Military Retirement Reform: A Review of Proposals and Options for Congress

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Summary

Few military subjects have generated as much interest or commentary as the military retirement system and efforts to reform the system have been many. Heightened concern over the national debt crisis, the economic recession, and stubbornly high unemployment has resulted in renewed congressional interest in the cost and effectiveness of the system. This report reviews various reform proposals and presents several potential options for Congress, ranging from maintaining the current system to a national commission to review military compensation, benefits, and retirement.

The military retirement system is a noncontributory, defined benefit plan which guarantees a specific monthly payment after 20 or more years of service. Vesting occurs at 20 years of service, regardless of age, and is therefore an "all or nothing" proposition. Retirement age varies, but most military retirees are young enough to pursue private-sector careers following their military service. Most observers note that ,while effective as a retention tool, military retirement is also very expensive—in FY2010 there were 2,271,000 retirees and survivors receiving a total of $50.842 billion from the federal government. However, because of the way the government accounts for military retirement, the direct cost to the Department of Defense (DOD) is significantly less. In FY2009, DOD paid $17.5 billion to the Military Retirement Fund to fund the future retirement of the military cohort who entered the military during 2009.

Critics of the military retirement system frequently cite several points in addition to cost: (1) It is inefficient because it defers too much compensation until the completion of a military career; (2) It is inflexible because it does not facilitate force management or encourage longer careers; and (3) It is inequitable because most servicemembers never qualify or vest.

The military retirement system has evolved over time (see "Major Legislative Reforms of Military Retirement"). Today, active component servicemembers choose between two retirement systems at their 15th year of service (either High-3 or Redux), reservists are restricted to one system (a modified version of High-3), and disability retirees also have the opportunity to choose between two systems (High-3 or Disability retirement). Many observers have agreed that a reformed retirement system could enhance retention, provide an improved force management tool, and provide an equitable retirement regardless of component or special situation. A review of past legislative proposals finds that they have been controversial, unpopular with DOD and servicemembers, and generally focused on reducing the cost of military retirement. The Redux option, in particular, has become a less attractive option and fewer and fewer servicemembers are selecting it.

The cost factor, combined with the recent emphasis on reducing costs in DOD and the overall federal deficit, resulted in a number of studies, commissions and reports in 2010. However, these efforts did not result in comprehensive policy changes. In addition to the most recent commission and think tank reports, two other efforts within the past five years included detailed recommendations for retirement reform. The 2005 Defense Advisory Committee on Military Compensation (DACMC) established a framework for a comprehensive restructuring of military retirement. This was followed in 2008 by the 10th Quadrennial Review of Military Compensation (QRMC) that further modeled, refined, and amplified on the work of the DACMC. Both efforts supported applying a reformed military retirement system to new entrants only; currently serving and already retired members would be grandfathered.

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Overview

Beginning with the 1948 Hook Commission,[1] few military subjects have generated as much interest or commentary as the military retirement system.[2] The number of reports, analyses and studies aimed at modifying or reforming the system have been voluminous. This has been especially true during periods when the system has been viewed as excessively expensive or when personnel costs have been highlighted for reduction in the defense budget. As Congress addresses the deficit, the escalating cost of military retirement is an area of concern.

Positions on the issue of military retirement reform can range from intense criticism to intense support among the community of defense manpower analysts, politicians, veterans support organizations, and military personnel. Those who are critical generally find fault with the 20-year "cliff" vesting, the generous retirement benefits to youthful beneficiaries, the overall cost of the system, the lack of force management flexibility, and the inefficiency of the system.[3] Those who defend the current 20-year retirement system argue that it is compensation for a career of arduous, and frequently hazardous, service and sacrifice for the nation and that it is relatively consistent with retirement systems for other high-risk occupations. Others view the retirement annuity as a "retainer" since retired military personnel can be recalled to active duty at any time.

The Military Retirement System

The military retirement system is a noncontributory, defined benefit[4] system that is viewed as a significant incentive in retaining a career military force. The system provides inflation-protected monthly compensation and other benefits after an active or reserve military career, disability retirement for those physically unfit to continue to serve, special retirement programs such as the Temporary Early Retirement Authority (TERA),[5] and survivor benefits for the eligible survivors of deceased retirees.[6] These retirement variations are all separate but interrelated. Retired pay is subject to federal income tax.

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[1] The 1948 Advisory Commission on Service Pay, colloquially known as the Hook Commission, conducted the first comprehensive review of military compensation since 1908. Its recommendations resulted in the structure of the military compensation system that exists today. It also recommended that military retirement be delivered at minimum cost.

[2] See Library of Congress, "A Summary of Major Military Retirement Reform Proposals, 1976-2006," November 2007, for a comparison of five major studies on the military retirement system, or RAND's "An Overview of Past Proposals for Military Retirement Reform," by John Christian, 2006, which summarizes reforms over the past 60 years.

[3] Critics argue that the current system is inflexible because it provides a strong incentive to remain in the military until 20 years of service and then a strong incentive to retire and begin the immediate receipt of a retirement annuity. In addition, the services are hesitant to better manage the force by separating some poor performers with 15 or more years of service because they would leave with nothing. Other observers note that the current system is inefficient because it focuses retention efforts of deferred compensation rather than increased bonuses or current basic pay and allowances.

[4] Defined benefit is an employer-sponsored retirement plan which promises a specified monthly benefit at retirement based on a predetermined formula that uses past earnings history, tenure of service or age rather than investment returns. According to the Internal Revenue Service, there are approximately 38,000 defined benefit plans today compared to about 114,000 in 1985.

[5] The Temporary Early Retirement Authority (TERA) was included in the FY1992 Defense Authorization Act to provide a drawdown tool for the services during the force drawdown of the 1990s. Selected officers with between 15 and 20 years of service were permitted to retire with full benefits but with a reduction in their retired pay.

[6] For a detailed description of active, reserve, and disability retirement, see CRS Report RL34751, *Military Retirement:* (continued...)

Active duty personnel become eligible for retirement by completing 20 years of service,[7] regardless of age, but may, under certain conditions, remain on active duty for up to 40 years. Retirement eligibility for reserve component personnel is based on "points" and equivalent years of service but reservists do not generally begin to receive their retired pay until age 60. Those who are retired due to physical disability will receive retired pay regardless of their length of service. Disability retirement offers a choice between two retirement options: one based on years of service and one on the severity of the disability.[8] Servicemembers who voluntarily separate prior to completing the minimum 20 years of service will generally receive no retirement benefits.

The military retirement system shares some similarities with private sector retirement systems, but it exists for very different purposes. According to the Department of Defense, military retirement is intended to support:

- "The provision of a socially acceptable level of payments to members and former members of the Armed Forces during their old age.
- The provision of a retirement system that will enable the Armed Forces to remain generally competitive with private-sector employers and the Federal Civil Service.
- The provision of a pool of experienced military manpower that can be called upon in time of war or national emergency to augment the active-duty forces of the United States, and the establishment of a mechanism whereby persons in this pool can move into and out of active duty smoothly.
- The provision of a socially acceptable means of keeping the military forces of the United States young and vigorous, thereby insuring promotion opportunities for younger members."[9]

Military retirees are subject to an involuntary recall to active duty and therefore remain subject to the Uniform Code of Military Justice to enforce the recall authority. In contrast to many private sector plans, the military retirement system also does not provide for the gradual vesting of benefits, it is an "all-or-nothing" proposition based on serving a minimum of 20 years.

At the conclusion of FY2010, there were approximately 2,271,000 beneficiaries of the military retirement system at an annual cost to the federal government of $50.842 billion. **Table 1** reflects the various categories of beneficiaries and the cost associated with each program:

(...continued)

Background and Recent Developments, by (name redacted).

[7] Until the 20-year point, there is no vesting. At 20 years, the servicemember becomes fully vested. This is commonly referred to as "cliff vesting" and is a common criticism of the military retirement system.

[8] This report focuses on nondisability retirement. For additional information on disability retirement, see CRS Report RL33991, *Disability Evaluation of Military Servicemembers*, by (name redacted) and (name redacted) and CRS Report RL34751, *Military Retirement: Background and Recent Developments*, by (name redacted).

[9] Department of Defense, *Military Compensation Background Papers: Compensation Elements and Related Manpower Cost Items, Their Purposes and Legislative Backgrounds,* Sixth Edition, April 2005, p. 682.

Table 1. Military Retirement System-Beneficiaries and Cost

(As of September 30, 2010)

Program	Number of Beneficiaries	Annual Cost
Nondisability Retirement	1,470,000	$40.02 Billion
Disability Retirement	93,000	$1.38 Billion
Reserve Retirement	357,000	$4.89 Billion
Survivor Benefits	294,000	$3.65 Billion
TERA[a] Retirement	57,000	$0.902 Billion
Total	2,271,000	$50.842Billion

Source: DOD Office of the Actuary, "Statistical Report on the Military Retirement System: Fiscal Year 2010," May 2010.

a. The Early Retirement Authority (TERA) was used selectively during the post-Cold War drawdown to retire officers with between 15 and 20 years of service.

In addition to retired pay, military retirees are also entitled to commissary and exchange access, medical care through TRICARE, and access to Morale, Welfare and Recreation facilities and programs, and certain other benefits.

Three Systems, Different Retired Pay Results

There are currently three different methods of calculating retired pay for active component personnel: Final Basic Pay, High-Three, and Redux. Eligibility is based on the date the person first became a member of the armed forces.

Final Basic Pay[10]

Servicemembers who entered military service prior to September 8, 1980 will retire under the Final Basic Pay system. This is the most expensive of the three systems currently in use because retired pay is based on the final amount of monthly basic pay, which is typically the highest level of pay the member has received. This amount is multiplied by 2.5% for each full year of service (plus 1/12th for each complete month less than a full year) and then multiplied again by the number of years of service. The product of 2.5% and years of service is referred to as the Computation Base. As a result, a servicemember who completes exactly 20 years of service will retire with 50%[11] of their final monthly base pay, a member with 30 years of service will retire with 75% of their final base pay and a member with 40 years of service[12] will retire with 100% of their final base pay.[13]

[10] Basic pay is the monthly pay received by all servicemembers of the same rank and longevity. It does not include the Basic Allowance for Housing, the Basic Allowance for Subsistence, or any other special pay or bonus.

[11] The product of 2.5% times years of service is generally referred to as the Computation Base.

[12] Until 2007, most military personnel were permitted to serve a maximum of 30 years on active duty and received their final longevity pay increase at 26 years of service. At 30 years of service, the Computation Base was capped at 75%. However, the John Warner National Defense Authorization Act of FY2007 expanded the military pay table from "Over 26" to "Over 40" and permitted some senior enlisted and officer personnel to be retained, to continue to receive retirement longevity increases, and to continue to accrue retirement credit at the rate of 2.5% per year. As a result, an (continued...)

An active duty member who entered the service prior to September 8, 1980 will have at least 31 years of service by the end of 2011. As a result, servicemembers eligible for the Final Pay system are quickly aging out of the system. DOD estimates that fewer than 15,000 remain on active duty and an additional 35,000 remain in the reserve components. Most of them should retire by 2016 and the Final Pay system, the most expensive of the three retirement systems, will begin to phase out.

The annual Cost of Living Adjustment (COLA)[14] for those retiring under the Final Basic Pay system is indexed to the annual Consumer Price Index (CPI), which is similar to the COLA calculation for Social Security recipients.

High-3

Servicemembers who entered service between September 8, 1980 and July 31, 1986 will retire under the High-3 system. High-3 is very similar to the Final Basic Pay system except the final monthly pay factor is replaced by the average basic pay for the highest 36 months of the individual's career. Therefore, the retired pay formula under High-3 is 2.5% times years of service, times the High-3 average.

The annual COLA for those retiring under the High-3 system is also indexed to the annual CPI.

Redux

Servicemembers who entered service on or after August 1, 1986, currently have a choice of two retirement systems: retire under the High-3 system, or the Redux[15] system, which now includes a $30,000 Career Status Bonus. The retirement choice must be made within 180 days of completing 15 years of service. Redux uses a different multiplier and a different COLA formula than the High-3 system. It was designed for the dual purpose of rewarding longer service and reducing the cost of the military retirement system.

Under Redux, a member retiring at 20 years of service will only receive 40% of their High-3. However, remaining on active duty beyond 20 years will earn an additional 3.5% per year up to the 30-year point when the retirement benefit would equal 75% of their High-3—identical to a 30-year retiree under High-3. Beyond 30 years, the member earns an additional 2.5% per year up to a maximum retirement of 100% of the High-3 for 40 years of service, similar to the accrual under the High-3 system.

The COLA for Redux retirees is the CPI minus 1% each year until the retiree reaches age 62. At that time, there are two adjustments to the retired pay: (1) For those between 20 and 30 years of

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individual who serves 40 years will have a Computation Base of 100%. See CRS Report RL33446, *Military Pay and Benefits: Key Questions and Answers*, by (name redacted).

13 Few military personnel are eligible to be retained beyond 30 years of service. For example, only the most senior enlisted (E8 and E9), warrant officer (W-4 and W-5) and officers (O-6 through O-10) may be retained.

14 The Military Reform Act of 1986 (10 U.S.C. 1401a) indexed the military retired COLA to the Consumer Price Index, similar to Social Security.

15 Redux is also referred to as the Military Retirement Reform Act or the "1986 Act."

service at retirement, the multiplier adjusts to what it would have been under the High-3 system, and (2) The CPI variable adjusts to a full CPI level as a one-time, one year adjustment. At this point (age 62), the Redux and High-3 retirement pays are equal. However, the CPI then reverts back to the previous formula of CPI minus 1% after age 62 and there are no further adjustments.

At no point in time does the accrual under Redux exceed that under the High-3 system. Additionally, the COLA adjustment under Redux is substantially less than under the High-3 system. Thus, very few individuals elect the Redux option.

Career Status Bonus (CSB)

Members who make the irrevocable decision to select the Redux retirement system within 180 days of completing 15 years of service receive a $30,000 Career Status Bonus (CSB) if they agree, in writing, to complete a 20-year military career. Of course, the member may remain beyond 20 years but they are only obligated to 20 years. The bonus may be paid in lump sum or in 2, 3, 4, or 5 installments. Those who elect multiple payments can use the bonus as a tax deferred contribution to their Thrift Savings Account, but it is taxable if paid directly to the servicemember, either as a lump sum or in installments. If, for any reason, the member does not complete 20 years of service, the member must repay a prorated share of the bonus.

When enacted in 1999, there was no provision for automatically increasing the CSB to adjust for inflation. As a result, the $30,000 bonus is only worth approximately $22,000 today, certainly not a strong incentive when compared to the High-3. If the CSB had been indexed to the CPI, it would be worth approximately $38,500 today.

Major Legislative Reforms of Military Retirement

Although there has been a military retirement system since 1861, the Army and Air Force Vitalization and Retirement Equalization Act of 1948[16] established the general framework for today's military retirement system. It featured vesting at 20 years of service, computed retired pay at the standard 2.5% per year of service, and applied to all of the services. In the six decades since then, there have only been three significant modifications or reforms of the system, mostly focused on the cost of the system. In 1980, the Final Pay methodology was changed to the High-3 calculation. Six years later, a major reform initiative, focused on saving $2.9 billion, resulted in the "1986 Act" or Redux plan. Redux reduced the retirement benefit at 20 years from 50% to 40% but kept it the same at 30 years of service (75%) to encourage longer careers. It also reduced the annual Cost-of-Living (COLA) increase by 1% per year until age 62. By 2000, Congress was convinced that Redux had a negative impact on retention and allowed servicemembers to choose either High-3 or Redux, while adding a $30,000 Career Status Bonus to the Redux plan to incentivize participation.

This section will review the legislative history of the past three retirement reforms which may lend perspective for policy makers reviewing the more recent reform proposals.

[16] P.L. 810, June 29, 1948.

High-3

During the 1970s, military pay raises frequently lagged behind the private sector increases as measured by the Employment Cost Index. This "pay gap" resulted in problems in recruiting, retention, and readiness. To restore reasonable comparability with the civilian sector, Congress, in the Department of Defense Authorization Act for FY1981,[17] approved an 11.7% military pay raise and followed that with a 14.3% pay raise in the Department of Defense Authorization Act for FY1982.[18]

To offset a portion of the added cost of this pay raise and to partially reduce the high cost of the military retirement system under the "Final Pay" methodology, the FY1981 Defense Authorization Act[19] also approved the first major modification of the military retirement system since 1948. As explained in the Senate Report on the FY1981 Authorization Act:

> The committee recommends this change because of the high and increasing costs of military retired pay and because of the need to increase pay for military personnel while they serve on active duty and instead of after their active duty careers are finished. [20]

The act reduced retirement cost by establishing a second retired pay computation base for members who entered the military on or after September 8, 1980 (the date of enactment of the Defense Authorization Act). Servicemembers would still calculate their retirement at 2.5% per year for the number of years served but Final Pay would be replaced by the "High-3," the average of the highest three years or 36 months of basic pay. The savings over the Final Pay plan were estimated at 13% by DOD.

Those who entered the military before September 8, 1980 were grandfathered from the High-3 system and continued to calculate their retired pay based on their Final Pay. The number still eligible for Final Pay continues to drop and nearly all of those eligible should be retired by 2016.

At the time, conversion to the High-3 system constituted the most significant legislative change to the military retirement system since the end of World War II.

"The 1986 Act"

The FY1986 Defense Authorization Act[21] required the Secretary of Defense to develop and submit to Congress two alternative options for reforming the nondisability retirement system with a goal of saving $2.9 billion in the military accrual account.[22] It specified that any recommended

[17] P.L. 96-342, September 8, 1980.

[18] P.L. 97-86, December 1, 1981.

[19] P.L. 96-342, September 8, 1980.

[20] Senate Report 96-826, June 20, 1980.

[21] Section 667, Defense Authorization Act for FY1986.

[22] Through 1984, military retirement was funded on a "pay-as-you-go" basis through annual appropriations in the defense appropriations bill. Since FY1985, "accrual accounting" has been used. Under this system, the DOD budget for each fiscal year includes, not the amount of retired pay actually paid to retirees, but rather, a contribution to the military retirement fund sufficient to finance future payouts to current uniformed personnel when they retire. For additional information, see CRS Report RL34751, *Military Retirement: Background and Recent Developments*, by (name redac ted), pp. 10-12.

changes could not impact on those currently serving or already retired, that the changes should encourage members to remain on active duty beyond 20 years, and enable the military to manage its career force better.

The models developed by DOD met the required savings target of $2.9 billion but predicted a potential major retention problem—a 8 to 12 % reduction in retention for the 10 to 20 year portion of the force and a 16 to 37% reduction in the 21 to 30 year cohort. As a result, when the report was submitted to Congress by Secretary of Defense Casper Weinberger, he noted in the forwarding memo that DOD did not support adoption of either option:

> Although the Department of Defense has prepared the draft legislation as required by the Congress, I want to make it absolutely clear that such action is not to be construed as support for either of the options for change. To the contrary, the Department of Defense is steadfastly opposed to the significant degradation in future combat readiness that would result from the changes required to achieve the mandated reduction. I am particularly concerned about the potential loss of mid-level leadership and technical know-how so vital to the defense mission.[23]

This position was reinforced during a House Armed Services Committee hearing on February 27, 1986 when Chapman B. Cox, the Assistant Secretary of Defense for Force Management and Personnel stated:

> we opposed both of these alternatives. We believe that the deep cut in retirement benefits associated with either alternative will severely hamper our ability to retain the high quality personnel we need, and would therefore pose an unacceptable risk to our future combat readiness. [24]

If the $2.9 billion could not be restored, DOD indicated that significant personnel cuts would be required immediately. Again according to Assistant Secretary Cox:

> if we do not have an adjustment by May 1, it would require a reduction of approximately 330,000 active force and about 176,000 reserve members in order to meet the budget decrement that presently exists.

Congress reviewed the alternatives presented by DOD and developed a hybrid version that became the Military Retirement Reform Act of 1986,[25] now colloquially referred to as Redux.

Redux, originally intended to be a single retirement system for all active duty personnel, retains the 20-year cliff vesting but reduces the Computation Base to 40% at 20 years of service (a multiplier of 2% per year). To incentivize longer careers, it increases the multiplier to 3.5% per year between years 20 and 30 and would thus equal 75% of High-3 at 30 years of service. Since the 75% cap on retired pay was lifted,[26] Redux increases the multiplier by 2.5% per year between

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[23] Memorandum from Secretary of Defense Casper Weinberger to Speaker of the House Thomas P. O'Neill, Jr., November 15, 1986.

[24] H.A.S.C. 99-40, Defense Department Authorization and Oversight Hearings of H.R. 4428, Committee on Armed Services, February 27 and March 12, 1986.

[25] P.L. 99-348, July 1, 1986.

[26] See section entitled "Pay Table Reform" in CRS Report RL33446, *Military Pay and Benefits: Key Questions and Answers*, by (name redacted).

years 30 and 40. As a result, compared to the High-3 method, Redux pays less for 20 to 29 years of service but the same as High-3 for 30 years of service and beyond.

Redux also cuts retirement costs by increasing retired pay annually by the CPI minus 1%. However, at age 62 there is a one-time adjustment in retired pay. The Computation Base is adjusted to be what it would have been under High-3 (e.g. the Computation Base for a retiree with 20 years of service would increase from 40% to 50%) and the COLA is adjusted to reflect full COLA increases since the date of retirement. Thus, at age 62, the Redux and High-3 retirement pays are equal. However, after age 62, the COLA calculation reverts to the CPI minus 1% for the Redux retiree.

With continuation of 20-year vesting, the first Redux eligible retiree was slated to retire on August 1, 2006. As discussed below, however, Congress modified the military retirement system again in 1999.

A more detailed assessment of Redux retirement is available in CRS Report 87-702, *The Military Retirement Reform Act of 1986: Issues and Implications,* by (name redacted) (out of print; available from the author of this report).

Career Status Bonus (CSB) and Choice of Retirement System

By 1999, seven years before the first servicemember would retire under Redux system, the Cold War drawdown was complete, the economy was healthy, the airlines were hiring military pilots faster than the military could train them, and service budgets had been significantly reduced. According to some measures, military pay was lagging significantly behind that of their civilian peers, the personnel tempo was stressing the services and military families, and military retirement had lost some of its effectiveness as a retention tool. Some advocates argued that servicemembers of the all-volunteer force were beginning to "vote with their feet."

In Congressional testimony,[27] the Chairman of the Joint Chiefs of Staff and the Service Chiefs portrayed a situation of deferred maintenance on military equipment, readiness concerns, and personnel shortages as a main consequence of the services not meeting their recruiting or retention goals.

According to General Henry H. Shelton, Chairman of the Joint Chiefs of Staff at the time:

> reforming military retirement (the Redux system) and military pay remains the Joint Chiefs' highest priority....

The Chief of Naval Operations, Admiral Jay L. Johnson, was concerned that the retention situation was continuing to deteriorate in the Navy:

> in retention, we are running 8 to 10 percent below requirements, first-, second-, and third-termers. We are also seeing a significant increase in the number of short term extensions being executed, which means our sailors are taking a wait-and-see attitude before making career commitments.

[27] House Armed Services Committee Hearing, "The State of U.S. Military Forces," January 20, 1999.

For the Air Force, the problem was aging aircraft and pilots separating to pursue civilian opportunities with the airlines. According to General Michael E. Ryan, Air Force Chief of Staff:

> Today in the Air Force we are over 800 pilots short of our requirement.... Last year for every two pilots we trained, three separated.

While the Services pointed to Redux retirement as the primary cause of the retention problem, it must also be noted that the military drawdown had just reduced the total active force from 2,043,705 in 1990 to 1,385,703 in 1999, a reduction of 32%. Military morale was low and fewer personnel may have viewed the military as a viable career opportunity.

In response to these concerns, the FY2000 NDAA expanded existing benefits and provided some new ones to stimulate both recruiting and retention. These included (1) a 4.8% military pay raise which was 0.5% above the Employment Cost Index (ECI); (2) a commitment to increase basic pay each year through 2006 by 0.5% more than the ECI; (3) a special subsistence allowance for military families eligible for food stamps; (4) voluntary enrollment of military personnel in the Thrift Savings Plan (TSP) for tax-deferred savings; and (5) a 13% increase in the Montgomery G.I Bill education benefit. A $30,000 bonus was added to the Redux retirement program at the 15th year of service and, most significantly from the perspective of retirement, *service members were allowed to choose between Redux and the High-3 programs.* The Congressional Budget Office estimated that this enhanced package of benefits would cost $18 billion more than the Administration's request over 10 years.[28]

With enactment of the FY2000 NDAA, servicemembers, for the first time, were given an opportunity to choose their retirement system. Those who selected Redux made an irrevocable decision within 180 days of their 15th year of service. They had to agree, in writing, to complete 20 years of service on active duty with no service commitment beyond that point. The Career Status Bonus (CSB) could be taken in cash (taxable) or in annual installment payments into the Thrift Savings Plan (nontaxable). If the servicemember failed to complete 20 years of active duty, a pro-rated share of the bonus would be recouped. Those who did not opt for Redux retained the High-3 retirement.

To aid in deciding whether to select the High-3 or Redux with the Career Status Bonus, DOD offered a calculator that allows an individual to enter their personal situation and do a comparison of the options. The calculator is available at http://www.dod/militarypay/retirement. DOD does not officially recommend either the High-3 or Redux/CSB,

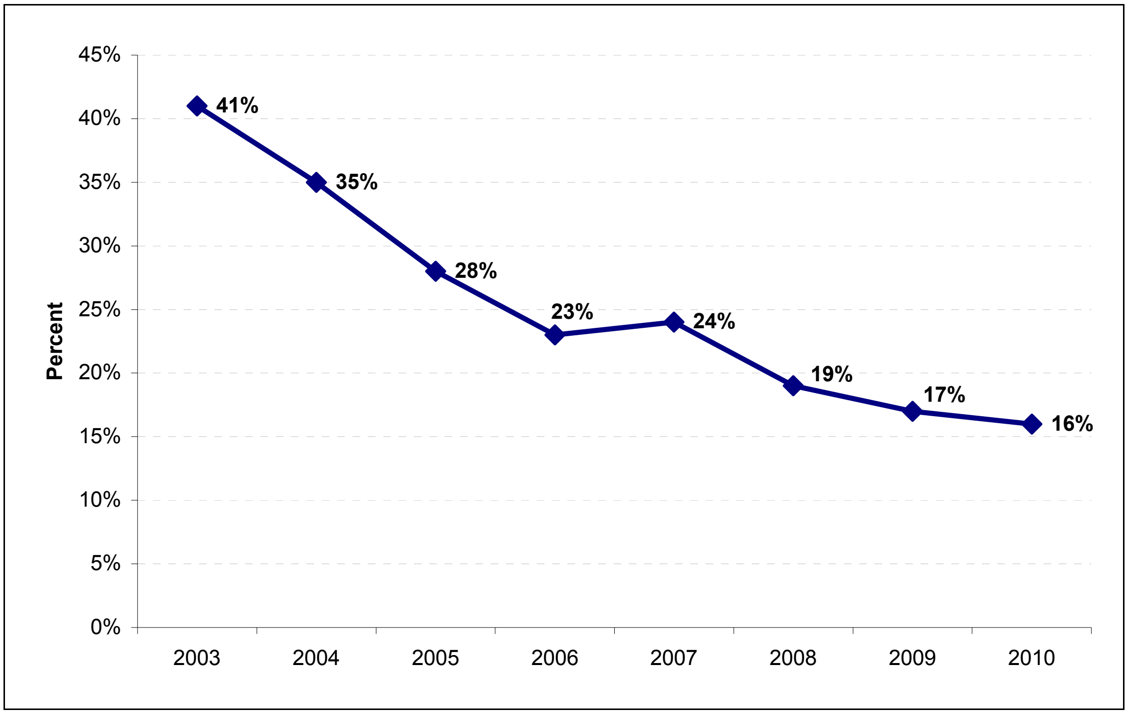
Trends in the CSB "Take Rate" Question Its Future Viability

DOD does not routinely compile data, by Service, on the numbers of servicemembers who opt for Redux/CSB at the 15th year of service, colloquially referred to as the "Take Rate." However, data has been maintained by the Navy and the Marine Corps for the years 2003 through 2010 for both officers and enlisted personnel and this data has been provided to CRS. Analysis of the trend (shown in **Figure 1**) demonstrates a significant decline in the number of CSB "Takers." From a combined high of 41% in 2003, the Navy and Marine Corps aggregate average has steadily decreased and was reported as only 16% in 2010. At least for the Navy and Marine Corps, the Redux/CSB option has declined, somewhat precipitously, in popularity. If the experience of the

[28] Government Executive, "Retirement Redux," by Sydney J. Freedberg, April 1, 1999

Army and Air Force are similar, High-3 is the dominant retirement program in the military with Redux/CSB increasingly viewed as a less valuable option.

Figure 1. Navy/Marine Corps "Take" for the Career Status Bonus (CSB)



Source: DOD Actuary.

Past Administration Proposals

There have been two major administration military retirement reform proposals in the past five years. They are examined below.

The Defense Advisory Committee on Military Compensation (DACMC)

The DACMC was chartered by the Secretary of Defense on March 14, 2005 to "identify approaches to balance military pay and benefits in sustaining recruitment and retention of high-quality people, as well as a cost-effective and ready military force."[29] This effort was chaired by Admiral D.L. Pilling, U.S. Navy (Retired) with six committee members and a support staff. Their report was published in April 2006.[30]

[29] This was the tasking to the DACMC from Secretary of Defense Donald H. Rumsfeld. It is contained in Admiral Pilling's memo that forwards the DACMC's report to the Secretary of Defense, April 28, 2006.

[30] Report of the Defense Advisory Committee on Military Compensation, "The Military Compensation System: Completing the Transition to an All-Volunteer Force," April 2006.

The committee reviewed and analyzed a wide spectrum of military compensation issues: retirement, basic pay, special and incentive pays, military healthcare, quality of life, and reserve component compensation. A chapter of the 150-page report focused on retirement reform and included several examples of a modernized, reformed retirement system.

The committee noted three common criticisms of the current retirement system: (1) it is perceived to be inefficient because it defers too much compensation; (2) it appears to be inflexible because it does not facilitate force management; and (3) it is inequitable because most servicemembers never qualify (or vest)[31] for the retirement benefit. Committee members also noted that military skills today are more transferable, life expectations are longer, and a generous retirement may be more expensive than increased retention incentives to ensure continuation on active duty.

These observations resulted in the committee recommending: (1) military careers of longer duration; (2) earlier vesting in the retirement system; and (3) a TSP-type program with government matching funds. To achieve the proper (more cost effective) mix of current and deferred compensation, the committee recommended a three-tiered retirement system characterized by (1) a retirement annuity beginning at age 60; (2) the early vesting (at 10 years) of a TSP account with a government match in the 5% range; and (3) compensation incentives in the form of "gate pay,"[32] separation pay or transition pay to produce required retention. The first two tiers would be consistent across all services while the third tier would allow for the flexibility to address service-specific management issues.

To demonstrate the potential of these recommendations, the committee modeled seven career scenarios against the current system. These variants all resulted in a smaller first-term force, a more robust mid-career force, and a reduced cost of the retirement system.

10th Quadrennial Review of Military Compensation (QRMC)

As required by Title 37[33] of the U.S. Code, the President convened the 10th Quadrennial Review of Military Compensation in late 2005. The QRMC was tasked with conducting "a complete review of the principles and concepts of the compensation system for members of the uniformed services." The memo convening the QRMC noted five areas of interest[34] and specified that "the implications of changing expectations of present and potential members of the uniformed services relating to retirement" be addressed.

The 10th QRMC was headed by Brigadier General Jan D. (Denny) Eakle, U.S. Air Force (Retired) and was composed of a senior advisory board and two working groups—one for compensation and another for health professionals. The Compensation Working Group that reviewed retirement

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[31] Currently, only 47%of newly accessed officers and 10% to 15% of new enlistees attain the 20 years of service required to vest under the existing system. DOD Office of the Actuary, "Valuation of the Military Retirement System: September 30, 2009, December 2010, p. 13.

[32] Gate pay is a form of additional pay or a bonus that is a multiple of basic pay and payable at key years of service such as 10, 15, 20, 25, and 30 years. It would vary from member to member to shape the career lengths in different specialties or for the force in general.

[33] Section 1008(b), Title 37 requires that the President, every four years, direct a complete review of the uniformed services compensation system. The first review was completed in 1967. The results of the review, along with any recommendations from the President, are submitted in a formal report to Congress.

[34] Of the five, the final one included, "particular attention should be paid to ... the implications of changing expectations of present and potential members of the uniformed services relating to retirement."

options included 26 members, representing all the Services, the Office of the Secretary of Defense, and the Joint Staff. The report of the 10th QRMC was published in two volumes in February[35] and July[36], 2008 respectively.

The QRMC modeled each component of the DACMC's recommendations—early vesting, age eligibility for retired pay, the defined contribution and defined benefit components, gate pay and separation pay—against actual servicemember preferences using data and survey results from a 17-year cohort of military personnel. This methodology resulted in minor modifications to the DACMC's proposal but appears to have resulted in a more refined proposal.

The QRMC proposal would use the same formula for the defined benefit portion of the retirement and vest this benefit at 10 years but would introduce a penalty for retiring with 20 or fewer years of service. Those who retire at or before 20 Years of Service (YOS) would begin receiving retired pay at age 60 while those retiring with more than 20 YOS would begin receiving retired pay at age 57 with the option of reducing the age by forfeiting 5% for each year less than age 57.

The defined contribution portion would still vest at 10 YOS and could be withdrawn without penalty at age 60. The government match, however, would be variable or tiered[37] based on YOS with a maximum match of 5% for those with more than 5 YOS.

While all servicemembers would have the same defined benefit and defined contribution components, the services would have more influence over the gate pay and separation pay elements of this retirement proposal. Rather than establishing gate pay at 10, 15, 20, 25, and 30 year increments, the QRMC would allow the individual services to determine these milestones based on service needs in particular skills. So, for example, the gates for Army infantrymen might be X, Y, and Z, while the gates for Air Force pilots might be A, B, and C.

Similar to this approach, separation pay would be enhanced by adding a multiplier to the formula (Base pay x YOS) but the multiplier would again be established by each service based on its manpower needs. For example, the separation pay multiplier in an "overstrength" career field might be X, but Y in an understrength field.

The 10th QRMC went beyond previous efforts by recommending:

1. The same retirement system for both the active and reserve component. The logic was that this would be consistent with the reserve realignment from a strategic to an operational reserve role.
2. A five-year demonstration project with a limited population sample to further test and refine the retirement proposal. A number of other government agencies have used demonstration projects extensively when preparing to modify compensation systems. For example, the recently terminated National Security Personnel System (NSPS) tested a number of pay plans in different

[35] Report of the Tenth Quadrennial Review of Military Compensation, Volume I: Cash Compensation, February 2008.

[36] Report of the Tenth Quadrennial Review of Military Compensation, Volume II: Deferred and Noncash Compensation, July 2008.

[37] Zero match for less than a year of service, 2% match with up to 2 YOS, 3% for those between 2 and 4 YOS, 4% for those between 4 and 5 YOS and 5% for those with 5 or more years of service.

DOD organizations over a number of years. If adopted following the demonstration project, the currently serving force would be grandfathered.

Table 2 compares the basic aspects of the current retirement system with those recommended by both the DACMC and the 10th QRMC.

Table 2. Comparing the Current System with Recent Administration Proposals

	Current Military Retirement System	DACMC Proposal	10th QRMC Proposal
Defined Contribution (Thrift Savings Plan)	Voluntary participation No matching contributions	Automatic enrollment Government match up to 5% begins immediately Vest between 5 and 10 years After vesting, individual can receive cash or continue TSP contributions	Automatic enrollment Variable government match—maximum of 5% for those with more than 5 YOS Vests at 10 YOS Withdrawals at age 60
Defined Benefit	Vests at 20 Years of Service (YOS) Annuity begins immediately upon retirement	Vests at 10 YOS Annuity begins at age 60	Vests at 10 YOS Payable at age 60 for <20 YOS and age 57 for >20 YOS
Annuity Base	High-3 or REDUX	High-3	High-3
Maximum Years of Service	Up to 40 YOS for selected personnel 2.5% x YOS x High 3	40 YOS 2.5% x YOS x High 3	40 YOS 2.5% x YOS x High 3
Retirement Health Benefit	Vests at 20 YOS	Vests at 20 YOS	
Transition/Separation Pay	For some voluntary and medical separations Pay grade x YOS	Payable after 10 YOS Pay grade x YOS	Base Pay x YOS x Multiplier determined by Service
Gate Pay	None	At 10, 15, 20, 25 and 30 YOS Base Pay x YOS	Milestone YOS determined by Service Base Pay x YOS
Base Pay	No change	Increase	No change
Grandfathered	N/A	Yes, but with option to convert	Yes

Source: Reports of the various commissions and task forces.

New Retirement Reform Proposals

The ongoing economic recession, persistently high unemployment, and the growing national deficit resulted in a number of studies and reports during 2010 and 2011 that focused on reducing the cost of government, including defense. Some of these reports made recommendations concerning the military retirement system. The six most prominent reports (the Quadrennial Defense Review Independent Panel, the Sustainable Defense Task Force, the Defense Business Board, the Debt Reduction Task Force, the National Commission on Fiscal Responsibility and Reform and the President's Plan for Economic Growth and Deficit Reduction) are discussed and reviewed below and incorporated into **Table 3** at the end of this section for comparison.

Quadrennial Defense Review Independent Panel

The Quadrennial Defense Review (QDR) was established by Congress[38] in the 1990s and directed the Secretary of Defense to "conduct a comprehensive examination of the national defense strategy, force structure, force modernization plans, infrastructure, budget plans and other elements of the defense program." The review is required every four years and must encompass the next 20 years. The first QDR was published in 1997.

By 2006, some in Congress felt that the QDR effort had become overly bureaucratic, resulting in a repetitive overview of global threats, explanations and justifications of established decisions, and a general strategic discussion rather than the free-ranging and unconstrained effort that was originally intended. The Senate report on the FY2007 National Defense Authorization Act (NDAA)[39] recommended a "red team"[40] assessment of the DOD QDR with a separate report being submitted to Congress. The "red team" became the "independent panel" as this legislative initiative evolved.[41]

The Independent Panel that reviewed and assessed the 2010 QDR noted that escalating personnel entitlements in the DOD budget foreshadowed a "train wreck"[42] in the areas of personnel, acquisition, and force structure. To address the personnel issues, the Panel recommended establishing a National Commission on Military Personnel similar to the 1970 Gates Commission.[43] This commission would make recommendations to "modernize the military personnel system, including compensation reform; adjust military career progression to allow for longer and more flexible military careers; rebalance the missions of active, guard and reserve, and mobilization forces; reduce overhead and staff duplication; and reform active, reserve, and retired military health care and retirement benefits."[44]

38 Section, 118, Title 10.

39 Section 1083, S.Rept. 109-254, May 9, 2006.

40 In wargaming, the opposing force is frequently referred to as the "Red Team." It's purpose is to reveal weaknesses which can then be eliminated or mitigated. In the corporate context, a Red Team is used to review a nearly final proposal from the perspective of the customer.

41 Section 1031, John Warner National Defense Authorization Act for FY2007, October 17, 2007.

42 "The QDR in Perspective: Meeting America's National Security Needs in the 21st Century," The Final Report of the Quadrennial Defense Review Independent Panel, 2010, p. v.

43 The 1970 Gates Commission was established by President Nixon to evaluate alternatives to the Vietnam-era draft (conscription). The commission unanimously recommended moving to an all-volunteer force and noted three prerequisites necessary for this change: (1) raise military pay, (2) improve the conditions of military service and recruiting and (3) establish a standby draft system.

44 "The QDR in Perspective: Meeting America's National Security Needs in the 21st Century," The Final Report of the Quadrennial Defense Review Independent Panel, 2010, p. xv.

Sustainable Defense Task Force

The Sustainable Defense Task Force was formed based upon a request from four Members of Congress[45] to the Project on Defense Alternatives[46] to "explore possible defense budget contributions to deficit reduction that would not compromise the essential security of the U.S." There were 14 individuals on the task force and their formal report was published on June 11, 2010.[47] The task force provided 19 options that were estimated to save $960 billion between 2011 and 2020.

Three of the 19 proposals discussed personnel costs.

1. Reform military compensation by considering the totality of pay—base pay, the housing allowance, the subsistence allowance, and the tax advantage of these two allowances—when deciding upon future pay raises. Along with gradually reducing the recent growth of the Army and Marine Corps, this option is projected to save $55 billion between 2011 and 2020.
2. Reform DOD's healthcare system by implementing the recommendations of the 10th QRMC for a savings of $60 billion from 2011 to 2020.
3. Reduce recruiting expenditures as wartime demand falls and endstrength begins to come down to save $50 billion over the next 10 years.

A general comment made by the task force was that "we cannot seek to economize on pay and benefits, while also over-using our military personnel."

Defense Business Board (DBB)

The Defense Business Board (DBB) is a Department of Defense (DOD) organization reporting directly to the Secretary of Defense. The board includes a maximum of 25 members and is responsible for providing independent advice and recommendations to improve effectiveness and service delivery based on best business practices. Board members are appointed annually by the Secretary of Defense.

In 2010 the board was tasked with identifying alternatives to reduce DOD's overhead based on Secretary Gates' announced goal of reducing the defense budget by $100 billion over 10 years. Arnold Punaro[48] was selected to chair this task force of DBB members.

The task force submitted its findings in July, 2010. While it made no specific recommendations concerning military retirement, the task force noted that, "numerous studies in recent years conclude that DOD must reform the current military retirement system." The task force

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[45] Representatives Barney Frank, Walter B Jones, Ron Paul, and Senator Ron Wyden.

[46] The Project for Defense Alternatives (PDA), established in 1991, seeks to "adapt security policy to the challenges and opportunities of the post-Cold War era" by creating conditions favorable to regional and global cooperative security.

[47] Report of the Sustainable Defense Task Force, "Debt, Deficits, and Defense: A Way Forward," June 11, 2010.

[48] Mr. Arnold Punaro is a Senior Fellow on the Defense Business Board, a retired Marine Corps Reserve Major General, former Chairman of the Commission on the National Guard and Reserves and former staff director for the Senate Armed Services Committee.

concluded that, "This is a long-term problem that requires discipline and a firm focus on a plan to address the issue over the next 20 years."[49]

A year later, on July 21, 2011, a task group within the Defense Business Board publically released a follow-on briefing on "Modernizing the Military Retirement System."[50] The military retirement system proposed by this task group would eliminate the defined benefit entirely and replace it with a defined contribution plan. The Thrift Savings Plan was noted as the most viable option for a defined contribution program, but TSP would now include automatic enrollment, member contributions, and an annual government contribution. The DOD match would vary depending on circumstances (combat versus noncombat assignments, hardship tours, critical skills, etc.) and the plan would be transportable into the private sector and back into the military. Fully disabled (100%) members would be exempt and would retire under the current disability procedures.

The DBB plan would vest after 3 to 5 years instead of the current 20 years and the plan would be payable at age 60 to 65 (or the Social Security age). There would also be a right of survivorship transferability upon death. There would be no impact on the current military retiree population.

The plan offered two implementation possibilities. The first would grandfather the current force, but new entrants would automatically be enrolled in the defined contribution plan. The second option would transition both currently serving personnel and new entrants but would allow currently serving members to retain a portion of their defined benefit based on their years of service at the transition point.

A more detailed analysis of this proposal is not possible at this time, as only very broad outlines of the proposal were published in the briefing. A full report was expected in August 2011, but the report has still not been released.

Debt Reduction Task Force

The Debt Reduction Task Force was established on January 25, 2010 by the Bipartisan Policy Center to "develop a long-term plan to reduce the debt and place our nation on a sustainable fiscal path." The task force's final report was issued in November, 2010. The task force was headed by co-chairs Pete Domenici, the former chairman of the Senate Budget Committee, and Dr. Alice Rivlin, former vice chair of the Federal Reserve and the former Director of the Office of Management and Budget. There were 19 members on the task force.

The task force's recommendation for military retirement was modeled on the Federal Employees Retirement System (FERS) and the recommendations of the 10th Quadrennial Review of Military Compensation (QRMC). Currently serving servicemembers with less than 15 years of service (YOS) would immediately be integrated into the new retirement plan; only those with more than 15 YOS would be grandfathered under the current retirement system.

[49] "Reducing Overhead and Improving Business Operations: Initial Observations," a briefing by the Defense Business Board, July 22, 2010, with narrative to accompany the briefing. No final report released yet.

[50] Defense Business Board, "Modernizing the Military Retirement System," July 21, 2011. No final report released yet.

The reformed system would retain a defined benefit equal to 2.5% times years of service but the pay base would be High-5 rather than High-3. Retirement pay would begin at age 57 for those with at least 20 years of service and the plan would vest after 10 years.[51]

The task force estimated that from 2020 to 2040, this new system would to save $131 billion.

National Commission on Fiscal Responsibility and Reform

In recognition of the nation's fiscal challenges, the National Commission on Fiscal Responsibility and Reform was established by Presidential Executive Order on February 18, 2010. The commission was tasked with "identifying policies to improve the fiscal situation in the medium term and to achieve fiscal sustainability over the long run" by proposing recommendations designed to balance the budget by 2015. The commission was required to complete its work and issue a final report by December 1, 2010.

The commission was headed by former Senator Alan Simpson and former White House Chief of Staff Erskine Bowles. There were 18 members, most of whom were serving Representatives and Senators from both political parties. The commission's charter required 14 of the 18 members to report out any recommendation.

The commission made only two recommendations concerning military retirement:

1. "Create a federal workforce entitlement task force to re-evaluate ... military retirement programs and recommend savings."[52]
2. Defer Cost of Living Adjustments (COLA) until age 62 and then provide a one-time catch-up.

"Living Within Our Means and Investing in the Future: The President's Plan for Economic Growth and Deficit Reduction"

This report,[53] released by the White House on September 19, 2011, is intended to pay for the American Jobs Act and to realize more than $3 trillion in net deficit reduction over the next 10 years. The recommendations combine program reductions and eliminations with tax increases to achieve the $3 trillion total.

For military retirement, the report recommends a commission being established and tasked to develop reform recommendations. DOD would make a proposal to the commission which can then add or delete provisions as it deems appropriate. It would then be forwarded to the President who can also make changes but must decide whether to forward the recommendations to Congress. If forwarded, Congress must approve or disapprove without any modifications. This procedure is similar to that followed by the 2005 Base Realignment and Closure Commission.

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[51] Debt Reduction Task Force, "Restoring America's Future: Reviving the Economy, Cutting Spending and Debt, and Creating a Simple, Pro-Growth Tax System," November 2010, p. 114.

[52] Report of the National Commission on Fiscal Responsibility and Reform, "The Moment of Truth," December 2010.

[53] Office of Management and Budget, "*Living Within Our Means and Investing in the Future: The President's Plan for Economic Growth and Deficit Reduction,"* September 2011.

The report specifically notes that any recommendations enacted would apply to new entrants only and that military personnel currently serving would be grandfathered.

Table 3 summarizes the primary findings of the various cost reduction panels in 2010 and 2011.

Table 3. New Military Retirement Reform Proposals

Proposal	Recommendations
Quadrennial Defense Review Independent Panel	No specific recommendations concerning military retirement. Recommended a National Commission on Military Personnel that, among other things, would be required to reform active, reserve and retired military healthcare and retirement benefits.
Sustainable Defense Task Force	No comments concerning military retirement Instead, focused on military compensation, healthcare and end strength
Defense Business Board	Eliminate the defined benefit as the primary element of the military retirement system and convert exclusively to a defined contribution plan using the TSP. Matching funds would be used as force management incentives for combat and hardship tours, critical skills, etc. Plan would apply to all active duty and reserve members; disability retirement would be unchanged for those determined to be 100% disabled.
Debt Reduction Task Force	Proposal based on FERS and the 10th QRMC recommendations. Only those with 15 or more YOS would be grandfathered under the current program. All others immediately convert: —Program vests at 10 YOS and retired pay begins at age 57. —Pay calculation is 2.5% x YOS x High-5. Projected to save $131 billion between 2020 and 2040
National Commission on Fiscal Responsibility and Reform	Create a task force to reevaluate the military and civilian retirement programs. Defer COLA increases until age 62 and then provide a "catch-up."
Living Within Our Means and Investing in the Future	Establish a commission to develop recommendations for reforming the military retirement system. Commission would evaluate a proposal from DOD, alter as appropriate, send to the President for forwarding to Congress. Congress must then approve or disapprove without any modifications.

Source: Reports and briefings published by these organizations.

Common Criticisms of the Military Retirement System

Those who advocate reform of the military retirement system generally offer several criticisms of the current system.

Cost

Most of the new, more recent reform proposals have focused on the cost of the military retirement system and specific cost-cutting initiatives. The Defense Business Board stated that the cost of military retirement was "unsustainable" while the Debt Reduction Task Force reform recommendation was projected to save $131 billion between 2020 and 2040. Other reform proposals identified no specific savings target but a number of the participants in these reform studies argued that military retirement is overly generous.

The current DOD retirement system is funded by an accrual accounting system that requires DOD to pay annually into the Military Retirement Fund an amount sufficient to finance future retirement payouts. This annual amount paid into the Fund will earn interest until the funds are distributed to pay future retirees through the General Fund of the Treasury. As noted in **Table 1**, in FY2010 there was a total of $50.842 billion paid to 2,271,000 military retirees and survivors from the Military Retirement Fund within the U.S. Treasury. The actual FY2009 cost to DOD was $17.5 billion (or approximately 2.5% of the annual DOD budget[54]) due to accrual accounting. By comparison, in FY2010 there was a total of $69.2[55] billion paid to 2,479,276 Civil Service retirees and survivors.[56]

Two of the most significant determinants of the cost of future military retirement are the basic pay received while on active duty and the annual Cost of Living Allowance (COLA) which is received after retirement.[57] Basic pay is a primary factor in all of the formulas for determining retired pay. As basic pay increases, the cost of future retirement also increases. Over the past 10 years, basic pay has increased by nearly 37%[58] in part to offset inflation and in part to increase the attractiveness of military service during continued combat operations in Iraq and Afghanistan. These increases will be reflected in higher retired pay in the future.

The military retired pay COLA has been inflation-protected since 1986 and indexed to increases in the CPI, a system similar to the inflation protection provided to Social Security recipients.

[54] The DOD contribution in FY2009 was $17.5 billion and the total DOD budget (including Overseas Contingency Operations) was $693.6 billion. The FY2010 DOD contribution will be included in "Valuation of the Military Retirement System, which should be released in December 2011 by the DOD Office of the Actuary.

[55] Office of Personnel Management, "Annual Report of the Civil Service Retirement and Disability Fund-FY2010," 2011, Washington, DC.

[56] Office of Personnel Management, "Statistical Abstracts FY 2010: Federal Employee Benefit Programs," 2011, Washington, DC.

[57] For detailed information on military pay raises, see CRS Report RL33446, *Military Pay and Benefits: Key Questions and Answers*, by (name redacted).

[58] From 2002 to 2011, the actual increase was 36.85%. Since 2005 the military pay raise has been indexed to the Employment Cost Index (ECI) (37 U.S.C. 1009) but Congress has frequently approved a pay raise that was 0.5% above the ECI.

Since 2002, COLA has increased by nearly 21.7% for those retired under the Final Pay and High-3 systems (1% less annually for those retired under the Redux system).

Another aspect of the cost issue is the fact that military retirees begin receiving their monthly retirement annuity immediately, regardless of age. The average enlisted member is 42 years old and has 22 ½ years of service at retirement while the average officer is almost 45 years old and has nearly 24 years of service.[59] In contrast, other public and private sector retirement plans typically do not begin providing an annuity until age 55, 60, or 65, although the age is often lower for those in 'high risk" public sector jobs such as firefighting and law enforcement.

Most servicemembers retire with a spouse and several children at a time when their children are usually in high school or beginning college. So even though "retired" and receiving retired pay, a second public or private-sector career is usually essential. For example, a retired E-7 who retired at 20 years of service on January 1, 2010 under the High-3 option will receive $1,921 a month or $23,052 a year.

Equity

Retirement reform initiatives have noted that the 20-year vesting rule is "inequitable" because it provides benefits in an "all or nothing" manner; those who complete 20 or more years are fully vested in a retirement annuity while those who separate voluntarily or involuntarily before 20 years of service usually receive no retirement benefit.[60] Current and previous studies have recommended different vesting formulas from 5 years (to be consistent with many private-sector pension plans) to 10 or 15 years. Others have recommended some type of transition or separation pay as either a deferred annuity or as a lump sum payment. However, the 20-year vesting rule has been maintained.

Some observers also note that a 20-year retirement encourages relatively short military careers during a time of lengthening life spans and longer careers in the private sector. These observers disagree with the military's emphasis on youth and vigor. To gain perspective on whether a 20-year career and immediate receipt of retired pay is appropriate, it may be useful to compare it with other "hazardous" or "arduous" occupations.

One possible comparison is with federal law enforcement professionals, fire fighters, air traffic controllers, and nuclear waste management personnel. These federal employees become eligible for an immediate annuity after 25 years of service which compares favorably with the military eligibility requirement of 20 YOS. As a result, most of these special category federal employees are also under the age of 55 at retirement. **Table 4** compares the FERS retirement requirements with the requirements for these special category personnel and the current military retirement system.

[59] Department of Defense, "Fiscal Year 2009 DOD Statistical Report on the Military Retirement System," Office of the Actuary, May 2008, p. 120.

[60] An exception would include the Temporary Early Retirement Authority (TERA) used during the post-Cold War drawdown. TERA allowed selected personnel to voluntarily retire between 15 and 20 years of service but with a 1% penalty for every year less than 20.

Table 4. Comparison of Civil Service, Law Enforcement and Military Retirement

	FERS	Federal Law Enforcement[a]	Current Military Retirement
Maximum Entry Age	None	37	42
Voluntary Retirement Age	55 w/30 YOS[b] 60 w/25 YOS 62 w/5YOS	Any age after 25 YOS	Any age after completing 20 YOS
Mandatory Retirement Age	None	Age 57	Age 62
Retirement Benefit Accrual	1.0% for each year of service	1.7% for each year of service up to 20 YOS and 1% per year thereafter	2.5% per year of service[c]
TSP Participation	Yes, with match up to 5%	Yes, with match up to 5%	Yes, but no match

Source: Various.

a. This category includes federal law enforcement officers, fire fighters, air traffic controllers, and nuclear waste management personnel under the FERS system.

b. YOS is the abbreviation for "Years of Service."

c. Applies to High-3 only.

Another aspect of the "youth and vigor" argument involves the health concerns as the military population ages. The military has emphasized youth, vigor and physical fitness since before WWII. However, today's force is somewhat older because its all-volunteer and more heavily reliant on the reserve component. In 2010, 62% of the active duty force was 25 years old or older and 37% was 30 or above.[61] Statistics from ten years of U.S. combat operations in Iraq and Afghanistan confirm that older servicemembers are more vulnerable to injuries and more likely to face long recoveries. [62] According to many experts, youth and vigor remain important, so retirement eligibility at 20 YOS may still be the most appropriate approach.

Civilian Comparability

Comparability concerns generally focus on the fact that the military retirement system remains primarily a defined benefit program but with the opportunity to voluntarily participate in a tax-deferred savings plan. This is unlike many private-sector employers who have reduced or eliminated their reliance on defined benefit programs and have focused almost exclusively on 401(K)-type programs, along with some level of employer matching contributions, for their employees. These 401(K) plans, however, were never meant to be the primary option for private

[61] Laura Ungar, "Aging Warriors," Louisville Courier-Journal, May 15, 2011.

[62] Laura Ungar, "Aging Warriors: As Military Grows Older, Injuries Increase and Treatment Proves Costly," Louisville Courier-Journal, May 15, 2011.

retirement benefits, sometimes have high fees and produce unpredictable returns,[63] especially in the recent economic downturns.

The FERS civil service retirement, introduced in 1984, includes both a defined benefit and a defined contribution component to include matching funds up to 5% through the TSP. Military participants in the TSP have a very limited opportunity to take advantage of matching funds; there is a provision that allows a military Service Secretary to authorize matching contributions for members who reenlist in a critical skill for at least six years.[64]

The National Defense Authorization Act of 2000,[65] while modifying the Redux retirement system to include the $30,000 Career Status Bonus, also extended participation in the TSP to military personnel. Members can contribute from 1% to 9% of their basic pay, before taxes, and up to 100% of any special incentive pays or bonuses, up to Internal Revenue Service annual limits. For those deployed to combat operations, the contribution limit is $49,000 per year. Contributions and earnings are taxed upon withdrawal. Participation in TSP is optional and there is no provision for automatic enrollment.

Even without a matching option, the TSP has proven to be very popular investment opportunity with servicemembers—over 600,000 active and reserve component members had enrolled by 2009.[66] Participation by officers is higher than enlisted members and participation by the active component is greater than the reserve component possibly because reserve component members may have better investment opportunities with their civilian employers. These trends are reflected in **Table 5**.

Table 5. TSP Participation Rates By Officer/Enlisted and Component

(As of August 2009)

	Participation Percentage			
	Army	Navy	Air Force	Marine Corps
Active Duty – Officer	39.5%	49.4%	48.3%	47.7%
Active Duty – Enlisted	21.8%	52.4%	30.6%	36.2%
Reserve/National Guard Officer	21.4% / 28.2%	13.8%	29.5%	31.7%
Reserve/National Guard Enlisted	10.8% / 13.3%	11.5%	23.7%	26.6%

Source: Department of Defense.

TSP participation by junior officer and enlisted personnel, who have lower incomes and may be less focused on retirement, is lower than more senior personnel who are committed to a military career and retirement. These trends are reflected in the data in **Table 6** and **Table 7**.

63 Robert Hiltonsmith, "Cuts, Fees Can Drain Even the Best Retirement Plans," Politico, December 17, 2010.

64 Section 662, P.L. 106-65, October 5, 1999.

65 Section 661, P.L. 106-65, October 5, 1999.

66 Secretary of Defense Report to Congress, "Cost and Impact on Recruiting and Retention of Providing Thrift Savings Plan Matching Contributions," February 2010.

Table 6. Percentage of TSP Participation, Active Component Enlisted Personnel

(As of August 2009)

	Army Enlisted	USAF Enlisted	Navy Enlisted	USMC Enlisted
E1	11.3%	2.8%	33.3%	11.0%
E2	19.5%	9.6%	52.8%	24.1%
E3	22.0%	18.1%	57.5%	34.9%
E4	15.3%	27.4%	60.8%	44.0%
E5	20.1%	36.6%	54.8%	43.2%
E6	28.6%	40.8%	46.7%	42.3%
E7	32.1%	38.7%	44.6%	44.5%
E8	31.8%	41.0%	40.4%	42.7%
E9	30.5%	38.9%	38.1%	36.0%

Source: Department of Defense.

Table 7. Percentage of TSP Participation, Active Component Officer Personnel

	Army Officer	USAF Officer	Navy Officer	USMC Officer
O1	22.2%	18.6%	31.5%	20.9%
O2	30.8%	35.7%	40.3%	39.2%
O3	39.2%	47.9%	49.1%	56.5%
O4	46.4%	55.8%	55.5%	57.1%
O5	48.3%	60.0%	59.6%	56.4%
O6	51.1%	60.4%	58.1%	56.6%

Source: Department of Defense.

Congress recently required DOD[67] to assess the cost of a new proposal to provide matching TSP contributions to all military personnel. Using a 4% match (rather than the 5% allowed under FERS) and assuming 100% enrollment with all personnel contributing a minimum of 5%, DOD estimated the annual cost at $2.8 billion.[68] In the current fiscal environment, this may be prohibitively expensive unless there were other major modifications to military retirement that reduced cost.

Force Management

Manning the force with the right number of personnel with the right skills and the right seniority is the primary goal of the various pays, incentives, and bonuses, which include the retention

[67] Section 110, P.L. 111-31, June 22, 2009.

[68] Secretary of Defense Report to Congress, "Cost and Impact on Recruiting and Retention of Providing Thrift Savings Plan Matching Contributions," February 2010.

incentive associated with the military retirement system. Critics of the current retirement system have argued that it lacks the flexibility to

1. Provide benefits to those who serve less than 20 years, either voluntarily or involuntarily.
2. Provide incentives that vary by position, skill or job description.

To address these perceived shortcomings, previous studies have recommended potential solutions ranging from retired or severance pay for involuntary separation, to deferred annuities that would not begin until age 60, to 10-year vesting, to separation pay incentives for those in "over strength" skills.

It should be noted that Congress did provide Temporary Early Retirement Authority (TERA)[69] as a flexible management tool during the military drawdown of the early to mid-1990s. Servicemembers with 15 to 20 years of service could apply for early retirement with their retired pay being reduced by 1% for every year of service less than 20 years. This program allowed for the targeted retirement of those at specific grades and with specific skills. The authority was originally limited to1992 through 1995 but was later extended to 1999. Early retirement was a popular drawdown incentive that permitted servicemembers to receive a retirement annuity for less than 20 years of service and retain the other military benefits associated with retirement.

Possible Options for Congress

Maintain Status Quo

Congress could determine that the current military retirement system, primarily the High-3, is the most appropriate method of meeting the retention requirements of an all-volunteer force and retain the current system.

Consider a Retirement System Similar to that Recommended by the Quadrennial Review of Military Compensation (QRMC)

Using the work of the DACMC and the QRMC to establish the foundation of a reformed retirement system, other options could be added or deleted to reduce costs or provide additional incentives. The resulting hybrid system could provide enhanced flexibility for force managers to retain personnel in critical skill areas, unconstrained by the current 20-year "all or nothing" system. It could also introduce a contributory element, the Thrift Savings Plan, which has already proven popular with military personnel.

With the framework established, Congress could authorize DOD to conduct a multiyear demonstration project prior to implementing the new system force-wide. If the demonstration is successful, it could be implemented for all new entrants and offered to currently serving members who otherwise are limited to Redux or the High-3.

[69] Section 4403, P.L. 102-484, October 23, 1992.

Establish a National Commission on Military Personnel

Congress could establish a National Commission on Military Personnel—one of the recommendations made by the Quadrennial Defense Review Independent Panel. The Panel found that the complementary relationship between pay, bonuses, allowances, incentives, retirement, healthcare, and deferred and in-kind benefits resulted in a cost to DOD that was unsustainable for the future and required a separate review process.

Specifically, the Panel recommended the following areas to be addressed by the Commission:

- Compensation reform
  - “Continuum-of-service” issues such as promotion, professional development, career length and retirement age
- The active-reserve force mix
- Active, reserve, and retired healthcare and retiree benefits
- Reduction of the numbers and composition of headquarters and staffs

The Panel felt that a Commission could complete this effort in a year.

Alternatively, as recommended in The President’s Plan for Economic Growth and Deficit Reduction,[70] Congress could set up a commission to develop recommendations for reforming the current system. The commission would receive input from DOD, alter this proposal as appropriate and forward to the President for approval and release. The President, if concurring with the Commission’s recommendations, would then forward it to Congress. Congress would be required to approve or disapprove without modification.

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[70] Office of Management and Budget, “Living Within Our Means and Investing in the Future,” p. 21, September 2011.