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Special Files, Budget Decision papers

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FY 1978
Defense
Presi-
dential
Review

~~DOD 1976 Budget
Presidential Review~~

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SF-72





**EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET**

DATE: 2/25/77

TO: Frank Matthews

FROM: Office of Management & Budget

Returned per telephone conversation
with Nell Doering. Please put
with President Ford's papers.



EXECUTIVE OFFICE OF THE PRESIDENT

OFFICE OF MANAGEMENT AND BUDGET

WASHINGTON, D.C. 20503

NOV 15 1976

MEETING ON FY 1978 BUDGET
Tuesday, November 16, 1976
2:00 p.m. (3 hours)
The Oval Office

FROM: Paul H. O'Neill

O'Neill

I. PURPOSE

To make decisions regarding the fiscal year 1978 budget for the Department of Defense and related small agencies.

II. BACKGROUND, PARTICIPANTS, AND PRESS PLAN

A. Background: The Office of Management and Budget has completed its review of the fiscal year 1978 budgets submitted for the Department of Defense and related small agencies. This meeting will raise the budget issues in these agencies that require Presidential review or determination. The primary supporting material was sent to you last Thursday. Additional materials concerning summary information and small agency budget requests are included in the attachment. In addition, a second complete set of materials is attached.

B. Participants: James Lynn, Paul O'Neill, Donald Ogilvie, Dale McOmber, Brent Scowcroft

C. Press Plan: David Kennerly photo

III. TALKING POINTS

1. Donald Ogilvie, what is the first issue that we should discuss this morning?



NATIONAL SECURITY COUNCIL

OK

Comments

OMB concurs with Agency request on staffing levels, but recommends a more limited funding increase for operating expenses. Agency has agreed to accept OMB recommendation.

	Budget authority (In thousands of dollars)	Outlays	Full-time permanent employment
1976 actual.....	3,052	3,192	68
<u>1977:</u>			
Employment ceiling.....	xxx	xxx	70
Agency request.....	3,210	3,300	70
OMB recommendation.....	<u>3,210</u>	<u>3,300</u>	<u>70</u>
Change.....	xxx	xxx	xxx
<u>1978:</u>			
Agency request.....	3,388	3,350	70
OMB recommendation.....	<u>3,235</u>	<u>3,250</u>	<u>70</u>
Change.....	-153	-100	xxx
<u>1979:</u>			
Agency request.....	3,388	3,388	xxx
OMB recommendation.....	<u>3,235</u>	<u>3,235</u>	<u>70</u>
Change.....	-153	-153	xxx



AMERICAN BATTLE MONUMENTS COMMISSION

Comments

The OMB mark would make minor adjustments to the operations and maintenance program funding level and would allow construction of a WWI/Pershing memorial in Washington, D.C., and completion of a memorial commemorating the missing in Vietnam. The agency has agreed to accept the adjustment.

OK.



	Budget authority	Outlays	Full-time permanent employment
	(In thousands of dollars)		
1976 actual	5,581	5,405	385
<u>1977:</u>			
Employment ceiling	xxx	xxx	392
Agency request	5,844	5,803	392
OMB recommendation	<u>5,844</u>	<u>5,803</u>	<u>392</u>
Change	-0-	-0-	-0-
<u>1978:</u>			
Agency request	6,733	6,603	392
OMB recommendation	<u>6,483</u>	<u>6,200</u>	<u>392</u>
Change	-250	-403	-0-
<u>1979:</u>			
Agency request	6,033	6,000	392
OMB recommendation	<u>6,033</u>	<u>6,000</u>	<u>392</u>
Change	-0-	-0-	-0-

U. S. Soldiers' and Airmen's Home

Comments

OK.

Agency requested increases for inflation and to improve maintenance and repair of facilities. Agency has agreed to accept reduction in inflation estimate.



	Budget authority (In thousands of dollars)	Outlays	Full-time Permanent Employment
1976 actual	15,502	14,513	934
<u>1977:</u>			
Employment ceiling	xxx	xxx	1,080
Agency request	15,939 ^{1/}	15,875	965
OMB recommendation	<u>15,939</u>	<u>15,875</u>	<u>965</u>
Change	0	0	xxx
<u>1978:</u>			
Agency request	16,260	16,215	965
OMB recommendation	<u>16,196</u>	<u>16,151</u>	<u>965</u>
Change	-64	-64	xxx
<u>1979:</u>			
Agency request	16,260	16,215	965
OMB recommendation	<u>16,196</u>	<u>16,151</u>	<u>965</u>
Change	-64	-64	xxx

^{1/} Includes pay supplemental of \$726.

Selective Service System

Keep agency

Comments

Agency requested increases in 1977 and 1978 for Reconciliation Services Program and in 1977 for deferred Reserve training and for increased severance pay costs. OMB mark approves only the increased severance pay and in addition would disestablish the Agency and transfer its functions and resources to the Federal Preparedness Agency, GSA. Agency agrees to part of mark but requests 1977 supplemental of \$602K and strongly urges retention as independent Agency.



	Budget authority (In thousands of dollars)	Outlays of dollars)	Full-time permanent employment
1976 actual	37,500	34,494	173
<u>1977:</u>			
Employment ceiling	xxx	xxx	90
Agency request	9,074	10,388	90
OMB recommendation	<u>8,124</u>	<u>9,438</u>	<u>90</u>
Change	-950	-950	0
<u>1978:</u>			
Agency request	6,590	6,820	83
OMB recommendation	<u>6,297</u>	<u>6,527</u>	<u>83</u>
Change	-293	-293	0
<u>1979:</u>			
Agency request	6,200	6,200	80
OMB recommendation	<u>6,200</u>	<u>6,200</u>	<u>80</u>
Change	0	0	0

Issue Paper
Selective Service System
1978 Budget

Background

Your tentative decision last year on the 1977 budget for the Selective Service System provided for an end to pre-registration and the Selective Service System as an independent agency. Residual planning and reserve training functions would have been assigned to the Federal Preparedness Agency in GSA.

In response both to Director Pepitone's appeal and OMB's recommendation that the System's independent status be retained until its pre-registration activities were phased down, you decided to defer your decision on the future organizational location of this agency until the 1978 budget review.

Statement of Issue

Should the Selective Service System's planning and training functions be assigned to the Federal Preparedness Agency?

Pros.

- Many Americans believe the Selective Service System is an agency without a mission. By taking the initiative now, we can demonstrate the seriousness of our purpose in cutting back unnecessary Federal Government activity.

Cons.

- Disestablishment of the Selective Service System as a visible and separate entity has the potential for being considered a sign of national weakness on the subject of preparedness.



Alternatives

- #1. Retain the Selective Service System as an independent agency (Agency req.).
- #2. Disestablish the Selective Service System and assign its planning and training functions to the GSA Federal Preparedness Agency (OMB rec.).

Analysis

Budget authority and outlays are roughly similar under both alternatives. Alternative #2 reflects the OMB view that these resources would purchase greater "preparedness" if the System's planning and training functions were transferred to GSA. The Agency argues the reverse.

The Selective Service System continues to indicate that their delivery performance in a future military mobilization would be well below that which was actually achieved just prior to World War II when they emerged from a similar operational posture. The table below illustrates some of the critical differences between the System's past and projected response times.

<u>Action</u>	<u>World War II</u>	<u>Current Projection</u>
Registration	M+30	M+60
Initial Induction Orders	N/A	M+90
Initial Inductions	M+62	M+110
100,000 Inductions	M+120	M+150

In our view the System's projected delivery performance should actually exceed that experienced in 1940 when the Nation's communications, transportation, and data processing facilities were primitive in comparison to today's capability.

The report of an informal interagency (DOD/SSS/OMB) study group on the budget concept for FY 1976 presented an analysis that further suggests that the System is understating the delivery performance its current processing procedure could achieve. Within 60 days of the initial issue of induction orders to registrants, 655,000 registrants could be inducted according to this report. By comparison, the Agency indicates that this figure would reach only 100,000.

In the current re-examination of foreign policy and military force requirement (NSSM 246), the possible need for an expanded draft capability is being considered. As part of this exercise, the System presented alternative funding levels and their associated delivery performance which were logically inconsistent. That is, for certain alternatives, increased funding resulted in decreased performance. While the System was quick to revise their estimates, this type of incident raises some concern about the credibility of their projections.

The Selective Service System argues that their current operational posture does not mirror that existing just prior to World War II when substantial portions of the Nation's mobilization manpower planning and training efforts were being funded in other agencies and in budgets at the State and local level rather than at the Federal level.

As to the report of the informal study group on the budget concept for 1976, Director Pepitone indicates that he has never formally accepted the report's conclusion on induction delivery performance.

Agency request: Alternative #1. Current procedures minimize the System's mobilization reaction time within existing resource constraints. A faster response cannot be obtained with improved procedures or with the proposed functional shift to FPA but only with increased funding.

OMB recommendation: Alternative #2. Mobilization capability depends primarily on the procedures used to process young men for induction. To a large extent, they are independent of the cost of operating the Selective Service System. There is substantial evidence that mobilization performance could be much better than now projected by the Selective Service System, with proper planning and training.

Agency efforts to secure increased resources through its continued use of pessimistic performance projections must be corrected. A functional transfer of the System's responsibilities to the FPA offers the best hope of realizing this goal. Even if NSSM 246 should result in an expanded standby draft capability, FPA would still be the preferred organization to assume the additional responsibilities.



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Issues

ISSUES

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* Affected by NSSM 246.

Overall Defense Level

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Pay and
Efficiencies

Department of Defense
1978 Budget
Pay and Efficiencies

The Defense budget is extremely labor intensive. The cost of people represents a very high proportion of the total and is very difficult to control. Federal pay levels are generous and future pay increases reflect major increases in the Defense budget.

The issues raised in this area can be grouped in four categories:

1. Broad policy issues concerning the basic structure of current compensation policy. Included in this area would be a review by an outside group of the work done to date by the QRMC, and the use of the outside group to generate a broad base of national support for reform of the Federal Wage System for blue collar workers.
2. Efficiencies in the way we now do business. These include civilian and Reserve Forces manning levels, the possibilities of further contracting out, base realignment studies, and the question of building ships in naval ship yards.
3. Changes in current practices which will take money away from current and future personnel. These will be most difficult to implement and will encounter severe opposition on the part of the affected parties as well as congressional obstacles. Specific issues include a renewed effort to reduce the commissary subsidy, reductions in Reserve compensation, and a reduction in civilian average grade levels.
4. Proposed new benefits not currently available to military personnel. Travel for junior enlisted personnel and new Reserve recruiting incentives are included in this area.



Further complicating the current situation is the perception by military people that there has been an ongoing erosion of the benefits that they have been historically entitled to and the attitude of organized civilian employee leaders that the Administration is "picking on" Federal civilians.

The changes proposed will be difficult to achieve and will require strong and personal Presidential leadership as well as the development of something approaching a national consensus that the changes are just and essential.



Issue Paper
Department of Defense
1978 Budget
Issue # 2: The Quadrennial Review of Military Compensation

Background

The present military compensation structure is a complex mixture of direct pays, tax advantages, purchasing advantages and in-kind benefits. The system originated at a time when most military people lived in a military environment where the employer provided food, shelter and most other necessities. Over the years, the pay system was patched to meet specific problems, and today we are still patching with no policy on what military pay should be and no rational way of adjusting military pay.

This situation led the Congress in 1966 to direct a comprehensive review of military compensation to be conducted beginning January 1, 1967 (and once each four years thereafter). The Congress also instituted what was viewed at the time as a temporary link of the adjustment process wherein military personnel pay raises are equated with those of Federal civilian employees.^{1/} Flaws in this temporary mechanism resulted in military personnel receiving larger annual increases than civilians for seven years. This imperfection has now been remedied. Many observers believe that while the flaws were in effect, direct military compensation shifted from a position which lagged Federal civilian pay to a point where it now appears to be ahead.

The Third Quadrennial Review of Military Compensation has been considering these issues since January 1975. Unfortunately, it has not been able to reach a consensus on what policy changes are needed in this area. Accordingly, the study group Chairman (Assistant Secretary for Manpower and Reserve Affairs, David Taylor) has submitted to Secretary Rumsfeld for decision three key issues:

- Should military compensation levels be set and adjusted on the basis of pay for similar levels of work in the private sector (a comparability principle) or should they be set and adjusted as needed to attract and retain the desired quality and quantity of personnel (a competitive principle)? Secretary Rumsfeld chose the comparability principle.

^{1/} The "Rivers amendment"

- Should compensation levels be based upon total compensation or upon the military equivalent of salary? Total compensation was tentatively approved.
- Should the current pay and allowances system be replaced by a salary system? The current system was retained.

These decisions, in turn, require a series of difficult decisions on unresolved questions, primarily:

- What is military pay?
 - . What value should be placed on retirement? (The QRMC has not reached a consensus.)
 - . What value should be placed on medical care? (The QRMC has not reached a consensus.)
 - . Does the extensive recreation system represent compensation? (The QRMC says no, but the GAO and many in the Congress say yes.)
- What should military pay be?
 - . What elements should be included in comparisons?
 - . Where should military and civilian pay lines be linked?
 - . What is the "military factor" (which some say requires special compensation consideration for the rigors of the military life) and should it be compensated for?

We understand that Assistant Secretary Taylor is in the process of obtaining Secretary Rumsfeld's position on these issues and it thus may be premature to reach a final conclusion on the likely outcome. Nevertheless, we believe it is likely that the net effect will be almost no change in a complex, controversial pay system that has been heavily criticized.

The present set of circumstances is not surprising. A series of actions have been taken (e.g., the change in the Rivers amendment and the pay raise reallocation measure) or proposed (e.g., the



retirement modernization act and elimination of the commissary subsidy) which are perceived by military personnel as an "erosion" of their earned benefits. The uniformed military leadership involved in the QRMC are keenly sensitive to this situation, and, in fact, share this belief. They feel deeply that this situation can lead not only to increasing pressure for unionization but also to a loss of morale which would reduce the effectiveness of their Services. There has thus been a reluctance to come to conclusions or follow analytical paths whose inevitable conclusion might worsen the situation as their members perceive it.

On the other hand, there are conflicting perceptions of military compensation. There are those not only in the Administration but in the Congress who believe that military compensation in total is excessive. Others believe it is inefficient. The Defense Manpower Commission, in April, recommended conversion to a salary system. They also recommended a competitive system. Given the existence of these fundamentally different views, it may be appropriate to use the forum of a distinguished outside group, whose objectivity and concern with the national interest would be unquestionable, to review the complex issue of military compensation and provide recommendations to the President. It is unlikely that anything less would be accepted by all concerned.

Statement of Issue

Should an outside group of distinguished Americans be established as a commission to review military compensation and make recommendations to the President?

Pros.

- The QRMC has been in process for almost two years. For an in-house group to finally emerge with what may be seen as fundamentally the status quo may serve to only prolong the debate on military compensation. The recommendations of a prestigious commission would possibly avoid this.
- It has been impossible for those directly involved, either military or civilian, to be objective about the issues. An outside group could be.
- The issue involved is of such fundamental importance that we should not be satisfied with a series of compromises. The military personnel appropriations are now at a level of \$26 billion and annual pay increases add about a billion and a half each year. At the same time the future success of the All-Volunteer force requires that service in the military be as attractive to young people as opportunities in the private sector.



Cons.

- After two years of study, there are obvious disadvantages to take the step of, what will be seen as, asking for another study.
- The military leadership can be expected to strongly oppose such a step.

Alternatives

- #1. Permit Secretary Rumsfeld to proceed on his current schedule which we now expect will result in essentially no real change in the current system (Agency req.).
- #2. Establish a Presidential Commission which would review the findings of the QRMC to date and provide an independent recommendation to the President. (Such a panel could also be asked to review the Administration's proposal on blue collar pay and serve as a means of building national support for the reform measures) (OMB rec.).

Agency request: Alternative #1. The Department believes that the issue of military compensation has been debated too long already and that the most needed reforms have already been achieved.

✓ OMB recommendation: Alternative #2. The issues will not go away and only a comprehensive review by an outside body can provide a credible assessment of the military compensation system. The Commission could use the research already done by the QRMC and thus could be expected to report in 3-6 months. You could ask the Quadrennial Commission on Executive Pay under Pete Peterson to take on this additional task or you could announce a new commission with appointments to be made later.

Issue Paper
 Department of Defense
 1978 Budget
 Issue # 3: Military and Civilian Pay Increases

Background

The Defense budget request assumes pay increases for FY 1978 and FY 1979 under current law. The assumptions used and the resulting costs are displayed below.

<u>Defense Budget Request Pay Raise Assumptions</u>	(\$ in millions)	
	<u>1978</u>	<u>1979</u>
<u>General Schedule:</u> 6.5% on Oct. 1, 1977 and 6.25% on Oct. 1, 1978	625	1,266
<u>Military:</u> 6.5% on Oct. 1, 1977 with a full 25% reallocation from basic pay to the Quarters Allowance and 6.25% on Oct. 1, 1978 with no reallocation	1,370	2,890
<u>Wage Board:</u> 8.8% in 1977, 7.9% in 1978 and 7.0% in 1979	<u>553</u>	<u>1,079</u>
TOTAL	2,548	5,235

General Schedule and Wage Board salaries are adjusted annually on the basis of "comparability" with salaries paid in the private sector for similar levels of work. Changes in military pay are tied by statute to changes in the General Schedule. Current law permits the President to propose an alternate pay adjustment for General Schedule (and military) employees if he considers the "comparability"



increase inappropriate "for reasons of national emergency or economic conditions affecting the general welfare." This authority does not extend to the wage board system. The amount of the General Schedule pay increases and the issue of an alternative plan will be covered later on a government-wide basis.

This issue discussed herein concerns treatment of the Wage Board system and exercise of the authority to reallocate up to 25% of the increase in military basic pay to the Quarters Allowance.

The Civil Service Commission plans to resubmit to the next Congress legislation to reform several features of the Federal Wage System that impede implementation of comparability. While the Department of Defense strongly supports enactment of this proposal, they are reluctant to anticipate the savings in the budget because they estimate a low probability of congressional acceptance.

For the October 1976 military pay increase you authorized the reallocation of 25% of the basic pay increase to the Quarters Allowance. This was done to better align the Quarters Allowance with the costs of housing and to facilitate an eventual move to a Fair Market Rental system which you approved last year. The 1978 budget assumes a full reallocation in 1978 but none in FY 1979.

Statement of Issue

Should the budget assume smaller pay increases resulting from enactment of the Federal Wage System reforms and a full 25% reallocation from basic pay to the Quarters Allowance in 1979?

Pros.

- It may not be credible to submit wage board reform legislation without reflecting the savings in the budget.
- Attainment of the goal of a quarters allowance that reflects the cost of housing requires full reallocation in both years.



Cons.

- If the wage board reform legislation is not enacted, Defense may have to absorb the additional costs.
- Military people who are nearing retirement object to the reallocation because it has the effect of reducing their retired pay.

Alternatives

- #1. Assume wage board salary increases consistent with current law and assume no reallocation in FY 1979 (Agency req.).
- #2. Assume enactment of the wage board reform legislation and full reallocation in both years (OMB rec.).

Agency Request
(\$ in millions)

Department of Defense

<u>(Difference from Alt. #1 (Agency Request)</u>	<u>1978 Outlays</u>	<u>1979 Outlays</u>
Alt. #2 (OMB rec.)	-337	-971)

Agency request: Alternative #1. While Defense strongly supports the wage board reform, they believe it has little chance of passage and they are reluctant to anticipate the savings in the budget. In reallocation, they prefer a slower approach to the same goal.

OMB recommendation: Alternative #2. Failure to anticipate 1978 enactment of the proposed Federal Wage System reforms in the budget estimates will severely dim prospects for enactment.



Issue Paper
Department of Defense
1978 Budget

Issue #4: Agency Budgeting for Federal Employee Retirement Programs

Background

Secretary Rumsfeld recommended that the current military retired pay appropriation be shifted to the income security function in the FY 1978 budget, excluding all funding for the military retirement program from the DOD budget. In the Spring Planning Review, we proposed a similar shift of those specific costs associated with past or current military retirees and their survivors. However, our recommendation would also budget the accrued retirement costs associated with the current active duty force in the Defense military function. In addition, we proposed that accrual estimates for all Federal employee retirement systems reflect "dynamic" assumptions that anticipate future salary increases, CPI adjustments, and applicable interest rates. Mr. Rumsfeld supports the OMB position as a long-term goal but does not feel that the functional transfer should be delayed pending implementation of full accrual budgeting.

A draft report on the CSC evaluation of the present financing of the Civil Service Retirement System was submitted on October 15, 1976, without specific recommendations on financing and budgeting for Federal employee retirement programs. Their evaluation has focused on the cash flow management aspects of the trust fund rather than the personnel management impacts of accruing full retirement liabilities. One of the alternatives developed in that report reflects the OMB staff position on this issue. The Civil Service Commission would recommend that this issue be deferred until after their report has been finalized and thoroughly reviewed.

Statement of Issue

Should agency budgets for military and civilian retirement programs reflect the full accrual cost of their current workforce?

Pros.

- Provides timely and appropriate incentives for efficient manpower, personnel and compensation decisions both within the Executive Branch and in the Congress
 - . by linking the cost of retirement benefits to the decisions from which such costs accrue, and
 - . by taking account of anticipated benefit increases due to wage and price inflation.
- More accurately reflects the cost of defense spending relative to non-defense spending in the Federal budget.
- Reduces defense budget authority and outlays by \$2 billion in 1979, although this is both later and less than the \$9 billion 1978 reduction resulting from the Defense proposal.

Cons.

- Projected 1979 total budget authority would increase by \$13 billion although total outlays would remain unchanged.
- Calculating accrual costs is both complex and difficult to check. Small changes in economic assumptions or continuation patterns introduce billion-dollar changes in accrual levels.
- The management objectives sought by full accrual advocates can be achieved without reflecting such costs in our budgeting system. It may be sufficient simply to include deferred costs as part of the justification for off-budget management and policy decisions.

Alternatives

- #1. Retain the current budget structure.



- #2. Shift the cost of the Military Retired Pay Appropriation to the income security function in 1978 (Agency req.).
- #3. In the 1979 budget combine the proposed functional shift of the Military Retired Pay Appropriation with the introduction of full accrual budgeting for both military and civilian retirement programs (OMB rec.).

Analysis

<u>Budget Authority/Outlays</u> (<u>\$ Billions</u>)	<u>1976</u>		<u>1977</u>		<u>1978</u>		<u>1979</u>		<u>1980</u>		<u>1981</u>		<u>1982</u>	
	<u>BA</u>	<u>O</u>												
<u>Dept. of Defense</u>														
Alt. #1	8	8	9	9	10	10	11	11	12	12	13	13	14	14
Alt. #2 (Agency req.)	8	8	9	9	1	1	1	1	1	1	1	1	1	1
Alt. #3 (OMB rec.)	8	8	9	9	10	10	9	9	9	9	10	10	10	10
<u>All Agencies</u>														
Alt. #1	10	16	11	18	12	20	13	22	14	24	15	26	16	28
Alt. #2	10	16	11	18	12	20	13	22	14	24	15	26	16	28
Alt. #3 (OMB rec.)	10	16	11	18	12	20	26	22	28	24	30	26	32	28

Secretary Rumsfeld is seeking implementation of his proposal in the 1978 Budget. The OMB recommendation would be implemented in the 1979 Budget with the President announcing his intention to do so in the 1978 Budget Message. Additional time is required to seek agency agreement on costing methodologies and procedures.

Agency request: Alternative #2. The Secretary of Defense supports the OMB staff proposal as a long-term goal. In his view, however, it is important that we not "muddy the water" and endanger his immediate FY 1978 objective by pushing for short-term implementation of full accrual budgeting. The Defense alternative will minimize the "apparent" size of the Defense budget and possibly secure additional resources to purchase other defense materials and services. Mr. Rumsfeld indicates that there is strong support for his proposal in Congress.



✓ OMB recommendation: Alternative #3. The OMB alternative seeks to improve the legislative and management processes, by relating future retirement payments to the policies and decisions that give rise to the liability for them. The agency request completely frustrates this cost management objective by removing DOD's incentive to limit annuity increases for current military retirees without substituting any incentive to manage the cost of their future retirees. It actually provides Defense with a perverse incentive to initiate manpower, personnel, and compensation actions that shift costs from military pay to retired pay appropriations in order to reduce the DOD cost of internal decisions. The Defense proposal would also result in serious undercosting of the Defense budget relative to other agency budgets which include a partial retirement accrual for all their employees.

With respect to Mr. Rumsfeld's expressed reluctance to "muddy the water" in Congress by pressing for early implementation of the OMB recommendation (which he supports as a long-term goal), it should be pointed out that a \$9 billion-dollar reduction in the FY 1978 Defense budget, followed one year later by an \$8 billion increase as full accrual budgeting is implemented, will be much more difficult to explain and justify than a single \$2 billion reduction in 1979 that results from simultaneous introduction of both actions. Furthermore, approval of his short-term proposal may substantially dim legislative prospects for his professed long-term objective. While there is support for the Secretary's proposal in some parts of the Congress, past inquiries on this question have revealed strong opposition to the idea by the Chairman of the House Appropriations Committee.



Issue Paper
Department of Defense
1978 Budget
Issue # 5: Commissary Subsidy

Background

The Defense commissary system was initiated to meet the needs of military personnel stationed at remote locations and evolved into an economic benefit to offset formerly low military salaries. Today military salaries are competitive with civilian salaries, but the subsidy remains unchanged. In the 1976 review, the President determined to phase out the subsidy over two years and in the 1977 review the President proposed to reduce the subsidy over three years. In each instance the House restored the funds while the Senate was willing to accept the reductions proposed (although in the 1977 bill, the Senate proposed a six-year phase out in lieu of the Administration's three-year proposal). In 1976 and in 1977, the conference committee restored most of the funds deleted. The Congress did accept savings in the subsidy which resulted from management improvements rather than the imposition of a surcharge. The subsidy, which totals \$340 million, pays the salaries and expenses of the 24,600 civilian and military personnel engaged in commissary operations.

Statement of Issue

Should the full costs of operating the military commissaries be passed on to the consumer by either ending the direct subsidy or adjusting future military pay increases to account for the value of commissary benefits?

Pros.

Today's military salaries and retiree programs and the ready availability of alternative (although somewhat more expensive) markets make the commissary system and, in particular, the direct Government subsidy to the commissary system archaic.

- . Military salaries are at least competitive, or more than competitive, with civilian salaries.

- . The military retirement system provides benefits far in excess of the average private pension plan. Military retired pay, unlike most civilian sector retirement plans, is automatically adjusted, based on the consumer price index, to insure that the retiree suffers no loss in purchasing power through cost-of-living increases. These cost-of-living increases have in the past been even greater than the increase in the CPI because of the 1% "kicker."
- Discounting the amount of future military pay increases until the value of the subsidy is fully recovered, as proposed in Alternative #3, would follow the general principle of valuing total compensation--including fringe benefits--when setting military and civilian salaries.

Cons.

- The commissary program is politically popular.
 - . Private sector service-oriented publications have publicized the proposal and urged their readers to protest to the Congress and the Executive Branch. A large volume of protest mail, particularly from retired personnel, can be expected.
 - . This recommendation requires legislation to either end the direct subsidy or to allow differentiation between the civilian and military pay increases.
 - . The reduction in compensation proposed in Alternative #3 will be clearly delineated each time that there is a pay increase, while the proposal is being implemented, thereby increasing the proposal's unpopularity.
 - . The QRMC has included the commissary subsidy as part of the unquantified compensation necessary to offset the "military factor."

Alternatives



- 1. Continue the subsidy on the basis that favorable congressional action is unlikely (Agency req.).

- #2. Terminate the existing subsidy over a three-year period beginning on October 1, 1977, and submit legislation in January to implement this change (OMB rec.).
- #3. Continue the direct subsidy but limit the amount of future military pay increases over the next two years until the value of the commissary to military personnel is fully discounted in military salaries.

Analysis

<u>Budget Authority/Outlays</u> (\$ Millions)	<u>1976</u>		<u>1977</u>		<u>1978</u>		<u>1979</u>		<u>1980</u>		<u>1981</u>		<u>1982</u>	
	<u>BA</u>	<u>O</u>												
Alt. #1 (Agency req.)	310	310	320	320	340	340	340	340	340	340	340	340	340	340
Alt. #2 (OMB rec.) ..	310	310	320	320	225	225	110	110	--	--	--	--	--	--
Alt. #3	310	310	320	320	90	90	--	--	--	--	--	--	--	--

Agency Request

<u>(Difference from Alt. #1 (Agency request)</u>	<u>1978 Outlays</u>	<u>1979 Outlays)</u>
Alt. #3	-250	-340)
Alt. #2 (OMB rec.)	-115	-230)

Agency request: Alternative #1. Retain the subsidy on the basis that Congress will not allow the subsidy to be ended.

OMB Recommendation: Alternative #2. Reiterate the decision of the last two years to phase out the commissary subsidy over a three-year period.



Issue Paper
Department of Defense
1978 Budget
Issue # 6: Junior Enlisted Travel Entitlements

Background

Junior enlisted personnel stationed in CONUS or overseas, even if accompanied by their dependents, are not eligible for travel and transportation allowances for these dependents. They are also ineligible for station allowances (cost of living, housing and temporary lodging) at rates otherwise allowable for those with dependents. Since 1975 DOD has attempted, unsuccessfully, to change this policy to include funds in the budget for this purpose. In 1975 they were deleted by Congress; in 1976 they were deleted by the Secretary of Defense after discussion with the President; and in 1977 they were deleted by the President.

Statement of Issue

Should existing entitlements for dependent travel and transportation allowances be extended to junior enlisted military personnel?

Pros.

- It would alleviate a definite financial burden imposed on the lowest-paid members of the armed forces.
- It would reduce family separations which should improve service morale and which may result in improvements in the attrition and re-enlistment rates.
- It would permit junior enlisted personnel to be treated the same as higher ranking members of the armed forces.



Agency Request

✓ (Difference from Alt. #1 (Agency request)	<u>1978 Outlays</u>	<u>1979 Outlays)</u>
(Alt. #2 (OMB rec.))	-189	-189)

Agency request: Alternative #1. The Department believes that extending the entitlement to junior enlisted personnel should be just the cost of doing business which is equitable and which would alleviate the financial burden on many service personnel and which may encourage re-enlistments.

OMB recommendation: Alternative #2. The Department has no evidence that extension of this entitlement to junior enlisted personnel would have any significant positive impact on re-enlistment as most service members qualify for the entitlement when they are eligible to re-enlist.



Issue Paper
 Department of Defense
 1978 Budget
 Issue # 7: DOD recruiting Costs

Background

Since the advent of the All-Volunteer Force (AVF) the cost of military recruiting has increased dramatically. Much of this increase results from the fact that, unlike the draft era, the military services must now compete directly with the civilian labor market for young males. This has resulted in new and improved bonuses for enlistments and re-enlistments and sophisticated marketing techniques, including a greatly expanded recruiter force, paid advertising and a great deal more management of the total military recruiting effort throughout DOD. Prior to the AVF, the recruiter was, to a great extent, simply "an order taker." He is now a carefully selected and highly trained service member who faces a real challenge to continually obtain the quality and quantity of people demanded of him by his military service.

The military services have concluded that the recruiter and their other recruiting resources should especially be directed at obtaining male high school diploma graduates, as opposed to non-high school or high school equivalency certificate (GED) graduates. DOD believes that high school graduates are much more likely to complete their enlistments and pose significantly fewer discipline problems. The services would prefer all of their male recruits to be high school graduates, but supply and demand factors make this impossible. All services require that their female recruits be high school graduates.

Each year, since the beginning of the AVF, the percentage of high school graduates entering the armed forces has increased.

<u>Percentage of Recruits Who are High School Graduates</u>			
<u>FY 1964</u>	<u>FY 1974</u>	<u>FY 1975</u>	<u>FY 1976</u>
68	66	72	75



The Department's success in improving "quality" can be attributed in part to its vigorous recruiting and advertising programs and its ability to pay enlistment bonuses up to \$2,500 to high school graduates who agree to enter shortage skills. However, some of their success must also be attributed to poor economic conditions and the lack of employment alternatives for young men and women in the private labor market.

While all the services completed FY 1976 with improvements over FY 1975, the Army was displeased with its performance. Army had established a FY 1976 high school graduate enlistment objective of 65%. During the first half of FY 1976, it was able to recruit 65%. However, in the latter half of the fiscal year, a downward trend in quality developed, and Army ended the year with only a slight improvement over FY 1975. If Army's first half FY 1976 performance had continued, DOD's overall rate in FY 1976 would have been 79% rather than 75%.

Army attributes the downward trend in the last half of FY 1976 to reduced recruiting resources. In FY 1976 alone, the Congress reduced its recruiting budget by 13 percent and in the FY 1977 President's Budget, funds for the enlistment bonus were significantly reduced - from \$73 million in FY 1976 to \$29 million in FY 1977.

As a result of the Army's problems in the second half of FY 1976, \$79 million in additional resources have been proposed for reprogramming in FY 1977, including additional funds for enlistment bonuses. All of the other services, however, met or exceeded their FY 1976 high school graduate enlistment goals.

To halt what Army considers as a continuing downward trend in high school enlistments, it proposes to increase FY 1978 funding by \$41 million from a proposed \$276 million in FY 1977 to \$317 million in FY 1978.

However, the Air Force and Marines, as well as the Army Reserves, are also programming higher levels of high school graduate enlistments. Both active and Reserve forces are requesting greater recruiting resources in FY 1978, including the Air Force, which historically has enjoyed nearly 100% high school graduate enlistments. Air Force complains that the increased recruiting resources provided to the other services is adversely affecting their capability to attract quality recruits.



And, if additional recruiting resources are provided to Air Force and Navy, Army's problems grow as today's youth prefer these two services over the Army.

Although there are other sources for "quality" recruits, such as college drop-outs and prior service personnel, DOD's recruiting efforts and resources are primarily concentrated on the Nation's high school seniors, as this group generally is much easier to contact.

The stated requirements of the military services for male high school graduates are compared with the anticipated supply on the following table.

	<u>Male High School Graduate Enlistments Required</u>		
	<u>FY 1976</u>	<u>FY 1977</u>	<u>FY 1978</u>
Active Forces	246,350	262,996	266,920
Reserve Forces	<u>42,846</u>	<u>61,960</u>	<u>68,575</u>
TOTAL	289,206	323,956	335,495

	<u>High School Graduate (HSG) Market*</u>		
	<u>FY 1976</u>	<u>FY 1977</u>	<u>FY 1978</u>
Anticipated No. of Males	1,543,000	1,541,000	1,547,000
No. Entering College	717,000	718,000	726,000
Never enter labor market	<u>60,000</u>	<u>60,000</u>	<u>60,000</u>
Available: HSG Market	766,000	763,000	761,000
% Required by Active Forces	30.2	32.5	33.1
% Required by Reserve Forces	5.6	8.1	9.0
Total % Required by DOD	35.8	40.5	42.1

* Source: Census Bureau and BLS data.

Statement of Issue

Should the military services quest for high school graduates be constrained and can more efficient use be made of recruiting resources by lowering the amount of interservice competition?



Pros.

- It would permit manpower resources currently utilized for recruiting to be applied to other military efforts.
- It would require that the military services aggressively examine measures to reduce first-term attrition (currently over 35%) other than by recruiting more high school graduates. This could mean further expansion in the enlistment of women and major changes to recruit training.
- DOD's FY 1977 and FY 1978 requirement for male high school graduate enlistments appears excessive and probably unrealistic unless this group of Americans continue to experience high unemployment.
- The quest for quality recruits results in expensive competition between the services. The military services, especially the Army, have not made maximum use of prior service personnel who wish to return to military life. These people, to a great extent, have made the adjustment to military living and 80% are high school graduates.
- We don't know what number of high school graduates are needed. We should review the overall need and identify places where others can be used.

Cons.

- If the military services recruit lower quality enlistees, DOD will incur significantly higher training and manpower cost due to increased attrition. A FY 1975 Army study of accessions showed that 1,200 non-high school graduates had to be recruited to perform the same useful service as 1,000 diploma holders. Army has estimated that the present level of quality results in cost avoidances of up to \$133 million per year.
- Policy changes which would support lesser quality recruits could lead to serious questions about the viability of the all-volunteer armed force.



- Much of the personnel disturbances experienced by the services during the late 1960's and early 1970's have been blamed on lower quality first-termers. To endorse a return to lower quality recruits may signal a return of these problems.
- If the services are required to enlist more prior-service personnel, then additional manpower costs, especially with respect to retirement, will be incurred in the outyears, as prior-service personnel tend to remain on to retirement in much greater numbers than recent high school graduate enlistees.

Alternatives

- #1. Approve the Department of Defense request which provides for additional recruiting resources for both active and reserve forces (Agency req.).
- #2. Maintain recruiting resources at the FY 1977 level and direct DOD to conduct a study of military recruiting. This study would examine the implications as well as the feasibility of continuously accessing more and more high school males. It would also study methods of reducing attrition such as possible modifications to recruit training programs. And it would examine alternatives to male high school graduate enlistments such as recruiting more women and prior service personnel.
- #3. In view of the major increases already planned in 1977, approve no more than one-half the increased resources requested for 1978 and direct the Department to conduct the study proposed in Alternative #2. The distribution of the increase should assure that a competitive balance exists among the services in the recruiting effort (OMB rec.).



Analysis

Budget Authority/Outlays (\$ Millions)	1976		1977		1978		1979-1982	
	BA	O	BA	O	BA	O	BA	O
DOD recruiting Costs:								
Alt. #1 (Agency req.)	486	486	595	595	720	720	720	720
Alt. #2	486	486	595	595	595	595	595	595
Alt. #3 (OMB rec.)	486	486	595	595	645	645	645	645

Agency Request

<u>(Difference from Alt. #1 (Agency Request))</u>	<u>1978 Outlays</u>	<u>1979 Outlays</u>
Alt. #2	-125	-125)
Alt. #3 (OMB rec.)	-75	-75)

Agency Request: Alternative #1. The military services have made tremendous strides in achieving an acceptable level of quality recruits each year. They should be commended and encouraged to improve past performances. To do otherwise, could undermine the very idea of an all-volunteer force.

OMB recommendation: Alternative #3. Present quality recruiting plans, when viewed individually, appear to be acceptable in most cases. However, when examined collectively, they make large demands on the young male population. Further, while the services are enjoying improved quality each year, they still experience a high level of recruit attrition. A study of military recruiting, including a review of methods to reduce the present level of recruit attrition should be initiated. Further alternatives to the present service recruitment plans should be explored, such as accessing more prior service personnel and resources. This review should particularly assure that no one service is permitted to maintain a significant competitive advantage over any other.



Issue Paper
Department of Defense
1978 Budget
Issue #8 : Average Grade Controls

Background

The average grade of Federal civilian workers under the General Schedule has risen from 7.458 in 1964 to 7.852 in 1974 and is currently reported at 7.997. Much of this increase is generally attributed to technological changes which have forced a change in the make-up of the Federal workforce, thus increasing the proportion of high level technical, professional, and managerial employees. However, it has long been recognized that not all of this average grade increase can be attributed to occupational or structural shifts and that some portion is attributable to unwarranted grade inflation. This prompted OMB to direct a Government-wide exercise in 1972-73 designed to arrest the trend of average grade increases. Estimates vary widely as to the portion of average grade increase that is unexplained by structural change. These estimates depend upon methodology, but the amount appears to be significant. It should be emphasized that all "unexplained" increases are not necessarily unjustifiable increases.

Included in the ongoing Presidential Management Initiatives is a year-long position and classification management objective (announced by a Presidential directive of May 27, 1976) which requires Federal agencies to re-examine their internal position management systems and take appropriate corrective action to restrain grade escalation. This initiative deliberately avoided setting grade reduction targets and instead requires individual agencies to implement the program under CSC guidelines and monitoring. CSC has begun a vigorous attack on the problem. Among other steps, CSC recently has identified statistically significant average grade changes occurring since May 1973 in twenty occupational series involving eight different agencies. These agencies are being given until next month to explain such changes. In cases which are not explained satisfactorily (by changes in series standards, classification appeals, etc.) CSC will direct position audits and ultimate corrective action where warranted. The question has been raised whether corrective agency action and compliance would be strengthened by projected budget reductions.

Statement of Issue

Should the anticipated results of this year's highly selective average grade reduction program be reflected in the 1978 budget by budgeting for a 1% reduction in the Government-wide average grade?

Pros.

- Could provide a stronger incentive for agencies to develop effective position management and evaluation systems.
- Could reduce competitive hiring disadvantages that the Federal Government may be imposing on the private sector.
- Could improve internal equity among Federal classified workers by ensuring that pay distinctions reflect work distinctions.

Cons.

- Could open OMB to repeated union charges that we have directed downgradings to save money regardless of case merits.
- Could suggest that agencies which do a conscientious job of position management will be rewarded by having their budgets reduced.
- Could induce perverse management actions which increase total program costs while reducing average grade, such as hiring of lower graded temporary personnel to drive down the average grade.
- Could create recruiting, retention, and morale problems (unless appropriate compensation adjustments are implemented).

Alternatives

- #1. Retain the current plan without budgeting for anticipated average grade reduction (Agency req.).
- #2. Budget for a reduction of 1% in the General Schedule average grade (OMB rec.).

Analysis

	Request (\$ Millions)	1978 Outlays	1979 Outlays)
✓ Difference from Alt. #1			
(Alt. #2 (OMB rec.) - Total Government		-18	-95)
(- DOD		-7	-38)

OMB has recently completed a preliminary analysis on the causes of changes in average grade and the cost implications of these changes. While this research has relied on several different data sources and 22 highly aggregated job families, the conclusions derived are likely to be supported by analysis of strictly comparable data bases and full review of all 422 classified occupational series. Its major conclusions are outlined below:

- Average grade for General Schedule employees increased 7% between 1964 and 1976.
- A substantial portion of the average grade increase is due to non-structural changes.
- Grade inflation in the occupations reviewed is most prevalent in
 - . Washington, D. C.
 - . High wage areas (Detroit, San Francisco, etc.)
 - . High grades (GS 12-15)
 - . Certain occupational groups (Clerical, Engineering, and Medical)
 - . Certain agencies (Agriculture, SBA, NSF, GSA, FTC, etc.)
- The proportion of higher graded positions in most of the occupations reviewed is higher than in the same private sector occupations.

- Overgrading is primarily the result of
- . Management distortion of position descriptions
 - . Management influence on classifier judgment
 - . Lack of classifier expertise

The design of any solution to the grade escalation problem must consider the incentive structure facing each manager. The manager who allows positions to be classified higher than permitted by CSC standards may obtain a recruiting and retention advantage over other managers. With this advantage he may have a better chance of mission accomplishment, for which he is rewarded. He will not necessarily be penalized for overgrading his people, nor rewarded for strictly holding grades to classification limits.

The OMB recommendation would establish a continuing OMB/CSC task force to reconcile differences in and refine various preliminary research efforts, in order to identify those specific agencies, occupational groups, grade levels, and geographic locations where grade reduction targets should be imposed on an agency or where an agency's classification authority should be revoked, modified, or centralized. These selective efforts will be designed to achieve a 1% reduction in projected average grade by the end of FY 1978. Full outlay savings of approximately \$219 million are not achieved until FY 1981. Projected savings will be reflected in the pay raise contingency in the 1978 budget pending allocation of specific targets to selected agencies and appropriations.

Agency request and CSC recommendation; Alternative #1. Continue and conclude the year-long, Presidentially-directed re-examination of internal agency classification systems and positions before projecting and budgeting for specific agency average grade reductions. Special CSC and agency actions under this initiative should be completed before further OMB action in this area.



OMB Recommendation: Alternative #2. CSC oversight of the agencies' classification responsibilities, and initiatives such as the PMIs, may not be sufficient to overcome the strong incentives facing some agencies and managers to overgrade portions of their work force. Effects of selective controls should be anticipated in the budget to help ensure results. The program must be coordinated across Federal agency lines, since any unilateral constraint on the civilian grade structure within DOD could disadvantage Defense activities in recruiting and retaining personnel.



Issue Paper
 Department of Defense
 1978 Budget
 Issue #9: Civilian Employment Levels

Background

For the past several years, Defense civilian employment has declined at a rate of 1% to 3% per year. The decreases have been directed by the Administration or Congress and have been absorbed through increased productivity, including the closing of unneeded facilities. In the employment plan approved in last year's budget, Defense would have reduced employment by 25 thousand from 967,000 at the end of September 1976 to 942,000 at September 1977. While Defense will begin FY 1977 at 957,000, there is great resistance by the military departments, particularly Army, to accomplishing the remaining planned reduction of 15,000.

The following table displays the total employment reflected in the Service budget submissions as compared with past history.

	(In Thousands)						
	<u>FY 1967</u>	<u>FY 1971</u>	<u>FY 1975</u>	<u>FY 1977</u>	<u>FY 1977</u>	<u>FY 1978</u>	<u>FY 1979</u>
Total	1,306	1,094	989	957	955	970	973

The FY 1977 request is an increase of 13 thousand over the current ceiling. Three thousand of the increase is offset by a decrease of 3 thousand in planned indirect hire foreign national employment and reflects the fact-of-life utilization of dependents in Germany to so some of the jobs previously filled by local nationals. The primary justification advanced for the balance of this increase is an alleged inability to accomplish the planned base closure actions contemplated in last year's budget. We expect that the Joint review will approve about half the requested increase and FY 1977 will end at 950 thousand. For FY 1978 we expect the Joint review to produce



a "requirement" of 960 thousand from which the Secretary will assume that productivity improvements of 1-1/2% can be achieved resulting in a civilian employment level of 945 thousand in 1978 and 1979. This is only a slight decrease from the revised 1977 level.

Statement of Issue

Should further reductions be planned in Defense civilian employment?

Pros.

- The employment planned in the Defense request may be inconsistent with a balanced budget in 1979.
- The planned savings in FY 1977 should be accomplished because the existing base structure is extremely inefficient resulting in much larger than needed overhead costs.
- The Presidential Management Initiatives include a plan for achieving productivity improvements of 2% annually and these should be reflected in the budget.

Cons.

- It may be unrealistic to expect productivity savings of 2% from the FY 1977 base in that workload in Defense in-house industrial activities is increasing and the overall growth in Defense purchases should have some impact on civilian manpower requirements.
- Productivity savings as they occur should be used to meet added requirements. Defense employment has been decreasing for several years while employment in other Government agencies has been increasing.
- There has been significant Congressional pressure against closing bases particularly during a period of high unemployment, and no additional base closures or reductions are being proposed in this budget review.

Alternatives

- #1. Approve the expected result of the joint review which would provide an employment program of about 950 thousand in FY 1977 decreasing slightly to 945 thousand in FY 1978 (Agency req.).
- #2. Retain the current plan for FY 1977 and require a productivity increase of 1% in FY 1978 and FY 1979 (OMB rec.).
- #3. Retain the current plan for FY 1977 and require a productivity increase of 2% in FY 1978 and FY 1979.

The employment which would be provided by the alternatives is displayed on the following table:

	<u>Total Employment (in thousands)</u>		
	<u>FY 1977</u>	<u>FY 1978</u>	<u>FY 1979</u>
Alternative #1	950	945	945
Alternative #2	942	933	923
Alternative #3	942	923	905

Analysis

The Presidential Management Initiative on productivity improvement has resulted in a concerted effort to improve and extend productivity measurements. Throughout the Government a goal of 2% annual improvement has been set and several agencies have set targets well in excess of 2%. DOD has established a productivity increase goal of at least 2% for each measured activity. They would claim that any savings are reflected in meeting of additional requirements.

Agency Request

	<u>1978 Outlays</u>	<u>1979 Outlays</u>
(Difference from Alt. #1 (Agency Request)		
(Alt. #2 (OMB rec.)	-90	-220
(Alt. #3	-175	-530



Agency request: Alternative #1. The Department believes that its request reflects the minimum employment needed to accomplish the funded workload and that appropriate productivity savings have been reflected. In the absence of base closures and reductions or other program reductions, it is not reasonable to anticipate further employment reductions.

OMB recommendation: Alternative #2. Given overall government productivity improvement goals of 2%, it is not unreasonable to require Defense to achieve an overall average of 1%.



Issue Paper
 Department of Defense
 1978 Budget
 Issue #10: Guard and Reserve Manpower

Background

Reserve and Guard manpower projections indicate the beginning of a recovery from the downward trends that began with the elimination of draft motivated enlistments. Reflected in authorized and requested strength levels is recognition of the current inability of Reserve forces to meet a paid drill objective of approximately 940,000 against a stated full wartime structure allowance of about 1 million men.

	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>
Paid Drill Strength (000)				
Manning authorization ^{1/}	904	878	902	906
Service request	823	862	899	906
(Latest actual-Sept. 1976)		(826)		

The administration's 1977 budget initiatives for utilization of lower training categories consistent with proficiency and mobilization needs, including legislative authority required to permit this latitude for National Guard units, were rejected by the Congress. Consequently, the manpower programs continue to be based almost exclusively on utilization of the most intensive and costly training category requiring 48 four-hour training periods and two weeks of active duty training annually.

^{1/} 1976-77, Congressional Floor; 1978-1979, DOD paid drill authorization.



Statement of Issue

Should Reserve manpower programs provide for more gradual recovery of manning levels than requested by the Services and greater utilization of available training categories consistent with unit/individual proficiency and mobilization needs?

Pros.

- Attainment of the requested strengths is highly questionable based on trends.
- Overoptimistic strength goals can result in quality deterioration, diversion from mission training and excessive utilization of recruiting and retention resources.
- Recognition of different deployment criteria and varying skill and proficiency levels, provides an opportunity for more meaningful and efficient training.

Cons.

- Lack of full support for service efforts to meet Reserve manning authorizations and provide maximum training opportunity casts doubts on the sincerity of stated reliance on the Reserves in any future conflict.
- Utilization of less intensive training options is considered counterproductive to recruiting and retention efforts due to reduced income opportunity.

Alternatives

- #1. Approve the funding requested to reach and train programmed manning levels (Agency req.).
- #2. Provide for a more gradual recovery of manning levels and more efficient utilization of available training options (OMB rec.).



Analysis

Manning levels. Notwithstanding intensive recruiting and retention efforts, the Reserve Components are consistently overoptimistic in their strength programs. In addition, to the extent that a sudden surge in strength does occur in any one year, the likelihood of large losses and associated short-term recruiting problems in the out-years is greatly increased. A more realistic projection of gain and loss estimates indicates that funding for a manning level approximately 21,000 less than requested by the Reserve Components would be reasonable and save approximately \$30 million in 1978.

Training Frequency. Last year's budget initiative to transfer significant numbers of Guard and Reserve personnel to lower training categories consistent with mobilization deployment and skill level requirements was rejected by the Congress. In rejecting the initiative to shift 40,000 Naval Reservists to a lower category, the Congress called for a Naval Reserve mission study, to be completed by February 1, 1977, to identify specific new missions for better utilization of authorized strength. Analytical effort within OSD and Navy is being accelerated so that the Secretary can determine the appropriate strength level for the 1978 budget.

While it is premature to address overall Naval Reserve paid strength levels, available program data indicates the potential for significant personnel cost savings through better management of training frequency for all Reserve Components. After consideration of unit skill requirements, the need for unit integrity and deployment criteria, a distribution of units and personnel by training category can be developed which is considered more appropriate and consistent with training requirements than the service request that places 98% of drilling reservists in the most intensive training category. We estimate that approximately 30% of all drilling unit personnel could potentially maintain required proficiency at lower than currently programmed training frequencies, including over 40% of the Naval Reserve due to its heavy emphasis on augmentee personnel. Such a plan, which would require resubmission of legislation with respect to the National Guard, could result in ultimate reduced funding requirements of \$125 million. Phasing of the redistribution over a five-year period would allow evaluation and adjustment during implementation and enhance the chance of acceptance by the Congress. The strongest administration support will be required to obtain Defense as well as congressional approval to proceed in this direction.



Agency Request
(\$ Millions)

(Difference from Alt. #1 (Agency Request))	1977 Outlays	1978 Outlays	1979 Outlays)
(Alt. #2 (OMB rec.)	-17	-55	-75

Agency request: Alternative #1. The Reserve Component Chiefs feel that nothing short of all-out support for reaching authorized manning levels as quickly as possible will result in a viable Reserve as a partner in the total force. Any initiative, such as reduced training, at a time of increasing reliance on Reserves is incomprehensible to them.

OMB recommendation: Alternative #2. The current austere budget climate warrants every effort for providing a viable Reserve force mobilization asset through a managed program to conserve resources. Defense should initiate the actions discussed, including resubmission of required legislation.

Issue Paper
Department of Defense
1978 Budget
Issue #11: Guard and Reserve Pay Initiatives

Background

The administration's 1977 budget initiatives included elimination of both dual compensation of Federal employees on active duty for training, and Administrative Duty Pay for reserve unit commanders. Both initiatives were rejected by the Congress.

The 1978 request includes \$20 million for an Army Guard and Reserve enlistment/re-enlistment bonus test which would also require legislative authority.

Statement of Issue

Should the 1978 legislative program include resubmission of the administration's 1977 Reserve pay initiatives and/or authority for a Reserve force enlistment/re-enlistment bonus?

Pros.

- Initial limited support in Congress may increase in a second attempt.
- A bonus test may provide an answer to the problem of current Guard and Reserve manning shortfalls with a minimal commitment of resources at this time.
- Support for a bonus test concurrently with resubmission of the 1977 initiatives may defuse the charge that the Administration "is out to get the Reserves."



Cons.

- Submission of any Reserve compensation initiatives may be viewed as prejudging the ongoing Presidential directed Reserve Compensation System Study.
- Resubmission of the 1977 initiatives will be perceived as a disincentive to Reserve participation at a time when manning levels are low, regardless of merit.
- Support of a bonus test may result in a significant long-term funding commitment.

Alternatives

- #1. Withhold further action on the 1977 pay initiatives pending consideration by the Reserve Compensation System Study but seek legislative authority required to conduct the enlistment/re-enlistment bonus test (Agency req.).
- #2. Include the 1977 pay initiatives and bonus authority in the 1978 legislative program.
- #3. Include only the initiative for elimination of dual compensation in the 1978 legislative program (OMB rec.).

Analysis

Dual Compensation for Military Training. Federal employees who are also reservists receive both their full civil service pay and military pay while on active duty for training. If the Federal Government followed the policy of many private employers by granting military leave and providing civilian pay only to the extent necessary to avoid loss of take-home pay, it would save up to \$45 million annually in civilian pay--split approximately \$30 million within Defense and \$15 million in other Federal agencies. The House Appropriation Committee agreed that the current policy represents a questionable practice but decided not to act pending action by either the Armed Services or Post Office and Civil Service Committees, neither of whom acted. Emphasis placed on this proposal as a Federal civilian pay practice initiative would enhance the likelihood of favorable consideration as well as minimize the argument that action should be deferred pending completion of the Reserve Compensation System Study.

Administrative Duty Pay. The 1978 Defense request includes \$2 million for payment to Reserve unit commanders for administrative duties performed outside of prescribed drill periods. In considering the administration's 1977 budget initiatives, the Senate Armed Service Committee recommended repeal of the authority, but receded in conference to the House Committee view that it was inappropriate to terminate this incentive. As a specific reserve pay entitlement, this issue could properly be left to the Reserve Compensation System Study for resolution. An interim report is due December 1.

Enlistment/Re-enlistment Bonus. The Defense request for an enlistment/re-enlistment bonus test to be conducted by the Army Guard and Reserve in FY 1978 is expected to cost up to \$50 million, with \$20 million in FY 1978. Despite current manning difficulties, the implementation of a bonus program prior to determination that other recruiting/retention initiatives being implemented are not successful, or that other more cost-effective alternatives are not available, appears questionable.

<u>Agency Request</u> (\$ Millions)			
<u>(Difference from Alt. #1 (Agency Request))</u>		<u>1978 Outlays</u>	<u>1979 Outlays</u>
✓ Alt. #3 (OMB rec.)		-50	-50)
Alt. #2		-32	-32)

Agency request: Alternative #1. The Department feels resubmission of the 1977 initiatives would stand no better chance of success than last year and may adversely impact on intensive efforts to improve manning levels. They would prefer to have review by the Compensation Study. Conversely, they feel the current strength situation warrants immediate action on a bonus test as part of the overall Reserve Component Readiness Improvement Package.

OMB recommendation: Alternative #3. Seek elimination of dual compensation as a civilian Federal Government pay practice initiative. Defer action on Administrative Duty Pay pending review by the Reserve Compensation System Study. Evaluate the full impact of additional non-compensation recruiting and retention actions being initiated before seeking a bonus authority.



Issue Paper
Department of Defense
1978 Budget

Issue #12: Modernization of Defense Domestic Installation Structure

Background

On June 30, 1975, the Department of Defense had 4,038 domestic installations located on 23 million acres at an initial acquisition cost of \$37 billion. These installations have evolved over the years. Many were founded originally during the 19th century, but the majority were formed in response to foreign wars. The major expansions occurred during World Wars I and II. Subsequent to World War II, the creation of the Air Force and new or revised missions for the other services has created more new installations. Our structure is still near its World War II level and is imposing a very heavy cost burden on Defense.

There has been steady pressure to close unnecessary installations, but we are still a long way from the optimum domestic installation structure required to support our current forces. Although Defense has accomplished 2,700 separate realignment actions in the last six years, most of these have been generated by short-range budget pressures and have not had a significant impact on the total installation structure. Neither the Services, nor the Department have conducted studies to determine long-range future installation requirements. The result has been the perpetuation of an inefficient, outdated basing structure.

The reasons for this continuing inability to modernize the installation structure are twofold:

- Congressional resistance to base closure. A major Defense installation is frequently the largest employer within a constituency and the economic impact of closures can be severe during the period of transition. The recent passage of Section 612 of the 1977 Military Construction Authorization (despite the President's initial veto) indicates that Congressional interference with plans to realign the base structure can be expected to continue and increase in the future.

- The Services have strongly ambiguous feelings on the subject of base realignments. On the one hand they are acutely aware of the budgetary drain imposed on them by maintaining obsolete facilities. However, they also believe that a network of military installations around the country serves to generate grass roots support for military programs in the Congress. They are concerned that an optimized base structure, which might result in concentration of the military presence in one or two regions of the country, would erode Congressional support of military programs to a severe extent. This concern is seldom expressed openly, but usually emerges on the basis that various installations must be retained for "surge" purposes or for "unforeseen contingencies."

We believe there should be a study to determine long-range future requirements in compliance with NSSM 246 and to prioritize construction programs. The Department has begun such a study but is already encountering strong resistance from the Services. With any cooperation, this study should be completed in a few months. However, a Presidential commitment is required to minimize resistance from the Congress, unions and impacted communities. Without such a commitment, an effective study may never be completed, and if one were completed, political opposition would probably kill any implementation plans. The Presidential commitment should be emphasized in the State of the Union message and in the formation of a Blue Ribbon Panel to study our domestic basing. Such a panel could ameliorate political opposition and could provide independent credibility. Its membership should consist of distinguished Americans (such as the Vice President), defense experts (such as Ambassador Bunker and David Packard), congressional representatives (such as Senator Stennis and Senator Goldwater) and leading business and labor leaders who could provide assistance in the difficult area of economic adjustment.

The Panel would be expected to produce a document that would identify our Nation's essential required installations. Any installation not identified as essential would be closed. If the study were completed by August 1977, candidates for closure or realignment could be announced then and environmental impact statements could be initiated. Because such a study is expected to reduce our basing structure, and to minimize criticism about sunk costs, some form of moratorium should be placed on FY 1978 domestic military construction, except for: safety and approved mission changes (TRIDENT). Nonawarded construction, projects from prior years could be placed in budgetary reserve. Upon completion of the Panel study, prior year projects could be released for the essential installations and proposed legislation would be prepared to revise the authorization for utilization of other funds on essential installations. With the August 1977 completion date, adequate time would exist to prepare the

FY 1979 construction budget. This FY 1979 budget would be redirected to a planned program to modernize, within four years, the essential installations. By so doing, readiness would be enhanced, a more efficient and effective Defense would result, and morale of military forces should increase.

Statement of Issue

Should there be a major Presidential initiative to optimize by FY 1982 the domestic military installation structure?

Pros.

- Based upon such a Presidential initiative:
 - . Department of Defense military basing structure would be reconfigured to conform to modern national security requirements, as revised by NSSM 246.
 - . DOD would enhance military readiness by establishing a modernized, efficient basing structure.
 - . Deferral of FY 78 and prior year construction programs would minimize sunk costs and would update programs to comply with NSSM 246.

Cons.

- Support for military programs might erode following withdrawal of military presence from certain parts of the country.
- Strong opposition can be expected on two fronts:
 - . Locally - reflecting the adverse economic impacts on local communities with resulting unemployment and lost revenues from major base closures or realignments after FY 1978.
 - . Congress - massive resistance to impact of construction slowdowns and base realignments in their communities.

Alternatives

- #1. Approve the FY 1978 military construction programs at the Department's requested level and program base realignments as currently planned (DOD req.).
- #2. Establish a Blue Ribbon Panel to identify optimum military basing requirements, place a moratorium on FY 1978 domestic construction (except for family housing operations, safety and approved major weapon systems), freeze FY 1977 and prior year projects not under contract, and modernize resulting base structure during the FY 79 to FY 82 period.
- #3. Same as Alternative #2 except for a partial construction moratorium to allow for projects on installations that can be reasonably agreed as having firm functional requirements (OMB rec.).

Analysis

Budget Authority/ Outlays (\$ Millions)	1976		1977		1978		1979		1980		1981		1982	
	BA	O												
Alt. #1 (DOD req)	2,483	2,019	2,482	1,945	2,881	2,100	3,035	2,575	3,285	2,775	3,578	2,995	3,557	3,250
Alt. #2	2,483	2,019	2,482	1,945	881	1,900	3,035	1,575	3,285	2,175	3,578	2,695	3,557	3,100
Alt. #3 (OMB rec)	2,483	2,019	2,482	1,945	2,381	2,050	3,035	2,325	3,285	2,625	3,578	2,920	3,557	3,210

The TOA reductions shown in the above table are \$-2.0 billion and -\$0.5 billion for Alternatives Nos. 2 and 3, respectively. These adjustments are based on our judgment as to the overall reductions consistent with the rationale of Alternatives 2 and 3. They do not reflect detailed project review and final adjustments for this issue could vary significantly!

	Agency Request	1978 Outlays	1979 Outlays
(Differences from Alt. #1 (Agency request)			
(Alt. #3 (OMB rec.)		-50	-250
(Alt. #2		-200	-1,000

Agency Request: Alternative #1. The Department believes that the FY 1978 military construction program should be approved at the requested level and that no outyear deferral should occur until completion of its long-range basing study. To do otherwise would be unrealistic. They also maintain that they place the great bulk of their construction projects at bases which are clearly to be retained indefinitely.

Alternative #2. A one-year deferral of most of the military construction program. The findings of a select Blue Ribbon Committee would govern (subject to Presidential approval) our future installation structure and investment over the next four years. The "hard-line" moratorium would make it clear that the Blue Ribbon Committee has a charter to consider the most comprehensive possible restructuring since no preconceptions would be built in on the basis of installations selected for modernization in 1978. Furthermore, deferral of the FY 1978 construction program would minimize sunk costs until the firmness of the basing structure was established.

OMB Recommendation: Alternative #3. Same as Alternative #2 except that only a partial moratorium would be imposed. This means that certain projects will be approved for construction in 1978. Approval of these projects would be on the basis that they will definitely be viable under any plan developed by the Blue Ribbon Commission.



Issue Paper
Department of Defense
1978 Budget
Issue #13: Contracting-Out Depot Maintenance

Background

OMB Circular A-76 sets forth the Government's "policies for acquiring commercial or industrial products and services for Government use." This circular states that the Government's general policy is to rely on the private enterprise system to supply its needs. Under some circumstances specified in A-76, however, it is in the national interest for the Government to provide directly the products and services it uses.

DOD depot maintenance activities, such as Navy shipyards, Navy and Air Force aircraft facilities and Army vehicle facilities, represent a large segment of DOD civilian employees (172,000). There are major problems in increasing depot maintenance contracting out because:

1. The Services want to protect their in-house capability in order to insure a ready and controlled source of the technical competence and capability necessary to meet military contingencies. Therefore, before any work is even considered for contracting out, it must be shown that doing so will not jeopardize their mobilization capability.
2. Once work is identified as being considered for contracting out, DOD generally conducts a cost comparison study to determine if doing the work in-house would meet the cost criteria set forth in A-76. Since these cost studies are based on incremental cost comparisons, the in-house option has a decided advantage; the expensive plant and equipment are a sunk cost to the Government, but a contractor would have to invest in and amortize similar equipment as a part of his cost.
3. Inertia is a powerful force which makes it difficult to change on-going work from in-house to contract or the reverse.



Under DOD depot maintenance policy, there is an implied goal for distributing workload between in-house and contract sources, i.e., no more than 70% of mission-essential workload should be accomplished in-house. However, the Services have not met this goal, since the latest actual data available shows that in 1975 77% of mission-essential work was done in-house. For non-mission essential workload, the implied DOD policy is that no special in-house capacity should be planned. In 1975, 40% of the non-mission essential work was done in-house. Since there are no clear criteria for distinguishing mission essential from non-mission essential workload, there is some doubt about how meaningful this policy is in any case.

It is also not clear that organic depot facilities can accommodate increased demand more rapidly than private industry even for "mission-essential" work. For example, the 1965-68 Air Force workload surge was initially carried by industry and not accommodated by the depots until 1970. The GAO criticized the Army for procuring new UH-1 helicopters from Bell when several hundred were awaiting repair at Army depots. GAO argued that Bell could have accomplished the repair and the procurement could have been avoided. In 1969, when the Services were forced to develop a rapid defense against Infra-Red missiles in Southeast Asia, effective countermeasure devices were provided very rapidly, but primarily by industry.

In addition, the possibilities of converting in-house maintenance facilities to contractor operation (Government owned-contractor operated) have not been fully explored. This approach could involve considerable cost savings.

Statement of Issue

Should DOD be required to prepare a plan for meeting specific objectives for contracting out depot maintenance workload and should there be a moratorium on depot facilities modernization and expansion until this is accomplished?

Pros.

- Would provide some discipline to the current A-76 implementation policy guidelines in DOD.
- Puts the burden of proof on DOD and the Services for exceptions to the general policy set forth in A-76.
- OSD and OMB will be able to review those areas identified by the Services which would least affect their mission capability and determine whether these particular cases would, in fact, reduce the Services' mission capability.

- . The Services would be required to develop and justify criteria for evaluating the effect of contracting out mission essential work on their mission capability.
- . The moratorium on depot maintenance facility improvements would reduce the continual growth of Service in-house capability which makes incremental comparisons between in-house and contract options weighted in favor of the in-house option.
- . Could reduce DOD civilian personnel by approximately 15,000.

Cons.

- Implementation of the above plan would meet considerable resistance from the Military Services and OSD.
- There would need to be some exceptions to a moratorium on facilities construction to permit continuation of on-going efforts.

Alternatives

- #1. Continue A-76 implementation in DOD under current system (Agency req.).
- #2. Request that DOD conduct a study to determine if more depot work could be contracted out and to establish more definitive criteria for retaining work in-house. In particular, the impact of contracting out 30% of mission-essential and 70% of non-mission essential work by 1979, and 35% of mission-essential and 80% of non-mission-essential work by 1980 should be examined. The study should also include specification of criteria for defining mission-essential effort. It should also analyze possibilities of converting in-house maintenance facilities to contractor-operated facilities.
- #3. In addition to alternative #2, direct DOD to submit a plan to meet the specific objectives stated in that alternative for contracting-out depot maintenance work, and impose a moratorium on in-house facility expansion (allowing for some exceptions). (OMB rec.).



Analysis

<u>Budget Authority/Outlays</u> <u>(\$ Millions)</u>	<u>1976</u>		<u>1977</u>		<u>1978</u>		<u>1979</u>		<u>1980</u>		<u>1981</u>		<u>1982</u>	
	<u>BA</u>	<u>O</u>												
Depot Maintenance														
* Facility Modernization:														
Alt. #1 (Agency req.)	75	4	94	35	129	59	157	94	160	124	146	140	149	129
Alt. #2	75	4	94	35	129	59	157	94	160	124	146	140	149	129
Alt. #3 (OMB rec.)	75	4	94	35	54	56	82	60	85	75	71	77	74	76

* Agency request represents DOD funds for depot modernization, OMB recommendation would reduce this program by an estimated \$75 million annually.

Agency Request

<u>(Differences from Alt. #1 (Agency request)</u>	<u>1978 Outlays</u>	<u>1979 Outlays</u>
(Alt. #3 (OMB rec.)	-3	-34
(Alt. #2	--	--

Agency Request: Alternative #1. DOD believes that their current policies are adequate for implementing A-76 guidance. Defense is trying to increase the amount of depot maintenance work being contracted out.

OMB Recommendation: Alternative #3. This assumes that there is significant potential for increased contracting-out and that requiring a study as in Alternative #2 would not be sufficient to accomplish desired actions.



Issue Paper
Department of Defense
1978 Budget
Issue #14: Shipbuilding in Navy Yards

Background

All ships have been built in private shipyards since the 1967 program. Lower costs for ships constructed in private yards and pressure from private shipbuilders for more work led to the policy of assigning all new ship construction to private shipyards. Reversing this policy to put Navy shipyards back into the business of constructing new ships would be a major Administration initiative.

Statement of Issue

Should shipbuilding be reinstated in naval yards?

Pros.

- New construction effort could help to fill in slack periods for ship repair, with a consequent increase in work force productivity.
- The new construction work force would provide a surge capability for repair work in time of war.
- Active experience with shipbuilding would enhance the expertise of Navy's engineering officers.
- Naval yards would provide competition to private yards which could hold down private yard prices.
- It would provide an alternative to private yards in the face of their reluctance to accept Navy work.



Cons.

- Naval shipyard work can be expected to cost 30-40% more than private yard work, in addition to start-up costs that would be associated with initiation of Navy yard construction.
- Administration policy stresses maximum reliance on the private sector. Public yard shipbuilding would be inconsistent with the President's initiative to encourage the contracting out of government functions.
- It is inconsistent with Administration efforts to restrain the level of government employment. Public yard shipbuilding would require 2,400 additional civilian naval shipyard employees in 1978 and as many as 8,300 additional in 1982.
- New construction in naval yards would compete for manpower resources now devoted to repair work, causing disruption and inefficiency.
- There are less costly ways of providing surge capability for naval yards and experience for engineering officers.
- There is no evidence to demonstrate that naval yard competition holds down private yard prices.
- Will require another supplemental budget request (\$.4 billion) in 1977.

Alternatives

- #1. Assign construction of two nuclear submarines and one destroyer tender to naval yards in 1977 and one submarine and one tender to naval yards in 1979 (Agency request).
- #2. Maintain the Administration policy of assigning no new ship construction to naval yards (OMB rec.).



Analysis

<u>Budget Authority/Outlays</u> <u>(\$ Millions)</u>	<u>1976</u>		<u>1977</u>		<u>1978</u>		<u>1979</u>		<u>1980</u>		<u>1981</u>		<u>1982</u>	
	<u>BA</u>	<u>O</u>	<u>BA</u>	<u>O</u>	<u>BA</u>	<u>O</u>	<u>BA</u>	<u>O</u>	<u>BA</u>	<u>O</u>	<u>BA</u>	<u>O</u>	<u>BA</u>	<u>O</u>
Shipbuilding in Navy Yards														
Alt. #1 (Agency req.)	--	--	450	20	16	95	176	105	177	140	183	125	114	16
Alt. #2 (OMB rec.)	--	--	--	--	--	--	--	--	--	--	--	--	--	--
	<u>Agency Request</u>													
	<u>(Difference from Alt. #1 (Agency request)</u>						<u>1978 Outlays</u>		<u>1979 Outlays)</u>					
	Alt. #2 (OMB rec.)						-95		-105					

Agency Request: Alternative #1. Defense believes that the benefits associated with public yard shipbuilding outweigh the costs involved.

OMB Recommendation: Alternative #2. It is unclear that even the potential benefits which have been identified can be realized through public yard shipbuilding. The cost of public yard shipbuilding is large and it is inconsistent with Administration policies to rely on private industry.

