted DoD to use the federal ceiling price for pharmaceuticals, which substantially reduced DoD costs. Congress permitted DoD to use Medicare rates to reimburse for outpatient care and care at small hospitals. It also agreed to modest increases in fees for retirees who use TRICARE. Finally, Congress permitted DoD to restructure and increase pharmaceutical co-pays in ways that steered beneficiaries toward more cost effective approaches such as generics and mail order delivery. Congress even went beyond DoD requests and mandated use of mail-order delivery for follow-on pharmaceuticals.
- *Pay raise limits.* For the past three years the President has exercised his existing authority to limit military basic pay raises below the levels that would have been mandated by the private-sector formula. Because basic pay makes up a large share of compensation, these limits contributed significantly to freeing up funding for readiness and, to date, have permitted the military to recruit and retain needed personnel.
- *Military retirement.* This year Congress took the lead in reforming the military retirement system to provide military members with a new 401(k)-like fund that includes matching government contributions while also reducing the size of pensions for future retirees who serve 20 or more years. The changes will reduce DoD accrual costs for military retirement.

Taken together, these changes reduced the DoD costs for military compensation by more than \$6 billion a year. These savings, which will continue in perpetuity unless they have to be reversed to meet recruiting and retention needs, did not come close to offsetting the large reductions in DoD funding mandated by the Budget Control Act of 2011 and other decisions. However, the compensation changes made available significant funds for readiness and achieved some needed modernization, especially for the military retirement system. Importantly, even after slowing growth in compensation, DoD has so far been able to recruit and retain needed personnel -- the key goal for the military compensation system.

Job Not Done. Despite these notable successes, further efforts to reform compensation and slow the growth of costs should be undertaken. DoD and Congress must proceed carefully to ensure that, in the face of improvements in the economy, the Department can still recruit and retain needed personnel. So long as that goal is met, further reform efforts can lead to a more effective compensation system and free up funds to support readiness and modernization.

As part of these efforts, continued limits on the size of basic pay raises may be appropriate if the recruiting and retention climate permits. Limits on basic pay raises free up substantial funds, some of which could be used to offset the costs the compensation proposals that may result from the next version of the Force of the Future initiatives. Media reports suggest that, as part of the next tranche of initiatives, DoD is considering changes in the basic pay table to increase incentives for retention of mid-grade officers and for persons with specialized skills. These types of flexibility almost always make the military pay system more effective and should be given careful consideration. Changes in out-of-pocket costs for basic allowance for housing and reduction in the commissary subsidy may also be appropriate.

The key candidate for future reform is the military health care system. The current system often imposes co-pays that are zero or nearly zero, which tends to lead to overuse of care. The system is also costly to administer. In the TRICARE portion of the system, the share of costs borne by beneficiaries has fallen well below the levels Congress mandated when TRICARE was established. Nor are benefit issues the only problem. Despite some overuse of care, there is substantial underutilization in military health care facilities, which results in wasteful spending.

For the past several years, DoD has proposed revisions that would modernize the TRICARE system and make it more effective. Changes including combining the three major TRICARE plans into one plan and imposing modest co-pays when retirees and active-duty dependents seek treatment (care for active-duty personnel would remain free). The co-pays are designed to reduce overuse of health care and to provide more incentives for use of military treatment facilities in order to improve utilization. Once fully implemented, the reforms proposed by DoD would save roughly a billion dollars a year. More than three

quarters of these savings would result, not from greater payments by beneficiaries, but rather from reductions in administrative costs and more selective use of health care. Imposing fees for new entrants into the TRICARE for Life plan, along with additional changes in pharmaceutical co pays designed in part to steer beneficiaries toward generic medicines, would generate substantial additional savings.

In its 2015 report, the Military Compensation and Retirement Modernization Commission recommended a much different approach to reform of the military health care system. The Commission approach would provide military personnel with an allowance for health care that beneficiaries could use to select from a menu of health care plans. The Commission's proposal offers beneficiaries a choice of health care plans, a significant advantage. Also, in part because the Commission proposed that retirees pay substantially more for health care, the Commission proposal saves a large amount of money – more than \$6 billion a year once it is fully implemented, according to estimates in the Commission report.

While the Commission proposal offers substantial advantages, it is not clear how the system of military treatment facilities, which must remain in place to train health care professionals for war, would be maintained. Significant further work is needed, perhaps along with a carefully designed pilot program, before the Commission plan could be implemented.

In addition to some version of these reforms, Congress needs to permit the military services to downsize or close underutilized military treatment facilities so long as reasonable patient care can be maintained and training needs met. For their part, the military services need to propose appropriate downsizing as part of the overall effort to maintain quality health care while holding down costs. Finally, as it reviews the health care system, Congress needs to address other issues such as access to care.

In sum, DoD and Congress have made important progress in reforming military compensation. This progress has freed up substantial funds that have been used to maintain readiness and modernization in the military while still allowing the services to meet recruiting and retention needs. Further reforms are needed, including consideration

of changes proposed by the Force of the Future Initiatives and – importantly – reform of the military health care system.

Selected Civilian Personnel Issues

The military personnel system needs continued attention. But I am more concerned about problems in the system DoD uses to manage its career civilian employees. DoD employs about 775,000 civilians who provide support that is critical to the Department's ability to maintain national security. Listening to debates over civilians, I sometimes feel that critics believe that most DoD civilians work at the Pentagon. In fact about 80 percent of DoD civilians work outside of the Washington DC area. They fix some DoD weapons, run the Department's training ranges, and manage DoD bases. They provide health care for military personnel and teach their children. They also perform many other necessary support functions.

The system that recruits, retains, and manages these civilian employees has major problems. However, compared to the military system, it gets much less attention in DoD and Congress. This relative inattention occurs in part because career civilians work in agencies throughout government. DoD tends to defer to the Office of Personnel Management and other government-wide organizations when civilian issues arise. DoD, however, employs about half of all career civilians in the federal government. Because of their numbers and their importance in maintaining an effective warfighting force, I believe that the Department needs to take a leading role in improving the civil service system, as does this Committee and other defense committees.

I have neither the time nor the expertise to provide a comprehensive assessment of DoD's civilian personnel system and its problems. However, during my 12 years of service as a senior DoD leader, I supervised many DoD civilian employees. Based on that experience, several problems stand out:

- *Hiring problems.* It takes too long to hire career civilian employees. Organizations that I oversaw as DoD comptroller (including the Defense Contract Audit Agency and the Defense Finance and Accounting Service) hired numerous civilian employees –

many of whom were just beginning their careers. These organizations lost qualified candidates because private-sector firms could hire much more quickly.

- *Problems handling poor performers.* DoD has a small proportion of career civilian employees who do not perform well. Executives working for me spent too much time disciplining and, when needed, attempting to terminate members of this relatively small group.
- *Lack of tools to set requirements and manage pay.* We have reasonable tools to help determine the numbers and types of military personnel needed to meet warfighting needs, or at least to generate information needed for an informed debate. We also have good tools to ascertain how military personnel will react to changes in compensation. Civilian personnel needs, however, tend to be established job by job, making it hard to debate what numbers and types of civilian employees are needed in the aggregate as warfighting and support requirements change. Also, we have almost no tools that permit us to judge how civilians will react to compensation changes.
- *Too many sticks, too few carrots.* In recent years we have furloughed civilian employees twice and frozen their pay three times. Some in Congress criticize career civilians, seemingly treating them not as valued employees but rather as symbols of a government they feel is too large. We also often fail to recognize the contributions that civilians make to meeting DoD's warfighting needs. In contrast, we regularly recognize the accomplishments of our military personnel.

Because of these various problems, morale has fallen sharply among career civilians. Each year the Partnership for Public Service creates a morale index for career civilians using questions administered by the Office of Personnel Management during an annual survey. Between 2010 and 2014, the index suggests that morale for the government's civilian employees declined by about 12 percent, even while recent improvements in the economy led to morale improvements among all U.S. workers.

Employees perform best when they believe that their employer values their services and will treat them fairly. Today, unfortunately, I believe that many career civilians in DoD, and probably in other federal agencies, wonder whether their employer really values their services.

I am not able to offer a comprehensive package of solutions to these and other problems affecting DoD's career civilian employees (and in many cases, civilian employees throughout government). I am hopeful that in future releases, Secretary Carter's Force of the Future Initiatives will include recommendations for improvements in the civilian personnel system. I trust that any proposals that are submitted to Congress will receive careful consideration.

While I can't offer comprehensive reform, I have found during my government service that progress often has to occur in increments. So I will conclude my statement by proposing some incremental improvements that seem practical to me and should help improve the civilian personnel system.

Congress should challenge DoD to provide a better basis for determining, in the aggregate, the number and types of civilians needed to support warfighting requirements. Requiring a one-year study by DoD's personnel experts, perhaps coupled with an analytic organization within DoD, seems to me a good place to start. In return for better tools, Congress should stop requiring cuts in civilian personnel that are proportional to military reductions. Proportional cuts rarely permit DoD to meet its support needs.

Even in the absence of better tools to establish requirements, it is clear that DoD needs to take steps to reduce the size of its civilian workforce while continuing to meet support needs. Some key steps require Congressional support. Permitting DoD to close unneeded military bases, and to downsize or close some military medical facilities, would help DoD begin to achieve needed civilian personnel reductions without harming needed support activities.

It is also clear that DoD needs to hire more younger employees. Today DoD civilian employees under age 35 represent less than one-fifth of the Department's career civilian workforce. Media and other reports suggest that future Force of the Future Initiatives will include specific initiatives to attract more millennials into the Department. I hope that is true and that the Department (and other agencies) can move in that direction. In this year's National Defense Authorization Act, Congress also sought to help by providing expedited hiring authority for civilian acquisition professionals. As I mentioned earlier,

slow hiring is a key problem in meeting civilian personnel needs. Making this expedited authority available for other skilled personnel – for example, for those with skills and experience in the audit of financial statements – makes sense to me.

Congress and DoD need to work together to help the Department deal with the relatively small number of poor performing civilians. The most recent authorization legislation, which permits DoD to take into account performance during employment cutbacks resulting from reduction-in-force (RIF) actions, represents a start. Extending the probationary period for new employees to two years also helps. But broader authority is needed. DoD and Congress might consider establishing periodic review points during a career when poor performance can lead to termination. Some safeguards would of course be needed to avoid politically motivated or inappropriate separations, but the safeguards must be sufficiently streamlined to permit terminations without the impossibly lengthy proceedings that are required today. I recognize the difficulty of making this change, but I also know it is needed.

DoD and Congress also need to provide more rewards for good performance – a few more carrots, if you will. Let me suggest a couple of actions. Today many career civil servants who are selected as members of the Senior Executive Service (SES) receive little or no increase in salary, even though their responsibilities grow sharply. Comprehensive civilian pay reform, including pay increases for senior civil servants, would provide the best solution to this problem of pay compression. But comprehensive pay changes for senior civilians seem highly unlikely in the current budgetary and political climate. Press reports suggest that the President is considering an executive order that would urge increases in SES pay within existing limits. That action could represent an incremental step toward fixing pay compression. As another incremental step, DoD and Congress could expand the proportion of SES performers who are eligible for Presidential rank awards, perhaps focusing on awards at the meritorious level. These rank awards, which are made competitively through a process of board reviews, offer both prestige and substantial financial rewards to SES members who perform exceptionally well. The expansion should apply to all federal agencies, not just to DoD.

Along with expansion, the Administration should be strongly encouraged to remove recent limits on the number of SES members who are eligible for Presidential rank awards. The Administration imposed these limits because of concerns about providing awards in tight budget times, but the limits have the unfortunate effect of reducing recognition and compensation for the most capable SES members.

Finally, DoD and Congress need to harness the power of praise as a way to recognize the importance of DoD's career civilian employees. DoD and Congress are both very good at recognizing the contributions of military personnel at all ranks, but less good for career civilians. While I served as DoD Comptroller, I always tried to thank the men and women in the military, *and* the civilians who support them. I hope more senior leaders will do that regularly. DoD, along with this Committee and others in Congress, could help by seeking opportunities to recognize the successes of career civilian employees. Greater recognition would acknowledge the important role that DoD civilians play in maintaining our nation's security, and it would help civilians feel that they are valued employees.

Throughout my government career, I have been privileged to serve with many highly capable DoD personnel – both civilian and military. I hope the thoughts I have offered today can play a small role in helping these men and women who do so much to support our national security.