



Modernizing Military Compensation: The Commissary Benefit and Evaluating the Need for Reform

WHO WE ARE

Business Executives for National Security (BENS) is a unique nonpartisan, nonprofit organization of senior executives who volunteer time, expertise, and resources to assist defense and homeland security leaders on a variety of national security challenges.

OUR MISSION

Apply best business practices to develop, for government officials, solutions to our nation's most challenging problems in national security, particularly in defense and homeland security.

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DISCLAIMER

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ABOUT THE REPORT

“The Commissary Benefit and Its Cost” is part of Business Executives for National Security’s Modernizing Military Compensation Series. Capitalizing on the knowledge and acumen of current and former private sector executives, this series examines military compensation programs and offers insights and recommendations for creating a more sustainable and effective compensation system. This report focuses on the military commissary benefit. The authors discuss the commissary benefit’s cost and relative value to the military and its service members, and assess selected reforms to the commissary system that have been recommended by various organizations. BENS shared the substance of this report in a meeting with the Military Compensation and Retirement Modernization Commission on April 9, 2014.

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EXECUTIVE SUMMARY

The commissary benefit is a traditional part of the military compensation package. The benefit provides service members, retirees, and their families' access to military installation grocery stores known as commissaries which sell brand name food items at-cost – typically a 30 percent savings to the patron compared to private sector grocers—with the addition of a nominal surcharge. Commissaries are operated by the Defense Commissary Agency (DeCA), which currently receives \$1.3 billion in annual congressional appropriations, nearly \$300 million more than a decade earlier. The steady rise in cost has encouraged some policy makers to consider reform to manage overall military personnel costs.

BENS found the increased cost of the program has largely been attributed to inflation. Numbers from the Department of Defense (DoD) in fact show that the cost of the commissary system has steadily decreased or flattened since the inception of DeCA in 1990 if cost is evaluated through constant dollars. The oft-cited rise in costs can therefore be misleading absent this perspective.

Additionally, BENS found the benefit appears to have strong value. The commissary benefit makes up two percent of an active duty officer's and four percent for active duty enlisted's compensation while costing less than one percent of the military compensation budget. DeCA estimates military families are receiving \$3 billion in annual savings for DoD's \$1.3 billion dollar investment – more than a 2:1 return on investment. Meanwhile, informal survey results from the Army Times and the Center for Strategic and Budgetary Assessments indicate service members from

all ranks and age groups value the benefit more than it costs to provide.

There are a number of reforms various groups have proposed for reducing the commissary's annual appropriations. They range from allowing commissaries to close and encouraging private sector grocers to offer unique discounts to military families, to increasing the surcharge customers pay to cover commissary maintenance. Each proposal has various advantages and shortcomings, and BENS outlines considerations for several of the more prominent recommendations. BENS believes metrics and valid business cases should drive change and recommends policy makers gather and consider more information before making changes to the commissary benefit. While the rise in the commissary benefits' actual cost is not trivial, the benefit does show a positive return. More formal surveys of service members and retirees can better highlight the value of the benefit to individuals and further determine the benefit's return on investment. Key metrics, like return on investment, should drive the impetus of change.

* The Military Compensation and Retirement Modernization Commission began conducting a value survey in June 2014 and Congress passed the 2015 National Defense Authorization Act which requires a study of various commissary reforms. BENS applauds these efforts.

Over the past two years, Business Executives for National Security (BENS) examined the military commissary system as part of their Modernizing Military Compensation Series. The cost of the system has reportedly risen for more than ten years and has recently come under scrutiny as policy makers look to manage military personnel costs.ⁱ BENS believes insights and perspectives from the private sector are valuable in shaping any potential reform and offers its findings and recommendation as a basis for further discussions between its membership and policy makers. BENS members, who are current or retired senior business executives, applied their business expertise as they evaluated the commissary system, and the advantages and drawbacks of some prominent reform proposals made by other organizations.

THE COMMISSARY BENEFIT, ITS COST, AND VALUE

The commissary benefit is a traditional non-monetary benefit that provides service members, retirees, and their families access to military installation grocery stores that sell items at wholesale prices with the addition of a nominal surcharge. On average these stores, known as commissaries, offer their patrons a 30 percent savings compared to private sector grocers.ⁱⁱ The Defense Commissary Agency (DeCA) operates the commissary system and estimates that shopping at a commissary saves a family of four \$4,509 annually in food costs, while a single service member saves about \$1,553.ⁱⁱⁱ

Along with a five percent surcharge on purchases to finance commissary construction and maintenance, commissary operations are offset by an annual government subsidy. The subsidy equates to less than one percent of the overall military compensation budget, but has steadily risen from \$1.028 billion in 1992 to \$1.4 billion in 2014.^{iv} The rise has some policy makers concerned the subsidy is limiting funding for other programs.

ARGUMENT FOR REFORM

The most prevalent argument for reforming the military commissary benefit is cost. The cost for military personnel programs have risen along with the commissary subsidy and in an era of constrained funding and desire to maintain an internally balanced defense budget, the subsidy has become a target for cutbacks. Upon review, however, the cost of the subsidy and potential for significant savings need to be carefully assessed and understood. Commissary costs as a percentage of the overall military compensation budget is less than one percent and has always equated to less than one percent. Therefore reform to the system would create a fraction of a percent in overall personnel budget reduction.

Furthermore, the rise in cost is attributed to inflation. Actual costs have gone from approximately \$1 billion to \$1.4 billion in the period 1992 to 2014, but held at constant dollars, the commissary system's adjusted costs have decreased from \$1 billion to \$650 million. In effect, when adjusted for inflation as shown by the red line in Figure 1, commissary cost has largely gone down over the last two decades. DeCA claims they have reduced costs by more than \$700 million a year.^v Again, the point is not made to discourage attempts for reform. The observation is made to ensure policy makers understand whether there is the opportunity for real and enduring savings.



VALUE OF THE COMMISSARY BENEFIT

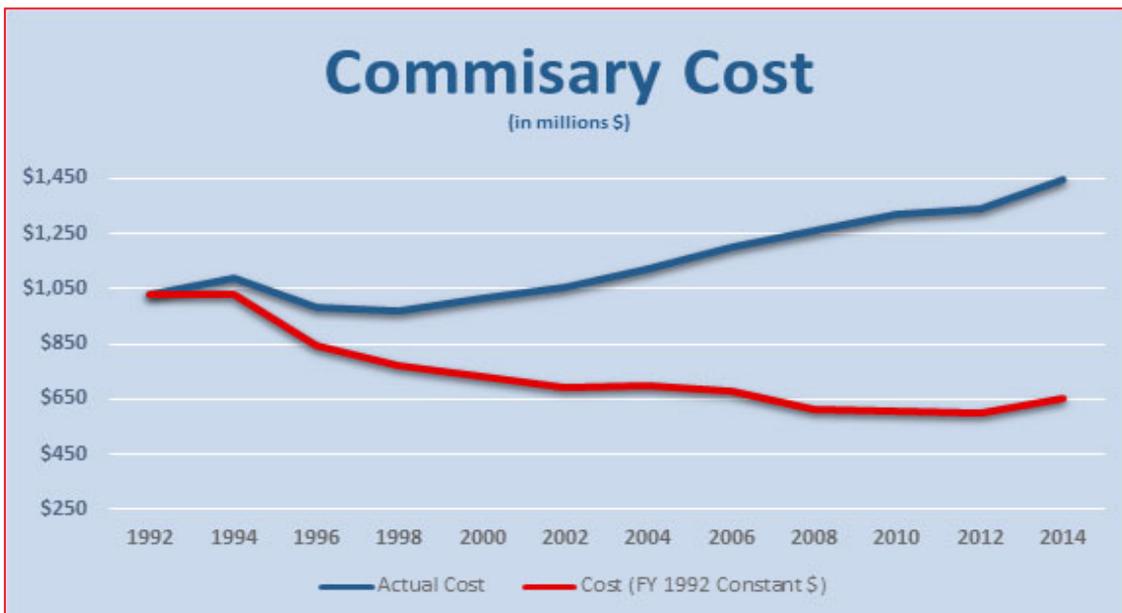
The military commissary benefit has a nearly 2:1 return on investment and, according to some studies, is regarded highly by beneficiaries. The commissaries' return on investment and high regard demonstrate that this ben-

efit holds significant value among its patrons.

According to DeCA, the \$1.3 billion spent on commissaries results in approximately \$3 billion in savings to commissary shoppers. DeCA estimates that service members and retirees save \$2 dollars for every dollar spent by taxpayers.^{vi} By this measure, the savings on food comprises a compensation mechanism more than twice as efficient as simply paying that cost in salary.

Moreover, informal survey results from the Army Times^{vii} and the Center for Strategic and Budgetary Assessments^{viii} in 2013 indicate service members from all ranks and age groups value the benefit more than it costs to provide. According to the Army Times survey, 80 percent of all active duty, retirees, and spouses ranked commissaries as a high or the highest priority benefit. Conversely, only approximately 20 percent of enlisted noted they could do without the benefit or would not miss it if it was gone.

Figure 1



Source: Defense Commissary Agency

EVALUATING REFORM OPTIONS

A number of reform proposals have been recommended over the years that range from eliminating the commissary benefit to providing coupons to local grocers that are comparable or near the current discount available at commissaries. Below are several of the more prominent proposals and their potential advantages and shortcomings. A summary of these proposals is portrayed in Table 1 at the end of this report.

KEEP THE SUBSIDY

Various veterans groups—as well as the DeCA—argue in favor of continuing the subsidy.^{ix} Going forward, the all-volunteer force may be difficult to maintain if benefit programs are reduced or cut, so eliminating the subsidy and associated commissary benefit could be harmful for recruitment and retention. While another common argument is that discounted groceries are a perfectly reasonable reward given to those who serve in the military, severing the benefit could be perceived to breaking a promise to those who volunteer to serve. Any reform would be difficult because of the public view at what would be widely perceived as a slight to military families.

There is also a practical argument to be made in favor of retaining the commissaries. For one thing, there is intrinsic value in the military having a system of grocery distribution in place, both domestically and especially internationally. Additionally, since the subsidy covers the costs of staffing the commissaries, not of buying the groceries, that subsidy creates jobs, and 64% of those jobs are held by persons connected to a military service member.^x If the commissaries were to close, the consequences would go beyond increased food prices; the jobs of many spouses and youths in military families would be eliminated.

Perhaps the most convincing argument in favor of the commissary subsidy, however, is the actual value of the system. As noted previously, the \$1.3 billion spent to keep commissaries running is expected to result in approximately \$3 billion in savings to commissary shoppers on a nearly 2:1 return on investment. Therefore, even if cuts are necessary, the commissary subsidy should be adjusted with care because it provides a high return.

While there is some merit to that concept, there are also flaws. For the savings estimates to be accurate, the demand for specific grocery items would have to be price inelastic, meaning that shoppers would buy the exact same items in the same quantities without searching for coupons or sales. In reality, consumption depends on price, so those same shoppers who are conscious enough of price to make an effort to shop at commissaries would probably exercise similar discretion in searching for low prices elsewhere. They would also likely purchase inexpensive items; commissaries stock some luxury foods like lobster, fillet mignon, and camembert, which are hardly necessary staples for a family's diet.^{xi} If food were more expensive, shoppers would likely be careful to buy cheaper foods, meaning that instead of providing food

necessities, the current \$1.3 billion subsidy pays for some ability to buy more expensive options. This further reduces the actual effectiveness of the commissary subsidy. Although the ratio of savings-to-subsidy might still be better than 1:1, the current measurements could be exaggerated.

Another critique of commissary benefits are that they are not evenly distributed. Only those who voluntarily shop at the commissaries actually receive their benefits, and with two thirds of active duty service members living off-base, many military families forfeit this opportunity due to the inconvenience.^{xii} According to one survey, 60% of military families do not consider commissaries to be an important aspect of their benefits.^{xiii} And even twenty years ago, half of commissary purchases were made by retirees, not active duty personnel, a portion that has surely increased as the relative number of retirees has also increased.^{xiv} This means that the benefits of the commissary are disproportionally exercised by retirees. This is different to the pattern of other benefits programs, which deliberately offer greater benefits to those actively serving; pensions, for example, are lower than salaries, and TRICARE is free for active duty personnel. Commissaries, which ostensibly should provide for the needs of military families as a priority, are of equal benefit regardless of status. It should be considered, however, that loss of revenue through creating disincentives or excluding the retiree population could result in increased cost of the commissary program.

COUPON APPROACH

Richard Stevens, a budget advisor to the Pentagon, advocates for completely ending the subsidy. He argues that “running a chain of

grocery stores is not a core competency of the Defense Department,” so that grocery chain has no justifiable reason to take up a billion dollars of the annual defense budget; the subsidy should cease and the stores should close.

^{xv} Instead, he advocates seeking discounts for service members at private businesses. There is some precedent, as many businesses in other industries already offer discounts on products from gym memberships to bus passes voluntarily, and Wal-Mart has apparently already agreed to such discounts if commissaries close, so other stores may follow.^{xvi} This approach would be ideal, assuming it were to work effectively. At no cost to the defense budget, commercially-sourced groceries could be made even more available to military families, however, the discounts would be unreliable and out of the control of the government. Although there is precedent for stores offering discounts to military shoppers, it is unlikely that the wholesale prices of the commissaries would be widely available. Still, this risk may be an acceptable tradeoff for eliminating over a billion dollars per year from the budget.

MERGER APPROACH

The Congressional Budget Office (CBO) favors a different approach.^{xvii} Their plan would eliminate the subsidy by restructuring the system of the commissaries, which, unlike in Stevens’ plan, would remain open. CBO proposes that the commissaries be combined into a single entity with the military exchanges, department stores that have successfully operated for decades without any subsidy.^{xviii} Combining the three separate exchanges and the commissaries would result in an estimated savings of \$10 billion over the next ten years. Operational costs would go down because the commissaries would be able to adopt the personnel management practices of a private

grocery store instead of a federal agency like DeCA; the exchanges have been successful in part because their human resources and product pricing schemes are more similar to a private retail company.

Such an approach would retain the readiness benefit of having food stores on bases, the convenience of on-base shopping for service members, and the employment opportunities for family members. However, in order to be profit-driven, the commissaries would have to raise prices to be comparable to private grocery stores. To compensate for this, CBO proposes a food subsidy of, on average, \$500 annually for service members. This amount could be adjusted based on rank or family size to help those who most need the subsidy. A direct subsidy to service members would ensure that this benefit goes to those actively serving, as opposed to subsidizing the retiree population as well. CBO's \$10 billion savings estimate already accounts for this subsidy, meaning that this option would reduce

spending while still providing a generous benefit—in fact, for many, this new system may be more helpful than commissaries.

SURCHARGE APPROACH

One alternative to the CBO proposition of competitive prices at commissaries proposed by DoD is for the commissaries to offer pricing lower than at grocery stores but higher than wholesale. There is some precedent for this concept as the commissaries instituted a small surcharge to cover their operating costs effectively increasing pricing over their wholesale costs. Starting in 1952, the commissaries began charging a small surcharge to cover operating costs, and the surcharge rate increased until capped at 5% in 1983.^{xix} However, while the surcharge has not increased, both benefits and operating costs certainly have. If the surcharge were increased, DeCA could cover some or all of its own operating costs without the annual \$1.3 billion subsidy, and without closing the commissaries.

Table 1

PROPOSAL	POTENTIAL FOR SAVINGS	CONSIDERATIONS
Keep the Subsidy	\$0	<ul style="list-style-type: none"> Highly valued benefit for many Viewed as 'keeping faith' Commissaries provide jobs for military families
Coupon Approach – Allow commissaries to close and encourage area stores to offer discounted prices to military families	Est. \$1 billion annually	<ul style="list-style-type: none"> Some argue managing grocery stores is inefficient an outside the core competency of the Department Government will not be able to ensure level of discount
Merger Approach – Eliminate the commissary subsidy while providing a \$500 increase in annual subsistence and incorporating commissaries into the Military Exchange System	Est. \$10 billion over 10 years	<ul style="list-style-type: none"> Retains the readiness and convenience of on-base grocery stores Provides direct compensation which could be more valuable to more service members
Surcharge Approach – Increase the 5% surcharge	≤ \$1.3 billion annually	<ul style="list-style-type: none"> Reduces or eliminates the need for a subsidy Reduction in savings on food stuff could discourage patrons from shopping at commissaries, reducing expected savings to overall budgets

Source: Sources: Defense Business Board, Congressional Budget Office, Air Force Times

CONCLUSION & RECOMMENDATION

BENS believes that the commissary system delivers good benefit for the value. Should reform be pursued, metrics and valid business cases should drive change. BENS therefore recommends that policy makers collect more information before making changes to the commissary benefit. Specifically, BENS recommends an evaluation of the commissary benefit's return on investment and value to service members, and to explore at least one other reform alternative: the smart consolidation of Commissary and Exchange supply chains. The rise in the commissary benefit's actual cost is not trivial, but the benefit does show a positive return.

In addition, formal surveys of service members and retirees are needed to further confirm the value of the benefit to beneficiaries and the benefit's return on investment as a part of the larger compensation and benefits package.

It is understood that at the writing of this report, a formal survey and requirement for further studies are underway. BENS applauds policy makers and officials for implementing these efforts.

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