



OFFICE OF THE UNDER SECRETARY OF DEFENSE
4000 DEFENSE PENTAGON
WASHINGTON, D.C. 20301-4000

OCT 20 2003

PERSONNEL AND
READINESS

The Honorable Duncan Hunter
Chairman, Committee on Armed Services
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

This responds to House Report 106-616 (page 373-374), which requested information be provided to the Senate and House Committees on Armed Services on the viability of changing military paydays to every 14 days.

As shown in the enclosed response, there is no significant advantage to adopting an every-14-days pay system over the current twice-a-month pay system. Research indicates that the financial problems of our Service members are not the result of the timing of pay periods. Mostly, they are due to poor financial management practices and the accumulation of debt. Further, modifying the current computer system used by the Defense Accounting and Finance Service (DFAS) to handle pay matters is estimated to cost \$25 million. Consequently, the Department recommends maintaining the current pay system.

The Department thanks you for your concern for the welfare and well-being of our military personnel. I am sending a similar letter to the Chairman and Ranking Member of the Senate Armed Services Committee.

Sincerely,


Charles S. Abell
Principal Deputy

Enclosure:
As stated

cc:
The Honorable Ike Skelton
Ranking Member





Report to Congress

**MILITARY
PAYDAY EVERY
14 DAYS**

September 2003

Report to Congress Military Pay Day Every 14 Days

Executive Summary

Title VI, Items of Special Interest (Military Pay Day Every 14 Days, p.373), Report of the Committee on Armed Services House of Representatives on H.R. 4205 (Floyd D. Spence National Defense Authorization Act for Fiscal Year 2001), House Report 106-616, May 12, 2000, requests the Secretary of Defense to study whether a change to a 14-day pay period for military personnel is both necessary and desirable. This report responds to that request and examines the arguments for and against changing the military pay system from twice a month to every 2 weeks -- from 24 to 26 pay periods per year. This is a very different question than asking whether a twice-a-month pay system is better than a system that pays every 2 weeks. If we were starting from ground zero, and assuming the costs of installing a pay system were the same no matter which one was selected, the system that was most beneficial to the member would be selected. Performing such an evaluation leads to the conclusion that none of the alternatives appears to have any distinct advantage over any of the others; and, therefore, there is no strong reason to prefer any one system.

One of the principal arguments favoring a 14-day pay system is that the variable length of time between paydays under the current system creates financial hardship, for example, when the member has to wait 19 days until his/her next paycheck. Having fixed paydays, it is argued, will improve financial management even among the junior enlisted. Financial problems especially among the junior enlisted are, however, not the result of the variability in pay periods. Rather, they are largely the result of accumulated debt. It should be noted that much of the variability in pay periods results from the Department's decision to move pay to the earliest business day, rather than providing pay at the closest business day. If the Department paid on the closest business day, or returned to the pre-1987 payday on the last day of the month vs. the 1st day of the month, variability would be reduced considerably. Financial problems do not result from timing. Financial problems occur in most instances because of poor financial management practices.

In the absence of any obvious benefit to the biweekly pay system, an evaluation must place more importance on the cost of changing the current system. The Defense Finance and Accounting Service (DFAS) estimates the cost of changing systems to be up to \$25 million and would take about 5 years to transition. Another cost of transitioning is the confusion and uncertainty that would result. While these costs are temporary, members would need some time to adjust to whatever new system is adopted.

Should the Department, in an effort to reduce the variability of pay dates, change its policy and pay members on the last day of the month instead of the first day, a significant concern would be the October 1st pay date. The actual obligation for that payday could fall in either of two fiscal years, depending on whether October 1st is on a weekend. It is important that the Department retain the flexibility to budget for those payments on a year-by-year basis, so that significant resource shifts are not required to ensure the Department is able to adhere to its budgetary requirements.

Background

Legislative authority for the present military pay system can be found in Title 37 USC section 1014:

Payment date for pay and allowances

- (a) *Amounts of basic pay, basic allowance for housing, basic allowance for subsistence, and other payments of military compensation (other than travel and transportation allowances and separation allowances) shall be paid on the first day of the month beginning after the month during which the right to such compensation accrues.*
- (b) *Subsection (a) does not preclude one payment in midmonth for any element of compensation and does not affect any authority to make advance payments of pay and allowances.*

Following section 1014, basic pay, most allowances and special and incentive pays are stipulated in law as being monthly rates (e.g., 37 U.S.C. 203) based upon a 360-day year.

- Direct deposits or paychecks are provided once or twice a month (end of month and mid-month).
- DFAS computer systems are set up to pay bi-monthly to active duty; monthly to retirees and survivors.
- Leave and some benefits are accumulated or paid on a monthly basis.

Problems with current system:

Members are paid on the 1st and 15th of each month, except when either of these dates falls on a weekend or holiday, in which case the pay date is moved up to the earliest business day. For example, if the 15th were a holiday and fell on a Monday, payday would be moved to the Friday before the Monday, 3 days early. This would mean that the member would be paid on the 12th of the month, only 11 days after the payday on the 1st and could have a wait of 19 days until the next payday. Some members complain when paydays are irregular. They say that the delay creates difficulties when they are 17 to 19 days apart.

Standard pay practices in the private sector are generally based on 14-day pay periods and computer-based software has been developed and is widely available to accommodate this pay system.

Arguments for switching to 26 payroll periods per year:

Military pay periods would be identical to Federal civilian employees and more like pay in the private sector. The period between paydays would be relatively fixed at 14 days and would vary only when the payday was a holiday, in which case it would be moved up 1 day. Most months members would receive two paychecks, and in some months three paychecks, depending on the number of 2-week cycles in a month. It is argued that this would facilitate better financial management on the part of our junior members, who live 'paycheck to paycheck.' Another benefit to a biweekly pay system would be that conversion would ease the transition to the civilian world where private sector workers are generally paid on a 2-week schedule.

Arguments against switching to 26 payroll periods per year:

The principal argument for switching is improvement in the ability to manage finances. It is argued that the variable length of time between paydays under the current system creates financial hardship, for example when the member has to wait 19 days until his/her next paycheck. Having fixed paydays, it is argued, will improve financial management even among the junior enlisted. Financial problems, especially among the junior enlisted are, however, not the result of the variability in pay periods. Rather, they are largely the result of accumulated debt. If a member chronically overspends or poorly manages his or her finances, switching pay systems will not be a cure. Even under the present system, variability in pay dates could be reduced by returning to the pre-1987 paydays of the last day of the month vs. the first day of the next month. This would establish an interval of 15 days between paydays in a 30-day month vs. the current 14 and 16 days.

It should be noted that the variability in pay periods results from the Department's decision to move pay to the earliest business day, rather than providing pay at the closest business day, and the 1987 law change moving payday from the last day of the month to the first day of the next month. If the Department paid on the closest business day or again on the last day of the month, variability would be reduced considerably.

The biweekly pay system has a number of drawbacks:

- Troops would receive less than 1 month's pay in 10 of the 12 months.
⇒ if pay is \$24,000 per year, the current system provides 24 paydays of \$1,000 per payday or 12 paydays of \$2,000 per month

- ⇒ Converting to 26 pay periods would mean 26 paydays of \$923 or \$1,846 a month for 10 of the 12 months and \$2,769 for the other 2 months.
- ⇒ after the change, the first payday would be smaller than the previous pay day the member had received.
- Most major bills (rent, utilities, and credit cards) come monthly and members can arrange to have the bills come around the 1st or the 15th of the month.
 - ⇒ if rent is due on the 1st and that coincides with the member's pay date, late payments and late payment fees are less likely to happen.
- Members living off base will be the group primarily affected by the change. Members living on base do not have the same concentration of bills at the first of the month. Rent and utility payments are not applicable. Grocery bills and entertainment could be easily balanced out under either pay system.
- Any change that abandons this monthly system would require changes to a number of our current pays and allowances and could increase expenditures if we converted to a 365-day year.
 - For example, monthly pays can be converted to daily rates; and ,if daily rates were then multiplied by 14, the total yearly pay would increase by 4 days.
- DFAS estimates that the cost of converting to a 26 pay period system to be up to \$25 million and would take about 5 years to implement.
- DFAS had other concerns including the recalculation of accrued leave from 2.5 days per month under the current system to 1.1538461 days per 14-day pay period.
- Allotments would have to be converted from the present monthly amounts to biweekly allotments.

Other Considerations

Currently, there is no lag in the earning and receipt of pay. Any changes to pay are typically done as corrections after the fact and money must be recouped from the member in case of overpayment. Some would argue that if conversion to a biweekly pay system were undertaken, a lag in the receipt of pay, similar to the one-week lag for federal civilians, should be instituted. This lag could reduce out-of-service debt as well as provide more accurate payments to members. This could be even more important in accounts with TSP contributions, where "brokerage" fees must be paid by the Services on every incorrect contribution.

But, lagging pay would not be well received by members who are used to being paid on time or early.

Evaluation

A Center for Naval Analysis (CNA) white paper advocates paying military members every other week. CNA argues that good financial management practices are difficult to teach when income arrives irregularly. Receiving a paycheck every 14 days, it argues, will especially help our junior members.

For the members who live on base and do not have a concentration of expenses, such as rent and utility payments at the beginning of the month, good financial management would dictate smoothing out their discretionary expenditures as evenly as possible. In this case there is probably a small advantage to having a paycheck every 2 weeks. Only about one-third of married members live on base. The two-thirds who do not live on base have a concentration of expenses, typically at the first of the month. For these individuals, a pay system with pay dates coincident with receipt of bills is probably of some advantage. Although even in this situation, the due dates on most bills, with the notable exception of rent or mortgage payments, have a grace period that could incorporate a switch to a 14-day pay period.

Evaluating the benefits of the current bi-monthly versus the suggested biweekly pay system does not lead to the conclusion that one is vastly superior to the other. A member who can manage his/her finances under the current system should easily be able to adapt to a biweekly pay system, and a member who is having difficulties with the current system will have difficulties with the biweekly pay system. For members living off base, there is probably an advantage to the current system. Members living on base would likely opt for the biweekly pay system.

There is one large and obvious disadvantage to switching at this time -- the biweekly system would cost up to \$25 million to install and take over 5 years to implement.

Recommendation

The principal argument against the current pay system is that it results in irregular pay periods. Most of the irregularity stems from a decision to move the payday to the earliest business day in the event of a weekend or a holiday and the 1987 law change moving payday from the last day of the month to the first day of the next month. It should be noted that paying on the last day of the month or moving the payday to the closest business day, instead of the earliest business day, would substantially reduce the variability and avoid 19-day waiting periods.

However, the Department should not explore alternative payment methods that disrupt the current practice of paying service members on time or early. But, returning to the pre-1987 payday on the last day of the month would reduce variability between paydays, while maintaining our practice of always paying members on time or early.

Extension of Time Limitation on Use of Reserve Education Benefits

The committee is concerned that the time limitation on the use of education benefits by members of the selected reserve detracts from the potential of the program to promote career-long retention. Section 16331 of title 10, United States Code, provides that members of the selected reserve who remain in an active status lose eligibility 10 years from the date the service member becomes eligible for benefits.

The committee directs the Secretary of Defense to study the time limitations on the use of education benefits by the selected reserve and determine if an extension of the time limitations is useful and cost effective. The committee directs the Secretary to report his findings and any recommendations to the Senate Committee on Armed Services and the House Committee on Armed Services by March 31, 2001.

Improved Basic Allowance for Housing

The committee believes that the additional funding for the basic allowance for housing (BAH) included in the National Defense Authorization Act for Fiscal Year 2000 (Public Law 106-65) and the proposal to reduce out-of-pocket housing costs in the fiscal year 2001 budget request will improve the quality of life for many military members and their families. The BAH rates in high cost areas have already been significantly increased as of January 1, 2000, pursuant to Public Law 106-65.

The committee is concerned that some landlords will view the increase in the BAH as an incentive to increase housing costs not only for military members, but also for civilians in the local community. The committee supports additional funding for the BAH to ensure that military families receive sufficient compensation for adequate housing as dictated by the local housing market. The committee intends to monitor any growth in housing costs within areas that appear to be fueled by BAH increases and not the economic forces of the local housing market. The committee is prepared to reexamine BAH rates in areas where there is evidence that BAH increases have unduly influenced local housing markets.

The committee directs the Secretary of Defense to study the growth of housing costs in areas where the local costs of housing are believed to be directly influenced by increases in BAH rates. The Secretary shall report his findings and recommendations for correcting the problem to the Senate Committee on Armed Services and the House Committee on Armed Services by March 31 of each year of the period beginning in 2001 and ending in 2006.

Military Pay Day Every 14 Days

The committee recognizes that the current practice of paying military personnel twice a month causes some pay periods to be longer, thus increasing the financial stress for military families. The committee notes that paying military personnel every 14 days would provide military members with more consistent pay periods.

Accordingly, the committee directs the Secretary of Defense to study whether the change to a 14-day pay period for military personnel is both necessary and desirable. The committee directs the

Secretary to report his findings and any recommendations to the Senate Committee on Armed Services and the House Committee on Armed Services by March 31, 2001.

Coordination Page

Acting Secretary of the Army	Joseph W. Westphal	May 16, 2001
Acting Secretary of the Navy	Robert B. Pirie	May 2, 2001
Acting Secretary of the Air Force	Lawrence Delany	April 20, 2001*
Under Secretary of Defense (Comptroller)	Doc S. Zakheim	Jun 27, 2001
Director, Defense Finance and Accounting Service	Steve Johnson	May 18, 2001
General Counsel	Douglas A. Dworkin	April 24, 2001
Assistant Secretary of Defense (Legislative Affairs)	Wayne Moore	May 23, 2001
Office of Management and Budget	Jeff Goldstein	September 19, 2003

* Agree that changing the pay period to every 14 days or 26 payroll periods in a year is not cost effective with the current DFAS legacy system. The new military pay system, the Defense Integrated Military Human Resources System, currently under development could include military payments every 2 weeks with the cost being incorporated into the development. Being paid on holidays and weekends would resolve irregular pay periods, but financial institutions don't operate during those periods so exploration may be mute. Also recommend DoD thoroughly assess the consequences of reversing the pay period decision from the earliest business back to the closest business day before any action is taken.