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## A SUMMARY OF MAJOR MILITARY RETIREMENT REFORM PROPOSALS, 1976–2006

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## PREFACE

This report summarizes substantive proposals to restructure the U.S. military retirement system, resulting from major U.S. Department of Defense–sponsored studies over the 1976–2006 period, including proposals from the 1976 Defense Manpower Commission, the 1978 President’s Commission on Military Compensation, the 1984 Fifth Quadrennial Review of Military Compensation, the 1988 Sixth Quadrennial Review of Military Compensation, and the 2006 Defense Advisory Commission on Military Compensation. In addition, two comparative charts appended to this report summarize the key features of the various reform proposals since 1948, including the five major studies examined in this report. Although most of the major studies on military retirement reform examine military compensation issues in general, this report focuses on the key features of the five major military retirement reform proposals, eliminating the discussions of methodology, modeling, cost analyses, and cost projections that accompany them.

**LIST OF ABBREVIATIONS AND ACRONYMS**

BAH—Basic Allowance for Housing

COLA—cost-of-living adjustment

CPI—Consumer Price Index

DACMC—Defense Advisory Commission on Military Compensation

DMC—Defense Manpower Commission

DMDC—Defense Manpower Data Center

DoD—Department of Defense

ERISA—Employee Retirement Income Security Act

GAO—General Accounting Office

Hi-3—Average of the highest three years of annual basic pay, used in the calculation of the military retirement annuity.

IAC—Interagency Committee

LMI—Logistics Management Institute

NCP—normal cost percentage

PCMC—President’s Commission on Military Compensation (Zwick Commission)

QRMC—Quadrennial Review of Military Compensation

RCSS—Reserve Compensation System Study

Redux—Military Retirement Reform Act of 1986

RSFPP—Retired Serviceman’s Family Protection Plan

SBP—Survivor Benefit Plan

TRICARE—the military health care program (formerly CHAMPUS)

TSP—Thrift Savings Plan

USRBA—Uniformed Services Retirement Benefits Act

VA—Veterans Administration

VHA—Variable Housing Allowance

YOS—year(s) of service

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## EXECUTIVE SUMMARY

The military retirement system comprises three separate retirement components: regular nondisability, reserve nondisability, and disability. Despite various modifications over the past several decades, the basic structure of the system remains the same. An individual who separates with at least 20 years of service (YOS) receives an immediate lifetime monthly annuity, regardless of age, based on a percentage of his or her retired pay computation base. A service member separating with fewer than 20 YOS receives nothing, unless he or she serves long enough in a reserve component to qualify for the reserve retirement benefit that begins at age 60. The annuity is equal to 2.5 percent of the average of the member's three highest years of basic pay (Hi-3) for each year served up to 30 YOS. Service beyond 30 years does not contribute to the amount of retirement annuity. Although the original intent underlying nondisability retirement was compensation for service extending beyond 30 years, eligibility for retirement is set at 20 YOS.<sup>1</sup>

Since its implementation in the late 1940s, the basic system, especially the 20-year retirement paradigm, has been the subject of intense criticism and equally intense support among military personnel, politicians, and defense manpower analysts. In the view of the general public, the two most salient aspects of the system are its cost and the relatively young age of military retirement.<sup>2</sup> Some critics charge that it is unfair for members separating at 20 YOS to receive a lifetime retirement annuity, while the vast majority of military service members who serve for shorter periods receive no retirement benefits; only about 30 to 40 percent of officer entrants and 10 to 15 percent of enlisted entrants will stay for a full 20-year career and receive benefits. Some analysts argue that the military should be included in the early vesting requirements of the Employee Retirement Income Security Act (ERISA). ERISA, the federal law requiring private-sector employers to vest employees in their retirement systems after five YOS, in most cases, does not currently apply to the military. Other critics, recognizing the political infeasibility of eliminating the military retirement system altogether, support a far less generous system, similar

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<sup>1</sup> As noted in "Appendix E, Mobilization Aspects of the U.S. Military Retirement System," in U.S. Department of Defense, Office of the Secretary of Defense, *Fifth Quadrennial Review of Military Compensation*, vol. 1A, *Supporting Appendixes to Uniformed Services Retirement System (A–G) F* (Washington, DC, January 1984), E33.

<sup>2</sup> In FY 2006, total federal budget outlays for military retirement were an estimated \$40.9 billion, and Department of Defense budget outlays were an estimated \$13.1 billion, according to Charles A. Henning, *Military Retirement: Major Legislative Issues*, CRS Issue Brief for Congress, Washington, DC, Library of Congress, Congressional Research Service, March 14, 2006, CRS–1.



to the type ERISA mandates for the private sector. Still others argue that the 20-year military career is essential to maintaining a high-quality career force capable of meeting wartime requirements.

Critics also charge that the military retirement system is inefficient and inhibits force-management flexibility. The services are well aware of the financial costs imposed on mid-careerists involuntarily separated before the 20-year vesting point. As a result, beyond a certain grade or YOS, their superior officers treat personnel as if they have an implicit contract. The services are reluctant to separate all but the poorest performers because of the negative effect of involuntary separation on morale. These implicit contracts limit the range of experience distributions in the services. The structure of the “desired” force—that is, the force profile modeled by the Department of Defense (DoD) on the premise that many members will be retained to 20 years and lost shortly thereafter—reflects the actual retention patterns resulting from the current compensation system. In actuality, the desired force, influenced and constrained by the current retirement system, differs significantly from one based on job-determined requirements.

The nondisability retirement system has been modified repeatedly over the decades to attract and retain qualified personnel and to provide a socially acceptable means to separate personnel in the interest of maintaining a youthful and vigorous military establishment. The major studies summarized in this report—the Defense Manpower Commission (1976), the President’s Commission on Military Compensation (1978), the Fifth Quadrennial Review of Military Compensation (retirement, 1982), the Sixth Quadrennial Review of Military Compensation (1988), and the Defense Advisory Commission on Military Compensation (2006)—propose the following adjustments to the service retirement system:

- Multiple year, high-three (Hi-3) averaging of basic pay for retired pay
- Modified multiplier for YOS
- Pre-30 YOS (early retirement) retired-pay adjustment
- Cost-of-living-adjustment (COLA) indexing
- Changes in vesting
- Coordination with social security
- Member contributions
- Combinations of these adjustments

The most recent proposal of the Defense Advisory Commission on Military Compensation (DACMC) in April 2006 borrowed from the President's Commission on Military Compensation (PCMC) of 1978, recommending a defined benefit pension beginning at age 60, in keeping with the reserve pension benefit. Thus, the DACMC's proposal eliminates the traditional immediate annuity at 20 YOS and the current all-or-nothing cliff vesting, instead allowing earlier vesting beginning at 10 YOS. Also like the PCMC, DACMC proposes a cash transition fund similar to the Thrift Savings Plan (TSP), with annual government contributions of about 5 percent of basic pay per year.

## **EVOLUTION OF THE MILITARY RETIREMENT REFORM ISSUE**

### **Introduction**

The military retirement system provides retirement benefits after an active or reserve military career,<sup>3</sup> for disability retirement, and for eligible survivors of deceased retirees. Physical disability retirement benefits, like nondisability retirement benefits, are based on a percentage of disability and/or YOS. In general, the same standards for disability retirement apply to all military members whether regular or reserve, officer or enlisted. The military may retire a member from active duty for physical disability if the service determines that the individual is physically unfit to perform the duties of the grade or office.

Of the total number of individuals retiring each year, the retired disabled and reserves account for a negligible number in comparison with the far larger nondisability group. With the exception of the Defense Manpower Commission study (1976), the post-1976 studies on military retirement reform do not focus on disability retirement, which has provisions with numerous similarities to nondisability retirement. Although disability retirement issues have received relatively little attention in the major studies on military retirement reform since 1976, the most controversial issue in legislative activity regarding military retirement reform in 2006 was whether military retirees should receive both military retired pay and their entitled Veterans Administration (VA) disability compensation. The simultaneous receipt of two types of benefits is known as concurrent receipt. Until 2004, military retired pay was to be reduced by the amount

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<sup>3</sup> In contrast to most foreign countries, the United States provides retirement benefits for reservists. Reservists and National Guard members who complete 20 creditable YOS for retirement purposes may become eligible to receive retired pay at age 60.

of VA disability compensation. Major arguments in favor of concurrent receipt reason that military retired pay is earned for length of service and VA compensation for disability and further, that VA disability compensation beneficiaries are entitled to other federal benefits and should also be entitled to military retired pay. Major arguments against concurrent receipt object to its additional cost (an estimated \$5 billion annually). Analysts warn that permitting concurrent receipt sets a precedent for reducing or eliminating similar offsets of federal payments, possibly costing billions of dollars, and that it means a significant increase in the cost of VA disability compensation.<sup>4</sup>

The fiscal year (FY) 2004 National Defense Authorization Act (NDAA), Pub.L.No. 108–136, provided, for the first time, concurrent receipt to large numbers of military retirees. The law, effective January 1, 2004:

- authorizes the payment of Combat Related Special Compensation (CRSC) to all otherwise eligible military retirees, regardless of their percentage of disability;
- authorizes a 10-year phase-in of concurrent receipt for all military retirees whose disability is 50 percent or greater, regardless of the origins of their disability; and
- includes hitherto almost completely excluded reserve retirees.<sup>5</sup>

The cumulative laws, regulations, and administrative procedures governing the components of the military retirement system are lengthy, detailed, and complex and more than a dozen official studies on reforming military retirement have been done since 1948. This report focuses only on the five major studies published during the 1976–2006 period. Charts in the Appendix offer a snapshot comparison of key features of military retirement reform proposals since 1948. Pre-1976 studies recommended maintaining the 20-YOS retirement system. The First Quadrennial Review of Military Compensation (First QRMC), Interagency Committee (IAC), and the Retirement Modernization Act (RMA) all preserved the basic structure of the existing system, continuing existing provisions for the lifetime annuity after 20 YOS. These pre-1976 studies attempted to accommodate three different goals of the military retirement system: to provide adequate income in old age; to provide an income supplement to assist transition to a civilian job; and to provide an attractive incentive to stay on active duty. These studies

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<sup>4</sup> Robert L. Goldich, “Military Retirement,” chapter 5 in *Military Pay, Benefits and Retirement*, edited by John V. Lund (New York: Nova Science Publishers, 2004), 83–84.

<sup>5</sup> Henning, *Military Retirement*, CRS–9; Goldich, “Military Retirement,” 61–62, 75–84; and Pub.L.No. 108–136, National Defense Authorization Act for Fiscal Year 2004, 117 Stat. 1392, November 24, 2003.

recommended a two-step annuity in which a lower annuity is provided for a period after leaving active duty, followed by an increased annuity at an older age.<sup>6</sup>

## **Key Features of Major Changes and Proposed Reforms**

### ***Defense Manpower Commission (DMC)***

Congress mandated the Defense Manpower Commission (DMC) to study a wide range of defense issues, including compensation, during 1974–76. The DMC recommended several major changes to the uniformed services compensation system, including conversion to a salary system and a significantly revised retirement system. The DMC recommendations redefined career personnel as those with 10 or more YOS, defining a full career as 30 YOS, except for some combat members. Hence, the DMC proposed eliminating 20-YOS retirement for most members. Except for combat members, the DMC proposal does not provide assistance for transition to a civilian job for those leaving with fewer than 30 YOS.<sup>7</sup> No compensation changes resulted from the DMC's study.

### ***Reserve Compensation System Study (RCSS)***

The Reserve Compensation System Study (RCSS), from October 1976 through June 1978, provided an extensive review of the reserve retirement system; it was completed at a time of greater concern with recruitment and early attrition than with retention. The RCSS concluded that, for reserve forces, there should be greater emphasis on current compensation than on deferred compensation; that the need for a retirement system for reserve members was much less apparent than for active-force members; and that reserve retirement was too costly, fostering an aging force and lacking comprehensive planning and control relative to manpower force effects and retirement costs. The RCSS developed two preferred alternative reserve compensation systems. The first alternative compensation system included a number of modifications to reserve retirement, the cumulative effect projecting annuity reductions in the range of 20 to 35 percent. No retirement system was included in the second compensation alternative. In place of

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<sup>6</sup> President's Commission on Military Compensation (PCMC), *Report of the President's Commission on Military Compensation* (Washington, DC: GPO, April 1978), 191.

<sup>7</sup> *Report of the President's Commission on Military Compensation*, 192.

retirement, the RCSS proposed a reserve career bonus, structured to provide an incentive for continued service through 30 years.<sup>8</sup>

### ***President’s Commission on Military Compensation (PCMC)***

The President’s Commission on Military Compensation (PCMC, also known as the Zwick Commission, 1977–78, was established to review all recently completed studies affecting service compensation done by the Quadrennial Reviews of Military Compensation (QRMCs) since the late 1960s, the study of the Interagency Committee (IAC) in 1971, the study of the Defense Manpower Commission (DMC) in 1976, as well as an unspecified study by the General Accounting Office (GAO). The PCMC recommended against a salary system and against a formal comparability standard for setting pay levels. It proposed a form of pay reallocation from the pay line (annual pay issues resulting from civil service linkage) into special and incentive pays to solve manning problems, and a new, noncontributory, three-part, mandatory retirement plan. The PCMC also recommended an early form of the current variable housing allowance (VHA) and longevity pay based either on time-in-grade or time-in-service. The Department of Defense refined the PCMC retirement proposal and submitted to Congress the Uniformed Services Retirement Benefits Act (USRBA) in 1979, but Congress took no action.

### ***Major Reforms of the Early 1980s***

The military retirement system underwent major reforms in the 1980s. By adopting the Defense Officer Personnel Management Act (DOPMA) of 1980 (Pub.L.No. 96–513),<sup>9</sup> Congress set out to provide unified retirement authority to make the career expectations of members more “clearly defined and uniform...across the services.” Before adoption of the Military Personnel and Compensation Amendments of 1980 (Pub.L.No. 96–343),<sup>10</sup> only regular enlisted members of the army and air force could retire with immediate retired pay after completion of 20 or more years of active service. Although army and air force reserve enlisted members could, in fact, retire on completion of 20 years of active service, they were not eligible for retired pay until 60

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<sup>8</sup> U.S. Department of Defense, Office of the Secretary of Defense, *Sixth Quadrennial Review of Military Compensation*, vol. 1B, *National Guard and Reserve Retirement* (Washington, DC, August 1988), xxv.

<sup>9</sup> Added Pub.L.No. 96–513, title I, Sec. 103, Dec. 12, 1980, 94 Stat. 2841; amended Pub.L.No 102–190, div. A, title XI, Sec. 1131(1)(A), Dec. 5, 1991, 105 Stat. 1505.

<sup>10</sup> Pub.L.No. 96–343, 9 (a) (1), 94 Stat. 1128, 10 U.S.C. 3914, September 8, 1980.

years of age. In contrast, enlisted members of the navy and marine corps reserve components could retire after 20 years of active service with immediate retired pay. To remedy this disparity in treatment, and to address disincentives to army and air force reserve enlistment, Congress, in the 1980 Military Personnel and Compensation Amendments, authorized 20-year retirement, with entitlement to immediate retired pay, for army and air force reserve enlisted members.

The Department of Defense Authorization Act, 1981, Pub.L.No. 96–342, instituted the first major change in the method of computing retired or retainer pay entitlements since the uniform voluntary retirement authority was adopted for officers of all service branches more than three decades earlier.<sup>11</sup> Under the 1981 act, the retired or retainer pay of any service member who first became a member on or after the date of enactment of the act is computed on the basis of the member's monthly retired pay base, or monthly retainer pay base, as applicable, rather than on the basis of the member's terminal basic pay. In practice, a member's monthly retired or retainer pay base is an average of the member's highest three years of basic pay (Hi-3). In 1980, in the Department of Defense Authorization Act, 1981, Congress further amended the COLA by providing that future COLAs should be made only once a year, at the same time that civil service retirement annuities were adjusted, and by the same amount.

In the early 1980s, the uniformed services retirement system included the following key provisions:

- Nondisability retirement after 20 YOS
- Disability retirement (with similar provisions) for active-duty members and members on active duty for training who were determined unfit to perform the duties of their office or grade because of a physical disability
- Reserve component retirement (with parallel but not exact provisions)
- No contributions by members of the uniformed services and no retirement trust fund (change effective FY1985)
- No vesting or retirement benefits before 20 creditable YOS except in the case of retirees eligible for disability
- Recall authority, limitation on postservice activity, retention of military status, and subjection to the Uniform Code of Military Justice
- Optional contributory survivor benefit protection through retired pay reductions for retirees and retirement-eligible reservists

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<sup>11</sup> Pub.L.No. 96–342, Department of Defense Authorization Act, 1981, 94 Stat. 1077, September 18, 1980.

- Integration with VA benefits and other federal service benefits
- COLA protection for both retired pay and survivor annuities<sup>12</sup>

Members of the uniformed services not meeting the prerequisites for an immediate annuity did not vest. However, a system of nondisability and disability severance made a lump-sum payment to certain members involuntarily discharged short of retirement eligibility. The system of severance payment, designed to assist former service members in readjusting to civilian life, was separate from the retirement system, yet clearly integrated in terms of eligibility criteria.<sup>13</sup>

### ***Grace Commission***

The President's Private Sector Survey on Cost Control (1983), also known as the Grace Commission for its chairman J. Peter Grace, was created to identify federal-sector opportunities where executive action or legislation could be used to increase efficiency and reduce costs. The Grace Commission identified federal retirement programs, specifically including the uniformed services retirement system, for substantial cost savings. It also proposed alternatives formulated solely on the basis of cost savings rather than on uniformed services manpower force requirements.

### ***Fifth Quadrennial Review of Military Compensation (Fifth QRMC)***

Nine studies of the uniformed services retirement system over a 35-year period preceded the retirement study of the Fifth Quadrennial Review of Military Compensation of 1982–84 (Fifth QRMC). In all cases, the earlier studies proposed to reduce benefits, suggesting that the existing system had become too expensive.<sup>14</sup> Criticism focused on general aspects of the system, such as the early retirement age with full benefits, full protection from inflation through adjustments using the consumer price index (CPI), the system's noncontributory nature, possible inequities to persons separating, and lack of coordination with social security.<sup>15</sup>

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<sup>12</sup> *Fifth Quadrennial Review of Military Compensation*, vol. 1, IV–1.

<sup>13</sup> *Fifth Quadrennial Review of Military Compensation*, vol. 1, VI–1.

<sup>14</sup> *Fifth Quadrennial Review of Military Compensation*, vol. 1, I–3, I–4.

<sup>15</sup> *Fifth Quadrennial Review of Military Compensation*, vol. 1, I–2.

In its detailed analysis of the uniformed services retirement system, the Fifth QRMC disagreed with a number of the proposed features of earlier studies. In particular, the Fifth QRMC found that the Grace Commission’s findings and recommendations failed to support national security objectives or to offer improved capability for the retirement system to meet defense requirements. On the contrary, the Fifth QRMC concluded that the Grace Commission’s “proposed changes would cause immediate recruiting and retention disincentives” and “would potentially lead to an immediate unacceptable degradation of middle and senior management, in terms of both numbers and quality.”<sup>16</sup> Therefore, the Fifth QRMC recommended that the uniformed services retirement proposals of the Grace Commission be disregarded. The Fifth QRMC found further that “none of the previous studies satisfactorily analyzed the impact of their proposed modifications on the service manpower requirements.” Thus, the Fifth QRMC considered a key objective of a reformed retirement system was achieving defense requirements. To that end, the Fifth QRMC used a requirements-based methodology and an analytical approach focusing on force structure.<sup>17</sup> Although the Fifth QRMC did not undertake a comprehensive study of reserve retirements, it validated many RCSS conclusions, for example, that reserve retirement resulted in a high flow of officers and a low flow of enlisted members to retirement.

### ***Military Retirement Reform Act of 1986 (Redux)***

The Military Retirement Reform Act of 1986, Pub.L.No. 99–348, also known as Redux, enacted cuts in retired pay for future retirees.<sup>18</sup> Redux is not a military retirement reform proposal or study, but its principles shaped the current military retirement system. Redux implemented at least three important changes to the structure of the military retirement system, including

- reducing substantially the benefits for those separating at 20 YOS,
- raising the growth in retired pay for each year served after 20 YOS, and
- reducing the real value of the stream of retired pay in an inflationary environment.<sup>19</sup>

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<sup>16</sup> *Fifth Quadrennial Review of Military Compensation*, vol. 1, I–27.

<sup>17</sup> *Fifth Quadrennial Review of Military Compensation*, vol. 1, I–3, I–4.

<sup>18</sup> Pub.L.No. 99–348, Military Retirement Reform Act of 1986, 100 Stat. 682, July 1, 1986.

<sup>19</sup> Henning, *Military Retirement*.



Under Redux, according to congressional analyst Charles A. Henning, “all military personnel who first entered military service *before* August 1, 1986, have their retired pay computed at the rate of 2.5 percent of the retired pay computation base for each YOS. The minimum amount of retired pay to which a member is entitled to compute his or her retired pay under this formula is therefore 50 percent of the retired pay computation base (20 YOS x 2.5 percent),” and “the maximum, reached at the 30-year mark, is 75 percent of the computation base (30 YOS x 2.5 percent). Personnel who first entered service *on or after* August 1, 1986, are required to select one or two options in calculating their retired pay within 180 days of reaching 15 YOS.” These options have different COLA calculations.<sup>20</sup>

The Redux formula greatly favored the longer-serving military careerist, providing an incentive to remain on active duty longer before retiring. Specifically, Redux altered the previous formula using two computational methods:

- Retired pay for retirees under age 62 would be computed at the rate of 2.0 percent of the retired pay computation base for each YOS through 20, 3.5 percent for each YOS from 21 to 30.
- Retired pay for retirees who reach age 62 would be recomputed based on the old formula (2.5 percent of the retired pay computation base for each YOS).

Accordingly, retired pay would range between 40 percent of Hi-3 average basic pay at 20 YOS and 75 percent of Hi-3 basic pay at 30 YOS. Moreover, rather than indexing retired pay for inflation, the annual COLA between separation and age 62 would be 1 percent less than the percentage growth in the CPI. At age 62, retired pay would then be fully adjusted for the CPI growth since separation. But thereafter, retired pay would increase, again, according to the CPI minus 1 percent rule.<sup>21</sup>

Under the Redux formula, therefore, a 30-year retiree would continue to receive 75 percent of the retired pay computation base [(20 YOS x 2.0 percent) + (10 YOS x 3.5 percent)]. Beginning at age 62, the 20-year retiree receiving 40 percent of the computation base for monthly retired pay (20 YOS x 2.0 percent) would begin receiving 50 percent of his or her original computation base; the 25-year retiree’s annuity would jump from 57.5 percent of the

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<sup>20</sup> Henning, *Military Retirement*, CRS–3.

<sup>21</sup> Henning, *Military Retirement*, CRS–3.

original computation base to 62.5 percent; and the 30-year retiree’s annuity, already at 75 percent of the original computation base under both the old and new formulas, would remain the same.<sup>22</sup>

Redux’s structural changes served to quiet some criticism of the 20-year system. These changes partially answered the criticism that the retirement system is too costly. By the mid-1990s, Redux had reduced the DoD’s annual accrual charge by more than one-third compared with the pre-1980 system. Redux also provided a much stronger incentive to remain in service beyond the 20-year point. Redux thus mitigated the criticism that personnel were retiring at excessively young ages. Moreover, Redux’s enhanced post-20 YOS retention incentives benefited many skill areas, with the main exception of the “youth and vigor” skills.<sup>23</sup>

However, Redux provided no incentive for pre-20 YOS retention, although Redux anticipated a modest decline in this category, offset by targeted payments such as bonuses.<sup>24</sup> Moreover, Redux did not actually solve the basic force-management difficulties associated with the 20-year system. For example, Redux

- maintained 20-year vesting in an immediate annuity;
- continued to lock in mid-careerists; and
- retained, until the 20-year mark, some under-performing personnel.<sup>25</sup>

Those who argued that the pre-Redux system was too generous considered enactment of Redux in 1986 a success. Nevertheless, the Clinton administration announced in 1998 its support for the repeal of Redux, in view of its potential problems, such as its negative impact on retention. The FY2000 National Defense Authorization Act, adopted in late 1999, repealed compulsory Redux by allowing post–August 1, 1986, entrants to retire under the pre-Redux system or to opt for Redux plus an immediate \$30,000 cash payment.<sup>26</sup>

### *Sixth Quadrennial Review of Military Compensation (Sixth QRMC)*

The Sixth Quadrennial Review of Military Compensation (Sixth QRMC, 1988) examined a number of alternatives to the current reserve retirement system, conducting a review of earlier

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<sup>22</sup> Henning, *Military Retirement*, CRS–4.

<sup>23</sup> Henning, *Military Retirement*, CRS–2, CRS–3.

<sup>24</sup> John T. Warner, *A Policy Analysis of Alternative Military Retirement Systems* (Santa Monica, California: RAND Corporation, 1994), 4–8.

<sup>25</sup> Henning, *Military Retirement*, CRS–2, CRS–3.

<sup>26</sup> Henning, *Military Retirement*, CRS–2, CRS–3.

recommendations for changing reserve retirement. These recommendations included reducing the value of reserve retirement, creating a penalty for those ceasing active participation before 30 YOS, lowering the age of eligibility for reserve retired pay or providing a lump sum payment option before age 60, and eliminating reserve retirement altogether.

### *Internal Department of Defense Panels*

Three internal DoD panels—the Defense Science Board (2000), the Officer Management Study Group (2000), and the Review of Morale and Quality of Life (2001)—argued that career lengths were too short and that changes in the retirement system would permit longer career lengths. All three panels suggested a retirement system that provided for earlier vesting of an old-age pension, and government contributions to a 401(k) or TSP-like account.<sup>27</sup>

In April 2003, the DoD sent to Congress a proposal, the Defense Transformation for the 21<sup>st</sup> Century Act, containing various retirement-related provisions designed to prevent the mandatory retirement of skilled high-level officers who preferred to stay on active duty. However, only one category of proposed military personnel management changes was adopted in either the House or Senate versions of the FY2004 National Defense Authorization Act. The approved provision called for reducing the number of years that an officer in various grades must serve before being allowed to retire in that grade, for both general/flag officers and officers in grades 0–5 (lieutenant colonel/navy commander) and 0–6 (colonel/navy captain).<sup>28</sup>

### *Defense Advisory Commission on Military Compensation (DACMC)*

The Defense Advisory Commission on Military Compensation (DACMC, 2006) sought to balance military pay and benefits with sustained recruitment and retention of high-quality people, providing a cost-effective and ready military force. With regard to the active-component retirement system, DACMC recommended a new system designed to provide earlier vesting at 10 YOS, to offer some retirement benefits for those with fewer than 20 YOS, and to raise the retention incentive with an up-front cash payment. The DACMC's report noted that its

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<sup>27</sup> Defense Advisory Committee on Military Compensation, *Completing the Transition to an All-Volunteer Force: Report of the Defense Advisory Committee on Military Compensation* (Arlington, Virginia: DACMC, April 2006), 28.

<sup>28</sup> Goldich, "Military Retirement," 69–71.

recommendations were similar to those made by the DMC in 1976 and the PCMC in 1978. The DACMC's findings and recommendations will be analyzed as part of the 10<sup>th</sup> Quadrennial Review of Military Compensation, chartered on August 2, 2005, to review the principles and concepts of the compensation system.

### General Framework of Analysis

Each retirement system summarized in this review includes a number of complex provisions that make precise comparisons difficult. However, in 1983 the General Accounting Office (GAO) based its framework of analysis on the following eight observations or categories. For comparative charts based on GAO's methodology, see the Appendix. GAO's suggested eight categories of reform include:<sup>29</sup>

1. *Retirement Eligibility, or Years of Service and Age at which Nondisability Retirement Benefits Are Payable.* The U.S. retirement system has allowed both officers and enlisted members to retire voluntarily with an immediate annuity after 20 YOS, regardless of age.
2. *Formula for Retired Pay, or Cost-of-Living Adjustments.* Before 1963, retired pay usually was adjusted or recomputed on the basis of active-duty pay increases. Since 1963, the specific provisions for adjusting military retired pay have changed several times, but the policy of full inflation protection generally has remained intact. A member who retires from active duty is paid an immediate monthly annuity based on a percentage of his or her retired pay computation base.
3. *Contributory versus Noncontributory Retirement and Integration with Social Security.* The uniformed services retirement system is noncontributory, meaning military personnel do not contribute a percentage of their salary to help pay for retirement benefits.
4. *Vesting of Retirement Benefits.* Individuals who may eventually benefit from a retirement plan are typically concerned with the date they obtain a legal, nonforfeitable right to either present or future enjoyment of retirement benefits. This is referred to as vesting. Vesting determines the conditions of service, such as age, YOS, or both, at which a service member becomes eligible for some form of a retirement benefit. Although it is often assumed that service retirement benefits are vested at 20 YOS, entitlement to retired pay after having completed 20 YOS is conditional. Retirees are subject to recall, they must comply with certain postretirement employment restrictions, and they may lose retirement benefits for violating certain provisions of the Uniform Code of Military Justice. The subject of vesting is a central concern of all major studies of the uniformed service retirement system. A central question in regard to vesting is whether any service

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<sup>29</sup> The Quadrennial Reviews of Military Compensation used this general framework, attributing it, without a specific source citation, to a "1983 GAO study." This study appears to be: U.S. General Accounting Office, *Defense Spending and Its Relationship to the Federal Budget: A Study*, GAO/PLRD-83-80 (Washington, DC: GAO, June 9, 1983).

member who leaves (voluntarily or involuntarily) before becoming eligible for an immediate annuity (currently at 20 YOS) should be eligible for a reduced deferred benefit at a later age.

5. *Severance Pay.* Proposals vary for severance pay, payment received at the time of involuntary separation but before becoming eligible for retirement at 20 YOS.
6. *Integration with Social Security.* The existing system's retirement benefit payments are not integrated with social security payments (social security benefits are 100-percent additive to military retired pay), that is, military retired pay and social security do not offset each other. However, military personnel have paid taxes into the social security trust fund since January 1, 1957, and are entitled to full social security benefits based on their military service. Seven of the pre-1983 studies, including the President's Private Sector Survey on Cost Control, recommended that DoD should seek legislation to integrate the service retirement system with the social security system. The services' survivor-benefit plan in particular requires a contribution from the retiree and is integrated with the social security program. Optional contributory survivor benefit protection is provided through retired pay reductions for retirees and retirement-eligible reservists.<sup>30</sup>
7. *Transitional and Save Pay.* Recommendations vary regarding payment to savings plans or during periods of transition.
8. *Adjustment Mechanism.* Usually the CPI is used to adjust pay. Military retired pay is protected against inflation by statute.

## THE DEFENSE MANPOWER COMMISSION (DMC), 1976

### Introduction

The Defense Manpower Commission (DMC) report of May 1976<sup>31</sup> established three reasons for modernizing what it referred to as the military estate program (the compensation and retirement system):

1. To provide a system that supports personnel-management objectives
2. To correct present inequities among service members
3. To reduce the total cost of the program<sup>32</sup>

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<sup>30</sup> Richard A. Kuzmack, John A. McTighe, E.J. Devine, and Marcella L. Wojdylak, "New Initiatives for the Military Estate Program: A Staff Paper for the Defense Manpower Commission," in U.S. Department of Defense, Defense Manpower Commission, *Defense Manpower Commission Staff Studies and Supporting Papers*, vol. 5, *Compensation and Retirement* (Washington, DC: GPO, May 1976), D-17.

<sup>31</sup> This section summarizes *Defense Manpower Commission Staff Studies and Supporting Papers*, vol. 5, especially the retirement-related chapters by Kuzmack, McTighe, Devine, and Wojdylak, "New Initiatives for the Military Estate Program," and E.J. Devine, John A. McTighe, and Marcella L. Wojdylak, "Postretirement Adjustment of Military and Federal Civil Service Retired Pay."

<sup>32</sup> Kuzmack, McTighe, Devine, and Wojdylak, "New Initiatives for the Military Estate Program," D-2.

The DMC sought to reform the promotion-driven retirement system of the World War II era, which provided an immediate annuity after only 20 YOS, or even earlier for the navy because of the navy's over-six-months rounding rule, as well as credit for early reenlistment. Moreover, the tenure provisions were not uniform across the military services and did not apply to enlisted members.<sup>33</sup> At the time, the military calculated the retiree's annuity at 2.5 percent of terminal basic pay for each creditable YOS up to a ceiling of 75 percent of basic pay. As the CPI changed, the amount of the annuity was to be adjusted in accordance with the law.<sup>34</sup>

In the DMC's view, the early retirement policy was expensive and disruptive, depriving many military operations of the skills and insights that personnel had developed through experience and specialized training. The DMC wanted a retirement system that recognized "the inherent differences in combat operations versus occupations in the technical, administrative, and professional areas."<sup>35</sup>

More than the studies that came after it, the DMC proposal focused attention on the military disability retirement subsystem. In 1976, when the DMC's study appeared, the disability retirement subsystem offered no special compensation for disabilities involving the loss of a limb, blindness, or disfigurement, and did not recognize dependency status. A disabled member with dependents did not receive any more compensation than one without dependents. Moreover, the system failed to recognize that military service requires much higher physical condition than is necessary for civilian employment in similar skills or occupations.<sup>36</sup> The military disability retiree was eligible for annuity benefits in addition to or in lieu of those the DoD provided, namely for social security and VA benefits. The general rule was that military members evaluated as totally disabled must have at least five YOS before receiving additional benefits under the SSA system when they were evaluated as being totally disabled. Members who were disabled before reaching 31 years of age could qualify for social security disability benefits with fewer than 20 YOS. The system provided no benefits for less than total disability.<sup>37</sup> The military member could opt "to receive a disability compensation annuity payable by the VA, either in lieu

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<sup>33</sup> Kuzmack, McTighe, Devine, and Wojdylak, "New Initiatives for the Military Estate Program," D-4.

<sup>34</sup> Pub.L.No. 91-179 of December 30, 1969, provided for 1 percent to be added to the percentage increase each time there was a general cost-of-living adjustment to retired pay, according to "Chapter 4: Basic Pay Rates, Legislative and Cost-of-Living Adjustments to Retired Pay," *DoD Financial Management Regulation*, vol. 7B, September 5, 1999, 115.

<sup>35</sup> Kuzmack, McTighe, Devine, and Wojdylak, "New Initiatives for the Military Estate Program," D-4.

<sup>36</sup> Kuzmack, McTighe, Devine, and Wojdylak, "New Initiatives for the Military Estate Program," D-12.

<sup>37</sup> Kuzmack, McTighe, Devine, and Wojdylak, "New Initiatives for the Military Estate Program," D-10.

of, or in combination with, the annuity payable by the DoD. In many cases, it was to the advantage of the member to elect whatever VA benefits were payable because they were exempt from federal income tax.”<sup>38</sup>

## **Key Features of the Proposed Reform**

### ***Retirement Eligibility***

The DMC recommended a system that rewards personnel in combat jobs with early retirement at 20 YOS and allows personnel in most noncombat jobs to retire with an immediate annuity after completing 30 YOS. Eligibility for retirement on an immediate annuity would be determined by a system of retirement points. Every job would be assigned an incentive multiplier according to its mission, with a minimum multiplier of 1 for most noncombat jobs and a maximum value of 1.5 for a combat job. Each day of active duty would earn retirement points equal to  $1/365^{\text{th}}$  times the incentive multiplier of the assigned job. Thus, in order for personnel in noncombat jobs to be eligible for retirement on an immediate annuity after a full career of 30 years, they would need 30 retirement points.<sup>39</sup>

In the DMC’s view, the value of the multiplier assigned to a job should reflect both the youth and vigor required and the service’s difficulties obtaining qualified volunteers for that job.<sup>40</sup> Thus, multipliers would vary within career tracks, depending, for example, on whether an individual in a combat job is assigned to a headquarters position, or on whether a noncombat member is assigned to a hazardous job, such as loading explosive ordnance manually.<sup>41</sup>

### ***Formula for Retired Pay***

The DMC proposed a two-tier system with three components for computing retired pay. The DMC report said that “initial determination of retired pay should be the product of three factors: Hi-3 average pay, retirement points, and a per-point retirement multiplier.”<sup>42</sup> Under the first tier of this system, a full career would earn an 80 percent total multiplier, that is, 80 percent

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<sup>38</sup> Kuzmack, McTighe, Devine, and Wojdylak, “New Initiatives for the Military Estate Program,” D–10.

<sup>39</sup> Kuzmack, McTighe, Devine, and Wojdylak, “New Initiatives for the Military Estate Program,” D–5.

<sup>40</sup> Kuzmack, McTighe, Devine, and Wojdylak, “New Initiatives for the Military Estate Program,” D–5.

<sup>41</sup> Kuzmack, McTighe, Devine, and Wojdylak, “New Initiatives for the Military Estate Program,” D–5.

<sup>42</sup> Kuzmack, McTighe, Devine, and Wojdylak, “New Initiatives for the Military Estate Program,” D–5.

of the highest three years (Hi-3) of basic pay on attaining 30 retirement points. Dividing 80 percent by 30 retirement points equals 2.66 percent per retirement point.<sup>43</sup>

Retirement would be permitted any time after a member accrued 30 retirement points. An individual could serve longer than 30 years, thereby earning a higher Hi-3 average pay benefit and an increased annuity, but an extended career would depend on service needs, the individual's occupation, and continued quality performance. Under the second tier, the retiring member with 20–30 YOS could elect either to defer receipt of the annuity until 30 YOS or to receive an actuarially reduced annuity at an earlier date.<sup>44</sup>

### *Vesting*

The DMC pointed out that provisions of the Retirement Modernization Act (RMA) of 1972 would significantly improve vesting rights for military members, although the proposed act also contained a social security offset provision “that would severely decrease the value of the deferred annuities through which this improved vesting would be implemented.”<sup>45</sup> The DMC proposed to limit vesting in the military retirement system to those service members who volunteer to serve in the career force if selected for it and who reach the 10-YOS point, although reserve enlisted personnel involuntarily separated after five YOS would continue to be eligible for severance pay. Whereas the existing system required enlisted personnel to periodically renew their service contract, the DMC proposed that officers and enlisted personnel enter a voluntary indefinite status at the 10-YOS point. A vested member who requests and is granted voluntary separation would qualify for a deferred annuity and would begin receiving payments when the member reaches age 65. An involuntarily separated vested member would receive an immediate cash payment for readjustment and would be given the choice of either a second cash payment or a deferred annuity.<sup>46</sup>

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<sup>43</sup> Kuzmack, McTighe, Devine, and Wojdylak, “New Initiatives for the Military Estate Program,” D–5.

<sup>44</sup> Kuzmack, McTighe, Devine, and Wojdylak, “New Initiatives for the Military Estate Program,” D–5–D–6.

<sup>45</sup> Kuzmack, McTighe, Devine, and Wojdylak, “New Initiatives for the Military Estate Program,” D–6.

<sup>46</sup> Kuzmack, McTighe, Devine, and Wojdylak, “New Initiatives for the Military Estate Program,” D–7, D–9.



### *Severance Pay*

The DMC criticized the severance-pay provisions of the system existing in 1976 because of the “significant lack of equity between officers and enlisted personnel,” as well as among the services.<sup>47</sup> The only enlisted personnel, except the disabled, eligible for severance pay under the 1976 system were the few members of the reserve enlisted personnel separated after five YOS in a reduction in force.<sup>48</sup> The DMC proposed to retain the worthwhile vesting and severance pay features of the proposed RMA as follows:

- Voluntarily separated vested members would receive a deferred annuity without any option for a cash payment, with payments beginning when the member reaches age 65. The payment amounts would be calculated by multiplying the member’s Hi-3 average pay times the per-point retirement multiplier times the number of YOS completed, with partial years prorated based on the number of days actually served.<sup>49</sup> The annuity would be adjusted periodically based on the CPI or on the indexing system currently in force. As early as age 60, a vested member could receive an actuarially reduced annuity.
- The involuntarily separated vested member would receive an immediate cash payment for readjustment and either a deferred annuity or a second immediate cash payment equal to the readjustment pay, at the member’s option. Readjustment pay would be calculated as annualized terminal basic pay times the per-point retirement multiplier for each YOS completed. The deferred annuity would be calculated in the same way as for the member separating voluntarily, except that the calculation would be based on the number of retirement points accrued rather than on the YOS.<sup>50</sup>
- The involuntarily separated member would be guaranteed the right to purchase adequate health and disability income insurance at standard rates or, for an appropriate annual premium, to extend coverage under the CHAMPUS program, now known as the TRICARE military health care program.<sup>51</sup>

### *Proposed New Disability Program*

The DMC proposed a disability program that would alter the linkage of disability compensation to the retirement system; this linkage had caused considerable abuse because disability determinations made at the time of retirement could secure favorable tax treatment of retirement benefits. The DMC proposed instead making the two systems “complementary rather than supplementary.” The DMC recommended that the VA should not be involved in payment of

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<sup>47</sup> Kuzmack, McTighe, Devine, and Wojdylak, “New Initiatives for the Military Estate Program,” D-7.

<sup>48</sup> Kuzmack, McTighe, Devine, and Wojdylak, “New Initiatives for the Military Estate Program,” D-7.

<sup>49</sup> Kuzmack, McTighe, Devine, and Wojdylak, “New Initiatives for the Military Estate Program,” D-9.

<sup>50</sup> Kuzmack, McTighe, Devine, and Wojdylak, “New Initiatives for the Military Estate Program,” D-9.

<sup>51</sup> Kuzmack, McTighe, Devine, and Wojdylak, “New Initiatives for the Military Estate Program,” D-9.

disability income indemnities, and that the DoD and VA programs should avoid concurrent receipt, that is, the simultaneous receipt of two types of benefits.<sup>52</sup>

### **Disability Criteria**

Because determining whether and when a disability exists can be difficult, especially when the impairment is only partial, the DMC proposed that the disability program serve as an extension of the military's sick leave policy, rather than as a replacement for it. After the member is on sick leave status for an appropriate period, a decision would be made as to whether the individual is fit for duty or should receive a disability discharge. The DMC recommended that, in determining fitness for duty, primary consideration be given to actual duties the member is normally expected to perform on the job. For example, the loss of an experienced and trained service member because the member is unable to perform a minor requirement of the job would waste taxpayers' money.<sup>53</sup>

### **Total Disability**

The DMC recommended granting the totally disabled person a disability discharge, and that the disabled person "be guaranteed, in combination with social security, a specified fraction (e.g., 60 percent) of the gross pay and allowances due the member just prior to the disabling event."<sup>54</sup> Payments would continue for a five-year period until, and if, the individual recovers from the total disability and is fit for duty. The member may then either return to duty or elect to fully separate with a deferred annuity calculated in the manner proposed for involuntary separatees. If the individual is unable to return to duty after a five-year period, "the guarantee should be continued only if the member is completely unable to engage in any other occupation for which the person is reasonably fitted by education, training, and experience." If an individual is able to perform some assigned occupational duties, then the person would qualify for a residual disability status, under which the guarantee would provide payments equal to 60 percent of the earned-income lost. If the person has no loss of income for 12 consecutive months or if it is medically determined that a disability no longer exists, then this status would terminate. In that

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<sup>52</sup> Kuzmack, McTighe, Devine, and Wojdylak, "New Initiatives for the Military Estate Program," D-12.

<sup>53</sup> Kuzmack, McTighe, Devine, and Wojdylak, "New Initiatives for the Military Estate Program," D-12.

<sup>54</sup> Kuzmack, McTighe, Devine, and Wojdylak, "New Initiatives for the Military Estate Program," D-13.

case, if the person has accrued fewer than 30 retirement points, the DMC recommends that the deferred annuity procedure be used.<sup>55</sup>

### **Partial Disability**

The DMC noted that, although the term is defined less well, *partial disability* generally means that a member “is able to perform some, but not all, of the duties of the individual’s *regular* (military) occupation, without having undergone a period of total disability.” In the DMC’s view, indemnification for loss of income due to partial disability is arbitrary. The DMC recommended that the program have a flexible readjustment period, varying from as little as three months to the five-year maximum suggested for total disability, and that, during the readjustment period, the individual receive the same benefit provided in total disability cases.<sup>56</sup>

### **Survivor Benefits**

The Survivor Benefit Plan (SBP), adopted on September 21, 1972 (Pub.L.No. 92–425), provided survivor income up to 55 percent of the retired pay of military officer and enlisted retirees.<sup>57</sup> The operating principle of the DMC’s proposed new survivor benefit plan was that the military member’s election of survivor benefit options “should neither increase nor decrease the actuarial value of the total retirement benefit from what it would be in the absence of such an election.” In other words, the value of the Retired Serviceman’s Family Protection Plan (RSFPP) and the SBP and its social security offset is independent of the marital or dependency status of the retiree. The survivor benefit proposed by the DMC depended on calculations involving the careful study of current and accurate mortality data. Basically, the proposal, although not explained in any detail, would provide the retiree “with alternatives of equal value when implemented with an appropriate interest rate” and thus, the DMC asserted, would be a major improvement over the RSFPP, as well as over the SBP and its social security offset.<sup>58</sup>

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<sup>55</sup> Kuzmack, McTighe, Devine, and Wojdylak, “New Initiatives for the Military Estate Program,” D–13.

<sup>56</sup> Kuzmack, McTighe, Devine, and Wojdylak, “New Initiatives for the Military Estate Program,” D–13–D–14.

<sup>57</sup> Pub.L.No. 92–425, 86 Stat. 706, September 21, 1972.

<sup>58</sup> Kuzmack, McTighe, Devine, and Wojdylak, “New Initiatives for the Military Estate Program,” D–15, D–18.

### *Adjustment Mechanism*

A study done for the DMC compared six different systems for adjusting annuities, concluding that the existing adjustment mechanism greatly overcompensated for the amounts needed to maintain the purchasing power of the annuity over a retiree's expected lifetime.<sup>59</sup> Taking this comparative study into account, the DMC's proposal called for "a two-part adjustment whenever monthly annuities were to be increased, both for the first post-retirement increase and for all subsequent increases," as follows:

1. A periodic percentage increase in the annuity payment based on a rise in the CPI of at least 3 percent over three consecutive months
2. A catch-up payment designed to compensate for the entire loss in purchasing power between pay raises<sup>60</sup>

The DMC concluded that its proposal was the only one that met the criterion of maintaining purchasing power in the sense that the cumulative payments over time were the same as those under the base case.<sup>61</sup>

### **Conclusions and Recommendations**

The DMC concluded that both the methods of establishing the initial amount of the annuity and making postretirement adjustments should both be changed. The DMC measured the effects on the purchasing power of retired pay under the adjustment system existing in 1976 and under five alternative systems and found that none of the systems would maintain purchasing power. In devising one that would, the DMC found that the various methods of adjusting annuities are all sensitive to two factors—inflation and the method of making the first increase in an annuity.<sup>62</sup>

The DMC devised an improved method for making the initial postretirement adjustment. Under the DMC's proposal, future inflation would not be a factor in establishing the initial

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<sup>59</sup> Devine, McTighe, and Wojdylak, "Postretirement Adjustment of Military and Federal Civil Service Retired Pay," E-23.

<sup>60</sup> Devine, McTighe, and Wojdylak, "Postretirement Adjustment of Military and Federal Civil Service Retired Pay," E-33.

<sup>61</sup> Devine, McTighe, and Wojdylak, "Postretirement Adjustment of Military and Federal Civil Service Retired Pay," E-34.

<sup>62</sup> Devine, McTighe, and Wojdylak, "Postretirement Adjustment of Military and Federal Civil Service Retired Pay," E-43.

annuity. The initial annuity would be established on the basis of its present purchasing power, with reasonable confidence that this purchasing power would be preserved regardless of the future rate of inflation. The DMC determined that under any set of reasonable assumptions the existing system eventually resulted in payments in excess of those needed to maintain purchasing power; these overpayments would increase as the rate of inflation increased. The DMC claimed that its proposal met the criterion of preserving the purchasing power of an annuity almost perfectly, resulting in purchasing power almost identical to that occurring when annuities are adjusted monthly by the percentage increase in the CPI. Not only were the cumulative payments over time the same under both systems, but the present values of the series of annuities under these two systems were almost identical. However, neither the DMC's proposals nor any other that had been advanced would prevent erosion of purchasing power as a result of the failure of the income tax structure to take inflation into account.<sup>63</sup>

Nevertheless, the DMC's proposal would maintain purchasing power under various rates of inflation regardless of when an individual retires. Although the DMC's proposal would increase annuities using the same base month procedure and time lag as the existing system, the first increased annuity check would include, if warranted, a catch-up payment to compensate (but not overcompensate) for lost purchasing power.<sup>64</sup> In conclusion, the DMC recommended that "a better method of adjusting annuities be adopted in order to maintain the purchasing power of retired pay," further recommending that, considering that the DoD is the largest employer of civilians, any method adopted be applied to federal civilian retirees as well as military retirees.<sup>65</sup>

## **PRESIDENT'S COMMISSION ON MILITARY COMPENSATION (PCMC), 1978**

### **Introduction**

By Executive Order 11998 of June 27, 1977,<sup>66</sup> President Jimmy Carter established the nine-member President's Commission on Military Compensation (PCMC) to review the analyses, findings, and recommendations related to military compensation completed by the

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<sup>63</sup> Devine, McTighe, and Wojdylak, "Postretirement Adjustment of Military and Federal Civil Service Retired Pay," E-44.

<sup>64</sup> Devine, McTighe, and Wojdylak, "Postretirement Adjustment of Military and Federal Civil Service Retired Pay," E-45.

<sup>65</sup> Devine, McTighe, and Wojdylak, "Postretirement Adjustment of Military and Federal Civil Service Retired Pay," E-46.

<sup>66</sup> 42 Fed. Reg. 33021 (June 29, 1977).

Quadrennial Reviews of Military Compensation, the Comptroller General, the Interagency Committee Study of Uniformed Services Retirement and Survivor Benefits, the Department of Defense Retirement Study Group, and the Defense Manpower Commission (DMC).<sup>67</sup> The PCMC's mission was to identify, study, and make recommendations on critical military compensation issues. Released on April 10, 1978, the PCMC's report, or Zwick Commission, for Chairman Charles J. Zwick, recommended the restructuring of the military compensation system to better serve the national interest, estimated the cost and purpose of any recommended changes, and provided a plan and timetable for implementing them.<sup>68</sup> With regard to military retirement, the PCMC posed questions about the purpose of the military retirement system, the effectiveness of the present system in achieving its purpose, and appropriate changes to the system.<sup>69</sup>

The PCMC's assumption was that "change is needed because of three inherent deficiencies in the existing retirement plan," suggesting that the current system was inequitable, inhibited effective and flexible force management, and was ineffective. The PCMC said of the military compensation system:

1. It is inequitable because, although both military and civilian retirement plans provide for old-age needs, those who serve many years in the military but leave before 20 YOS receive no military retirement benefits. Therefore, the PCMC believes that military retirement must provide incentives for continuing to 20 YOS and must assist the transition of those who leave the military before they complete a full working career.
2. It inhibits effective and flexible force management because it provides benefits only after 20 YOS. As a result, managers are reluctant to separate ineffective people who are approaching retirement eligibility.
3. It is ineffective because it apparently has little influence on prospective recruits or on service members in their first enlistment, while at the same time providing a strong incentive for more senior personnel to remain on active duty, particularly those in their 12<sup>th</sup> through 19<sup>th</sup> YOS.<sup>70</sup>

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<sup>67</sup> *Report of the President's Commission on Military Compensation.*

<sup>68</sup> John Woolley and Gerhard Peters, The American Presidency Project, University of California, Santa Barbara, <http://www.presidency.ucsb.edu/ws/?pid=7731>.

<sup>69</sup> Woolley and Peters, The American Presidency Project.

<sup>70</sup> "Chapter Two: Military Compensation: An Overview," U.S. President's Commission on Military Compensation, *Report of the President's Commission on Military Compensation* (Washington, DC: GPO, April 1978), 26–27.

## Key Features of the Proposed Reform

### *Eliminates Inequities*

The PCMC plan addresses the major internal inequities of the system of 1978. The plan's main proposals were vesting in the retirement plan, deferring compensation after 10 years, and adopting Hi-3 averaging of basic pay. According to the PCMC, Hi-3 averaging “effectively removes the incentive to manipulate retirement dates to increase retirement pay.”<sup>71</sup> Under the PCMC plan, members with similar rank and service who retire at the same time would receive the same retirement pay.<sup>72</sup>

The PCMC argued that its three-part retirement plan, by being more equitable, efficient, and flexible, had several advantages over the current system, including:<sup>73</sup>

- Benefits to more service members (see table 1)
- Greater discretion over the timing and form of members' benefits
- Greater benefits for all members separating with 10 to 19 YOS
- Fairer benefits for members serving more than 10 years but fewer than 20 years
- Levels of deferred compensation at 20 years that are sufficient to aid transition to civilian employment
- Greater benefits for those serving beyond 30 years, including an increasing annuity multiplier for years 31 to 35
- Severance pay for officers and enlisted members separated mandatorily with more than five YOS (the current system provides no severance pay for enlisted grades)

<b>Personnel</b>	<b>Current System</b>	<b>PCMC plan*</b>
Enlisted Persons	10.5	20.0
Officers	28.6	47.3

\*Based on moderate retention estimates for PCMC plan.  
 Source: U.S. President's Commission on Military Compensation (PCMC), *Report of the President's Commission on Military Compensation*, Washington, DC, April 1978, 80.

<sup>71</sup> *Report of the President's Commission on Military Compensation*, 81.

<sup>72</sup> *Report of the President's Commission on Military Compensation*, 80–81.

<sup>73</sup> *Report of the President's Commission on Military Compensation*, 73.

In addition, the PCMC plan combined with social security would replace a major portion of pre-retirement income in old age. Table 2 shows the percentage of disposable pay to be replaced by the PCMC plan at age 65.<sup>74</sup> However, the plan's disadvantage was that it provided lower benefits than the current system to the 20-YOS member, as well as lower benefits for those with 20–30 YOS.

<b>Rank</b>	<b>Years of Service</b>	<b>Percent</b>
E-6	16	79.5
O-4	16	63.0
E-7	20	78.5
O-5	20	65.8
E-7	22	77.5
O-5	22	68.6
E-8	25	78.0
O-6	25	73.4
E-8	30	85.6
O-6	30	81.7

Source: U.S. President's Commission on Military Compensation (PCMC), *Report of the President's Commission on Military Compensation*, Washington, DC, April 1978, 80.

### ***Improves Force Management***

#### **Retention**

According to the PCMC, its plan would lead to increased retention for up to 10 or 12 YOS, encouraging members to remain on active duty for 30 or more years. Although the PCMC acknowledged that its plan would result in lower continuation rates from 10 or 12 to 20 YOS, it argued that "higher continuation to 10 or 12 years and lower continuation thereafter tend to offset one another in terms of their effects on the age of the force." In the PCMC's reasoning,

<sup>74</sup> *Report of the President's Commission on Military Compensation*, 73–75.



this offsetting tendency combined with severance pay for enlisted members would ensure that the “youth and vigor of the force should remain near current levels.”<sup>75</sup>

The PCMC contended that its plan would change the pattern of incentives for continued service. Whereas the current system provides a significant retention effect only for those beyond 10 or 12 YOS, the PCMC plan would provide incentives to stay on active duty much longer by offering the increasing value of deferred compensation and the retirement annuity. The fact that the value of these benefits increases at an average rate of 17 percent per year to 20 years and at an average rate of 11 percent per year from 20 to 30 years would provide a significant incentive, in the view of the PCMC. At 30 years, the value of deferred annuities would increase significantly because at that point the retirement annuity would be paid five years earlier, at age 55, according to the PCMC.<sup>76</sup> The PCMC’s plan would reduce the incentive to leave active duty by allowing members to withdraw a portion of their accounts while on active duty and by requiring that deferred compensation payments be spread over some months or years after leaving active duty.<sup>77</sup>

The PCMC pointed out that its proposed changes would have little effect on recruiting or retention during the initial enlistment period because young people discount future compensation and because the retirement system is not an important enlistment incentive. Thus, the PCMC acknowledged that its plan would affect only a fraction of prospective enlistees, since only 11 percent of enlistees reached retirement under the existing system. Rather, the PCMC plan will affect two groups:

1. Service members between the end of their initial enlistment period and 10 YOS who would otherwise leave before 10 YOS.
2. Service members who would stay for 20 years under the current system.<sup>78</sup>

#### **Five to 10 Years of Service**

The PCMC stated that the additional retention of service members attracted by 10-year vesting for deferred compensation and retirement would offset the losses of those who would otherwise be attracted by the current 20-year retirement system. The PCMC’s analysis of the

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<sup>75</sup> *Report of the President’s Commission on Military Compensation*, 81.

<sup>76</sup> *Report of the President’s Commission on Military Compensation*, 81.

<sup>77</sup> *Report of the President’s Commission on Military Compensation*, 85.

<sup>78</sup> *Report of the President’s Commission on Military Compensation*, 81–82.

behavior of those with five to 10 YOS showed that in these groups retention would increase. For those who would otherwise leave before 10 years, the PCMC plan would increase the incentive to stay for 10 to 12 years; however, it would lower the incentive to stay for 20 years. The PCMC plan represented a 16 percent increase in compensation (the present value of regular military compensation plus the present value of retirement pay) for an additional five YOS for those with five YOS, and a 35 percent increase in compensation for two additional YOS, for those with eight YOS.<sup>79</sup>

### **10 to 20 Years of Service**

For a 20-year career, the PCMC plan would reduce the retirement benefit. For those with five YOS, the PCMC plan would represent a 9 percent reduction in the compensation received for an additional 15 YOS. Using results of previous studies of the bonus program, the PCMC estimated that the combined effect of these changes would produce a 17 to 43 percent increase in retention during this period of service for those with five to 10 YOS. The PCMC argued that its plan, in conjunction with the DoD's bonus program, would provide substantial incentives to remain for 10 to 12 YOS.<sup>80</sup>

The PCMC maintained that its plan would attract more personnel to the 10-year point, acknowledging that losses between 10 and 15 YOS would increase as a result of vesting for the old-age annuity and the deferred compensation trust fund. Compared with the existing system, in which 20 percent of enlisted members and 13 percent of officers completing 10 YOS leave active service by 15 YOS, the PCMC estimated that losses under its plan during this same period would be 63 percent for enlisted persons and 53 percent for officers.<sup>81</sup>

In the view of the PCMC, the incentive to stay on active duty would be strong for most military members beyond 15 YOS, as a result of the growth in the deferred compensation account, the increasing value of retirement, and active-duty pay similar to the pay civilian counterparts earn. According to PCMC calculations, continuation rates would rise, from about 89 percent for officers and 85 percent for enlisted persons in the fifteenth year, to more than 97

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<sup>79</sup> *Report of the President's Commission on Military Compensation*, 83.

<sup>80</sup> *Report of the President's Commission on Military Compensation*, 83.

<sup>81</sup> *Report of the President's Commission on Military Compensation*, 84.

percent by the twenty-ninth year. Before the 20-year point, retention rates would be lower than under the existing system, but thereafter rates would be higher.<sup>82</sup>

In analyzing the effect of the present 20-year retirement annuity on retention of quality people at 20 years, the PCMC noted that members the services identify as highly trained and capable people, who have been promoted rapidly, have lower rates of voluntary retirement than those identified as less capable, who have been promoted at slower rates. According to the PCMC, high-performing members would not be any more likely to leave active duty under its plan than under the existing system because a time-in-grade pay table would further enhance their retention incentives, and their retention would not be adversely affected by the availability of deferred compensation beyond 10 YOS.<sup>83</sup>

### **The Age and Experience Distribution of the Force**

The PCMC estimated that its plan—assuming moderate retention and no adjustments in active duty pay—would produce a force with a larger percentage of members with 10 YOS or less, a smaller percentage with 11 to 20 YOS, and a larger percentage with 21 or more YOS, than the force under the existing system (see table 3).<sup>84</sup>

As illustrated in table 4, only minor changes in the average age of the force would result from the PCMC plan. There would be more members with fewer than 10 YOS, and more enlisted members under age 29. According to the PCMC, its plan would therefore create a new force with “the requisite youth and vigor to engage in the arduous, physically demanding tasks that a fighting force must undertake.” At the same time, those selected members staying longer than 20 years would provide the technical ability and experience needed by the force. Under the PCMC plan, the promotion system and severance pay could be used to separate out, between their tenth and sixteenth YOS, those members with limited technical, supervisory, or managerial skills.<sup>85</sup>

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<sup>82</sup> *Report of the President’s Commission on Military Compensation*, 84–85.

<sup>83</sup> *Report of the President’s Commission on Military Compensation*, 85–86.

<sup>84</sup> *Report of the President’s Commission on Military Compensation*, 88.

<sup>85</sup> *Report of the President’s Commission on Military Compensation*, 88.

<b>Table 3. Percentage Distribution of the Force by Years of Service</b>				
<b>Years of Service</b>	<b>Current System (percentage)</b>	<b>PCMC Plan Retention Estimates*</b>		
		<b>Low (percentage)</b>	<b>Moderate (percentage)</b>	<b>High (percentage)</b>
<b>Enlisted Persons</b>				
0–5	62.4	69.7	62.9	57.3
6–10	15.6	18.8	18.6	17.0
11–20	19.4	9.8	13.9	16.4
21–30	2.6	1.7	4.6	9.3
<b>Officers</b>				
0–5	40.8	48.5	40.6	35.4
6–10	20.1	26.0	23.8	20.8
11–20	29.8	19.1	22.8	24.6
21–30	9.3	6.4	12.8	19.2

\*Low retention assumes a relatively large decrease in retention compared with the current system after 10 YOS. High estimates assume only a small decrease.

Source: U.S. President’s Commission on Military Compensation (PCMC), *Report of the President’s Commission on Military Compensation*, Washington, DC, April 1978, 90.

<b>Table 4. Average Age of the Force</b>				
<b>Personnel</b>	<b>Current System</b>	<b>PCMC Plan Retention Estimates*</b>		
		<b>Low</b>	<b>Moderate</b>	<b>High</b>
Enlisted Persons	25.5	24.0	25.4	26.9
Officers	32.4	30.6	32.6	34.3

\*Low retention assumes a relatively large decrease in retention compared with the current system after 10 YOS. High estimates assume only a small decrease.

Source: U.S. President’s Commission on Military Compensation (PCMC), *Report of the President’s Commission on Military Compensation*, Washington, DC, April 1978, 90.

### Accessions

According to the PCMC, the force’s overall retention pattern influences the required number of new accessions.<sup>86</sup> Table 5 compares the average man-years that may be expected from each new accession. The PCMC estimates that, in the long run, its plan—assuming moderate retention and no other management action—would require a slight increase in enlisted

<sup>86</sup> *Accessions* are means of increasing or adding to the workforce. Examples include enlisted recruiting, officer commissions, chief warrant officer appointments, civilian hiring, and recall of retired or reserve personnel, <http://152.121.2.2/hq/psc/ps/whgdata/whlstg0.htm>.

accessions and a slight decrease in officer accessions, but that the expected man-years per accession would be comparable to that of the existing force.<sup>87</sup>

<b>Table 5. Average Man Years Expected for Each Accession</b>				
<b>Personnel</b>	<b>Current System</b>	<b>PCMC Plan Retention Estimates*</b>		
		<b>Low</b>	<b>Moderate</b>	<b>High</b>
Enlisted Persons	5.8	5.2	5.8	6.3
Officers	10.2	8.6	10.2	11.7
*Low retention assumes a relatively large decrease in retention compared with the current system after 10 YOS. High estimates assume only a small decrease.				
Source: U.S. President's Commission on Military Compensation (PCMC), <i>Report of the President's Commission on Military Compensation</i> , Washington, DC, April 1978, 92.				

### **Promotions**

The PCMC plan is consistent with the “up-or-out” promotion philosophy.<sup>88</sup> As explained by the PCMC, promotions are affected to the extent that retention rates at different YOS change. Under the PCMC plan, therefore, as these retention rates change, the DoD should adapt promotion phase points and promotion opportunities while separating out, through the use of severance pay, members who stagnate and impede promotions of younger people. The incentives of the fully implemented PCMC plan would motivate many members in special categories to stay for longer careers than are now allowed. The PCMC contended that, under its plan, the benefits would be consistent with policies mandating retirement of officers at and beyond 0–6 and of E–8’s and E–9’s between the ages of 55 and 62.<sup>89</sup>

### ***Increases Cost Effectiveness***

The PCMC estimated that its plan would cost less than the existing system while providing a force at least as effective as the existing force. However, the PCMC’s cost estimates depended not only on factors such as retention estimates but also on assumptions about future wage growth and inflation. The PCMC indicated that under its plan,

<sup>87</sup> *Report of the President's Commission on Military Compensation*, 88.

<sup>88</sup> According to the “up-or-out” policy, when a member reaches the maximum year of service for a particular pay grade, the member must either be promoted to the next higher pay grade or leave.

<sup>89</sup> *Report of the President's Commission on Military Compensation*, 92–93.

- government outlays would increase initially for up to the first 15 years, decreasing sharply thereafter;
- steady-state retirement outlays would decrease by 36 percent;
- the accrual percentage needed to fund the retirement system fully would decrease immediately for the ungrandfathered (nonexempt) force, from 36.6 percent to 28.5 percent of basic pay; and
- accrual costs would decrease immediately in FY1980 by \$1.5 billion under the PCMC's proposed accrual accounting convention.<sup>90</sup>

### **Budget and Steady-State Outlays**

The PCMC noted that under its plan actual payments to retirees would change. Additional separations of enlisted members, payments of deferred compensation to those leaving with 10 or more YOS, and higher active-duty pay costs, as the result of a higher rate of retention of members with five to 10 YOS, were expected to cause outlays to increase initially. Increased retirement savings would not begin until the year 2000 because the first of the nongrandfathered group would not achieve 20 YOS until 1996. After 2000, savings from retirement offset would increase in deferred compensation, severance pay, and active-duty pay.<sup>91</sup>

Table 6 shows the PCMC's calculations of outlays at the point, known as steady state, when contributions and interest on accumulated assets are sufficient to fund the program. In the PCMC plan, FY2070 is the anticipated year in which a steady state for the current retirement system would be achieved. Table 6 also shows separately the retirement and deferred compensation outlays for the PCMC plan. The PCMC estimated that total retirement costs would decrease by 36 percent, assuming moderate retention rates.<sup>92</sup>

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<sup>90</sup> *Report of the President's Commission on Military Compensation*, 94–95. According to the PCMC, accrual costs usually are calculated as a percentage of basic pay that must be set aside to fund retirement.

<sup>91</sup> *Report of the President's Commission on Military Compensation*, 94.

<sup>92</sup> *Report of the President's Commission on Military Compensation*, 94.

<b>Table 6. Total System Outlays with 1.5 Percent Real-Wage Growth: Steady State (1978 dollars in billions)</b>		
<b>Outlays</b>	<b>Current System</b>	<b>PCMC Plan</b>
Retirement	\$31.5	\$15.1
Deferred Compensation	n.a.*	\$5.1
Total Retirement Costs	\$31.5	\$20.2
Changes in Retirement Costs		–\$11.3
Percentage Change		–36.0 percent
*n.a.—not available.		
Note: These costs assume 1.5 percent real growth in wages and 4.0 percent growth in prices each year to 2070. To show figures in 1978 dollars, that portion of the increase due to price increases was removed. The dollars shown here, although in 1978 terms, reflect real wage growth to the year 2070.		
Source: U.S. President’s Commission on Military Compensation (PCMC), <i>Report of the President’s Commission on Military Compensation</i> , Washington, DC, April 1978, 96.		

### Accounting For Retirement Costs

The PCMC noted a shortcoming in the DoD’s pay-as-you-go accounting procedure, namely that the DoD budget reflected only the checks written to current retirees, not the accruing retirement liabilities of the active-duty force. The DoD had no incentive to consider future retirement costs resulting from decisions concerning current manpower requirements. Under the PCMC plan, Congress would appropriate money directly to the active-duty retirement fund as the liability is paid out. Table 7 compares the estimated accrual cost of the existing system with that of the PCMC plan over 20 years. In addition, table 7 indicates the direct appropriations required to pay service members retired under the pay-as-you-go plan, as well as appropriations required to pay members on active duty, who had accrued YOS under the former plan. According to the PCMC, if its plan were adopted, the DoD’s budget authority would decrease immediately by \$1.5 billion in FY1980.<sup>93</sup>

Table 8 shows the accrual percentages for the existing system and for the PCMC plan, under different retention patterns. The PCMC pointed out that whereas the existing system required a contribution equal to 36.6 percent of basic pay, the PCMC plan would require an estimated contribution of only 28.5 percent of basic pay.<sup>94</sup>

<sup>93</sup> *Report of the President’s Commission on Military Compensation*, 96–97.

<sup>94</sup> *Report of the President’s Commission on Military Compensation*, 97.

**Table 7. Budget Authority for the Military Retirement Fund (1978 dollars in billions)**

<b>Retirement Accrual for the Active Forces</b>				
<b>Year</b>	<b>Current System*</b>	<b>PCMC Plan**</b>	<b>Change from Current System</b>	<b>Additional Appropriations to Liquidate Unfunded Liability***</b>
1980	6.9	5.4	-1.5	9.3
1982	7.0	5.3	-1.7	9.7
1984	7.2	5.5	-1.7	9.9
1986	7.5	5.9	-1.6	10.0
1988	7.7	6.2	-1.5	10.0
1990	7.9	6.3	-1.6	9.9
1992	8.1	6.4	-1.7	9.7
1994	8.4	6.5	-1.9	9.5
1996	8.6	6.5	-2.1	9.1
1998	8.9	6.7	-2.2	8.6
2000	9.2	7.0	-2.2	8.0

Note: Estimates are in FY1978 billions of dollars with 1.5 percent real-wage growth.

\*This estimate assumes the retirement accrual to equal 36.6 percent of basic pay.

\*\*This estimate assumes the retirement accrual to equal 28.5 percent of basic pay, where basic pay costs are somewhat different from the current system because the YOS distribution of the force changes.

\*\*\*This unfunded liability includes retirement outlays to those retired before FY1979 plus a prorated share of retirement costs for those on active duty in FY1979 and who later retire. Estimates include survivor costs equal to 1.6 percent of total outlays.

Source: U.S. President's Commission on Military Compensation (PCMC), *Report of the President's Commission on Military Compensation*, Washington, DC, April 1978, 98.

**Table 8. Accrual Costs: Percentage of Basic Pay to Fully Fund Retirement**

<b>Elements of Plan</b>	<b>Current System (in percentages)</b>	<b>PCMC Plan (in percentages)</b>
Retirement	36.6	18.3
Deferred Compensation	n.a.*	10.2
Total Retirement	36.6	28.5

\*n.a.—not available.

Source: U.S. President's Commission on Military Compensation (PCMC), *Report of the President's Commission on Military Compensation*, Washington, DC, April 1978, 99.



## Conclusions and Recommendations

The PCMC's primary retirement-related recommendation called for establishing a new noncontributory retirement plan with the following features:

- An old-age retirement annuity
  - eligibility for a deferred annuity at age 55, 60, or 62 depending on YOS, starting at 10 years;
  - annuity levels similar to those earned in federal civil service employment;
  - partial integration of social security benefits and annuities;
  - inflation protection;
  - health care, exchange, and commissary benefits for most annuitants; and
  - fully coordinated military and civil service retirement plans, with no dual compensation.
- A deferred-compensation trust fund to strengthen retention and provide deferred income for service members with 10 or more YOS. This fund would
  - provide government-paid credits after five YOS and aid service members in their transition to civilian life after 10 or more YOS;
  - guarantee existing retirement benefits for service members beyond their initial term of service, as well as for members with more than four YOS (these members would not be eligible for deferred compensation or the proposed severance pay).<sup>95</sup>
  - Severance pay to assist former career service members in their adjustment to civilian life, to include all personnel with five or more YOS.

The PCMC listed eight recommendations covering each of these three areas—old-age retirement annuity, deferred-compensation trust fund, and severance pay—as follows:

### *Old-Age Annuities*

#### Recommendation 1:

For military members with 10 or more YOS, provide old-age annuities as indicated in table 9. Compute the annuity by multiplying high-three-year average basic pay by the multipliers shown in table 10.

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<sup>95</sup> *Report of the President's Commission on Military Compensation*, 3–4.

In the view of the PCMC, the old-age annuity, allowing the military to remain competitive with the retirement provisions of other employers and providing incentives for continued service through 35 years, is a force-management tool. However, the PCMC recommended that using other more efficient and flexible tools, such as severance pay, active-duty pay, and bonuses, would help to meet changing force requirements.<sup>96</sup>

<b>Table 9. Eligibility for Retirement Annuity</b>	
<b>Years of Active Service Completed</b>	<b>Age at Which Annuity Begins</b>
10–19	62
20–29	60
30 or more	55

Source: U.S. President’s Commission on Military Compensation (PCMC), *Report of the President’s Commission on Military Compensation*, Washington, DC, April 1978, 64.

<b>Table 10. Annuity Multipliers</b>	
<b>Years of Service</b>	<b>Per-Year Multipliers (percentage)</b>
1 to 5	2.00
6 to 11	2.25
11 to 35	2.75

Source: U.S. President’s Commission on Military Compensation (PCMC), *Report of the President’s Commission on Military Compensation*, Washington, DC, April 1978, 64.

The PCMC’s recommended eligibility for retirement annuities equal to the percentages of Hi-3 basic pay is shown in table 11.<sup>97</sup> The PCMC recommended Hi-3 average basic pay as an income base because it

- mitigates large differences in retirement pay for service members with similar work histories, who retire a short time before or after a pay raise or longevity increase;
- minimizes the effect on retired pay of the exact date of retirement;
- removes inequities resulting from the current use of terminal basic pay;
- is a commonly used method; and
- is generous by private-sector standards.

<sup>96</sup> *Report of the President’s Commission on Military Compensation*, 63–65.

<sup>97</sup> *Report of the President’s Commission on Military Compensation*, 64.

<b>Table 11. Annuity Multipliers for Current System and PCMC Plan</b>		
<b>Years of Service</b>	<b>Percentage of High-Three Basic Pay</b>	
	<b>PCMC Plan</b>	<b>Current Plan</b>
10	21.25	n.a.*
15	35.00	n.a.
20	48.75	54.6
25	62.50	68.5
30	76.25	79.3
35	90.00	79.3

\*n.a.—not available.

Source: U.S. President’s Commission on Military Compensation (PCMC), *Report of the President’s Commission on Military Compensation*, Washington, DC, April 1978, 65.

#### Recommendation 2:

At age 65, or age 62 if social security is elected early, reduce military retirement pay by 1.25 percent of the initial social security primary benefit for each YOS. In no case should the reduction exceed 50 percent of an individual’s military retirement paycheck.

The PCMC agreed with previous military retirement study recommendations that social security benefits should be considered in setting the level of retired military pay. The PCMC’s recommended offset formula would produce a 50 percent offset for a member with a 40-year career. Those who work fewer than 40 years would have proportionately smaller offsets. Table 12 shows examples of the effect of recommended offset procedure on representative individuals at age 65. In case of rapid increases in social security benefits, a retiree’s military annuity would never be reduced by more than 50 percent.<sup>98</sup>

<sup>98</sup> *Report of the President’s Commission on Military Compensation*, 65–66.

<b>Grade</b>	<b>Years of Service</b>	<b>Percentage Reduction in Military Retired Pay at Age 65 Due to Social Security Offset*</b>
O-3	10	32.0
E-5	10	50.0
O-4	15	23.1
E-6	15	39.4
O-5	20	17.4
E-7	20	34.3
O-5	25	13.1
E-8	25	26.6
O-6	30	11.2
E-8	30	20.0

\*Social security benefits were calculated using the provisions of the 1977 Social Security Act Amendments, assuming an individual will collect social security benefits in the future at age 65. Military covered earnings were based on average enlisted and officer career paths; civilian earnings were based on the median income of high school graduates for enlisted persons and the median income of college graduates for officers, assuming a 1.5 percent annual real-wage growth.

Source: U.S. President's Commission on Military Compensation (PCMC), *Report of the President's Commission on Military Compensation*, Washington, DC, April 1978, 67.

Even with the offset, the combined military and social security annuity would replace a higher percentage of the after-tax, active-duty pay of enlisted personnel than of officers, as shown in table 13.<sup>99</sup>

<sup>99</sup> *Report of the President's Commission on Military Compensation*, 66.

<b>Years of Service</b>	<b>Percentage of Basic Pay</b>
6 to 10	20
11 to 20	25
21 to 25	15
26 to 30	5

Source: U.S. President's Commission on Military Compensation (PCMC), *Report of the President's Commission on Military Compensation*, Washington, DC, April 1978, 68.

### Recommendation 3:

Adjust all annuities for changes in the Consumer Price Index (CPI) using a procedure similar to that now used. For deferred annuities, raise the income base by the percentage increase in the CPI from the date the person left active duty to the date he or she attains age 62, 60, or 55. Use the CPI-adjusted income base for calculating deferred annuities.

The PCMC advocated CPI protection to deferred annuitants, from the time they leave active duty until the time they begin receiving their deferred annuity. For example, without the CPI protection, a person leaving the military at age 30 in an era of 4 percent inflation would see a 70 percent decrease in the purchasing power of the annuity during the 32 years before age 62. The CPI protection is consistent with the recommendations of previous military-retirement studies.<sup>100</sup>

### *Deferred Compensation for Active-Duty Members*

#### Recommendation 4:

Part 1. Establish a deferred compensation trust fund for each member who completes five YOS. Make government contributions to this account according to the schedule in table 13 and accumulate interest at a rate to be determined.

Part 2. At the completion of 10 YOS, vest the amount in the account to the military member. If the member leaves active duty or dies after that point, distribute the balance of the account to the member or his estate according to one of the following three options:

- Leave in account and withdraw at later point.<sup>101</sup>

<sup>100</sup> *Report of the President's Commission on Military Compensation*, 66–67.

<sup>101</sup> Yearly distributions from the account should never exceed basic pay for the last year on active duty.

- Convert to monthly annuity for no fewer than two years.
- Convert to annual payments for no fewer than two years.

Part 3. Allow members who have completed 10 or more YOS to withdraw a portion of their account while still on active duty. Details on withdrawal rules should be developed by the DoD, but in no case should a person be allowed to have withdrawn cumulatively more than 50 percent of the value of his or her account had nothing been withdrawn. To preclude members incurring additional tax liability while on active duty, deferred compensation and the interest on the trust fund should be taxed only when it is withdrawn. Unlike regulations applying to civilian deferred compensation plans, money in the trust fund should not be taxed if it is available for withdrawal, only after withdrawal.<sup>102</sup>

According to the PCMC, the trust fund account

- assists former service members in their transition to civilian life and provides additional incentives to remain on active duty;
- provides a strong incentive for many who leave after one enlistment to stay until the 10th year because it allows them to draw deferred retirement benefits after 10 YOS;
- creates other strong incentives to continue on active duty as a result of the higher government contribution rate after 10 years, the continued accumulation of interest, and the deferred taxes;
- allows a member with 10 to 20 YOS adequate time to resettle and to search or train for a new job after leaving active duty;
- provides greater discretion to military members with respect to the mix of current and deferred compensation, as compared with the existing system;
- allows a member with 10 YOS to convert a portion of the account to current income; and
- allows a member leaving active duty to either defer or accelerate receipt of the vested amount.

In addition, the PCMC considered its plan advantageous to both the military manager and the service member because the contribution amounts are larger than those that private employers typically contribute to such plans. Larger contributions provide retention incentives offsetting the disadvantages of military life, such as the demanding nature of military duty, the many hours that a military member often must work without overtime pay, the frequent moves

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<sup>102</sup> *Report of the President's Commission on Military Compensation*, 67–68.

the member must make, and the likelihood of assignments in remote or hostile parts of the world.<sup>103</sup>

### *Severance Pay for Involuntary Separations*

#### Recommendation 5:

Make severance payments to officers and enlisted members who are mandatorily separated for nondisability reasons with five or more YOS equal to one-quarter of a month of basic pay for each YOS up to 10 years and one-half of a month of basic pay for each YOS from 11 to 30 years. Severance pay should in no case exceed one year's basic pay, nor should it be paid to anyone otherwise eligible for an immediate annuity.<sup>104</sup>

Although the existing system provided severance pay only to officers (the rules varied depending on the service and regular or reserve status), the PCMC recommended extending severance pay to enlisted members and standardizing the amounts for regular and reserve officers in the four services. Table 14 shows the amount that would be paid under the PCMC's recommendation as compared with the existing system. A person with more than 10 YOS also would receive deferred compensation trust fund payments and a deferred annuity at age 60 or 62.<sup>105</sup>

Years of Service at Separation	Officers		Enlisted Persons	
	Current System (in dollars)	PCMC Plan (in dollars)	Current System*	PCMC Plan (in dollars)
5	12,804	1,431	0	721
10	15,000	3,475	0	1,643
15	15,000	8,493	0	4,057
20	n.a.**	15,325	n.a.	7,157
25	n.a.	24,621	n.a.	11,598
30	n.a.	32,040***	n.a.	15,473***

\*Enlisted reservists with five or more years of active duty are entitled to severance pay.  
 \*\*n.a.—not available.  
 \*\*\*Maximum of one year's basic pay.

Source: U.S. President's Commission on Military Compensation (PCMC), *Report of the President's Commission on Military Compensation*, Washington, DC, April 1978, 71.

<sup>103</sup> *Report of the President's Commission on Military Compensation*, 67–70.

<sup>104</sup> *Report of the President's Commission on Military Compensation*, 70.

<sup>105</sup> *Report of the President's Commission on Military Compensation*, 70–71.

### *Medical, PX, and Commissary Benefits for Retirees*

#### Recommendation 6:

Medical, PX, and commissary benefits should be provided to retirees as follows:

- For those with 25 or more years of active service, immediate entitlement on leaving active duty;
- For those with 15 to 24 years of active service, entitlement at age 60 or 62 when the deferred annuity begins; and
- For those with 10 to 14 YOS, no entitlement at any time.
- These benefits should be provided in the same manner as, and at levels comparable to, those currently given to retirees.<sup>106</sup>

The PCMC recommended that members retiring with 25 or more YOS should receive medical care from the military because they would probably have difficulty getting medical coverage under another medical plan. The PCMC chose the fifteenth and twenty-fifth years as thresholds to provide additional incentive for people to stay beyond 10 and 20 years, respectively.<sup>107</sup>

### *Dual Compensation*

#### Recommendation 7:

No military old-age annuities should be paid to former military members while they are employed by the federal civil service. Members who leave active duty and are subsequently employed in the civil service should receive retirement pay according to the following rules.

- Former military members who are otherwise vested in the civil service, that is, who have five or more years in civil service, should be able to apply active military service toward their civil service retirement and receive a civil service annuity based on combined years in both systems, and on Hi-3 civil service salary.
- Former military members who are otherwise vested in the military retirement plan, that is, who have 10 or more years of military service, should be able to apply years in the civil service toward their military old-age annuity and receive the military annuity based on combined years in

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<sup>106</sup> *Report of the President's Commission on Military Compensation*, 70–71.

<sup>107</sup> *Report of the President's Commission on Military Compensation*, 71–72.



both systems and on high-three military basic pay adjusted for CPI increases after leaving military service.

- A person vested in both systems should be able to choose option 1 or 2 above, whichever is most advantageous.
- At age 65, or age 62, if social security is elected early, either the military or civil service annuity should be reduced according to the procedure in recommendation 2.<sup>108</sup>

The PCMC recommended complete portability between the military and civil service retirement systems. In the PCMC's view, payment of a deferred military compensation should not infringe on a retired military member's civil service employment or subsequent receipt of a civil service annuity. This PCMC recommendation was intended to eliminate double dipping, as well as the so-called "Catch 62," which refers to the problem of former military members who count military service toward civil service retirement losing credit for military service on reaching age 62.<sup>109</sup>

### ***Grandfathering***

#### Recommendation 8:

Current retirement rules and policy should continue to apply to those with four or more YOS, serving their second enlistment, or serving beyond their initial period of obligated service at the date of enactment. Recommendations 1 through 7 should apply only to those not included in the above categories.<sup>110</sup>

According to the PCMC, many military members (who have been grandfathered) remain on active duty to qualify for retirement at 20 YOS. The PCMC's proposed new system is designed to appeal to younger first-term members attracted by deferred compensation, retirement vesting at 10 years, and severance pay at five years.<sup>111</sup>

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<sup>108</sup> *Report of the President's Commission on Military Compensation*, 72.

<sup>109</sup> *Report of the President's Commission on Military Compensation*, 72–73.

<sup>110</sup> *Report of the President's Commission on Military Compensation*, 73.

<sup>111</sup> *Report of the President's Commission on Military Compensation*, 73.

## FIFTH QUADRENNIAL REVIEW OF MILITARY COMPENSATION (FIFTH QRMC), 1984

### Introduction

Organized in September 1982, the Department of Defense established the Fifth Quadrennial Review of Military Compensation (Fifth QRMC) to evaluate, in relation to national security objectives, the adequacy of the nondisability military retirement system and certain special and incentive payments to military personnel.<sup>112</sup> The Fifth QRMC recommended, to meet defense requirements, that the uniformed services retirement system have retirement, force-management, and compensation systems with an interrelated, integrated, and closely linked structure supportive of service force-management requirements. The system should provide an incentive to each member to serve the maximum-length career, or, if the service requires a mandatory retirement, to retire without penalty.<sup>113</sup>

The Fifth QRMC based its review on the Post-Service Earnings History File, created from data in the files of the Social Security Administration (SSA), the Internal Revenue Service (IRS), the Defense Manpower Data Center (DMDC), and the staff of the seven uniformed services. The file created by the Fifth QRMC consolidated earnings data over a number of years for a large sample of individuals.<sup>114</sup>

In its general findings, the Fifth QRMC explained that the uniformed services retirement system must support and complement the management of the total force (active and reserve components) in support of national defense requirements. Thus, because its mission is to support readiness in both the active and reserve forces, the military retirement plan is not simply an old-age pension system similar to those normally found in the private sector or in other federal retirement programs, but a unique system. Moreover, the United States is the only free nation to have a retirement system for both active forces and the reserve components.<sup>115</sup>

According to the Fifth QRMC, eight viable methods of modifying the retirement system by adjusting the level of the retired/retainer pay include

1. Multiple-year averaging of basic pay for retired pay

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<sup>112</sup> U.S. Department of Defense, Office of the Secretary of Defense, *Fifth Quadrennial Review of Military Compensation*, vol. 1, *Uniformed Services Retirement System* (Washington, DC, January 1984).

<sup>113</sup> *Fifth Quadrennial Review of Military Compensation*, vol. 1, I-2.

<sup>114</sup> *Fifth Quadrennial Review of Military Compensation*, vol. 1, IV-1.

<sup>115</sup> *Fifth Quadrennial Review of Military Compensation*, vol. 1, I-29.

2. Modified multiplier for YOS
3. Pre-30 YOS (early retirement) retired pay adjustment
4. Cost-of-living adjustments
5. Changes in vesting
6. Integration with social security
7. Member contribution
8. Some combination of the above adjustments<sup>116</sup>

The Fifth QRMC endorsed a dominant feature of the existing uniformed services retirement system—no vesting short of the attainment of 20 years of active service (and 20 creditable YOS for the reserve components as well), except in the case of disability retirement. According to the Fifth QRMC, earlier, pre-20 YOS vesting for a deferred benefit costs more while providing no benefit in regard to mission readiness, whereas extending the initial retirement eligibility to some point beyond 20 YOS costs more but is counter to stated service requirements. In the Fifth QRMC's view, the current system of severance pay, along with the enlisted bonus structure, provide sufficient remuneration for services rendered and a degree of equity for service members who are either voluntarily or involuntarily terminated from the service short of 20 creditable YOS.<sup>117</sup>

The Fifth QRMC found that implementation of a contributory retirement system, with a meaningful percentage from member contributions, would significantly increase accessions and reduce the size of the career force. Thus, an offsetting pay raise of an equal or greater percentage than the contribution would be required to maintain acceptable force size and mission readiness. Therefore, the Fifth QRMC found that the government would not gain from a contributory retirement system because it would be paying a bonus in the form of a forced savings account to those individuals who do not stay until retirement.<sup>118</sup>

The Fifth QRMC found that social security benefits are expected to continue to be less than for comparable private-sector earnings because members of the military make contributions only on basic pay rather than on basic military compensation (BMC). This trend, which establishes an implicit, partial integration with social security, is preferable, in the Fifth QRMC's

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<sup>116</sup> *Fifth Quadrennial Review of Military Compensation*, vol. 1, I–30.

<sup>117</sup> *Fifth Quadrennial Review of Military Compensation*, vol. 1, I–33.

<sup>118</sup> *Fifth Quadrennial Review of Military Compensation*, vol. 1, I–29–I–33.

view, because explicit integration would have a more severe impact on enlisted personnel's old-age income. In its cost comparison of the current service retirement benefits with private-sector old-age pension plans, the Fifth QRMC found that

- service retirement costs the government 1.2 to 2.0 times more than the average of a large sample of private-sector plans;
- service retirement costs for the government and service member combined are 1.2 to 1.6 times higher;
- the present value of the 20-YOS retiree's total benefit is about 30 percent higher than a private-sector individual who retires with full benefits at age 62 with 20 YOS (ninetieth percentile); and
- the 30-YOS military retiree's total benefit is about 15 percent higher than a civilian retiree age 65 with 35 YOS (ninetieth percentile).<sup>119</sup>

Although it did not conduct a detailed analysis of the disability retirement system, the Fifth QRMC observed that the difference in classification of a fairly sizable portion of retirees between the DoD and the VA had implications for the mobilization base and needed to be reviewed. The Fifth QRMC noted that the ability of disabled retirees to cycle between two annuities (VA benefits and DoD retiree payments) was not intended by law and needed to be resolved.<sup>120</sup> The Fifth QRMC categorized the existing uniformed services retirement system as a pay-as-you-go system. Under accrual accounting, the DoD, as of FY1985, may classify retirees as nondisability retirees, although they are also eligible for VA disability payments. Although the DoD and VA use the same guidelines to determine eligibility, the DoD rates a retiree's condition only once, at the time of retirement, whereas the VA allows reevaluation. Thus, the Fifth QRMC explained, retired members frequently find it advantageous to accept the VA disability benefit because it is exempt from federal income tax. The amount that a retiree receives from the VA is then subtracted from the retiree's DoD retirement benefits.<sup>121</sup> Of the approximately 1 million retirees classified by the DoD as nondisability, 25 percent have an offset to their retirement annuity as a result of payments received from the VA for disability. The Fifth QRMC found that "nondisability retirees are a mobilization asset" but suggested that the 25 percent who received disability benefits from the VA "may not be a viable mobilization asset."<sup>122</sup>

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<sup>119</sup> *Fifth Quadrennial Review of Military Compensation*, vol. 1, I-29-I-33.

<sup>120</sup> *Fifth Quadrennial Review of Military Compensation*, vol. 1, I-11-I-17.

<sup>121</sup> *Fifth Quadrennial Review of Military Compensation*, vol. 1, I-34.

<sup>122</sup> *Fifth Quadrennial Review of Military Compensation*, vol. 1, I-34.

The Fifth QRMC explained that its ability to analyze the reserve component retirement system also was constrained by both data and limitations. Nevertheless, the Fifth QRMC found a number of conclusions of the 1976 Reserve Compensation System Study (RCSS), which focused only on National Guard and reserve compensation, still valid, including the finding that reserve entitlement results in a high flow of officers and a low flow of enlisted members to retirement. In addition, the Fifth QRMC observed that the compensation system for the National Guard and Reserve Forces must be an integral part of the overall system by which manpower is managed.<sup>123</sup> In view of increased emphasis on the shift of active-duty responsibilities to the Reserve Forces, the Fifth QRMC proposed undertaking a study similar to the RCSS.<sup>124</sup>

### Key Features of the Proposed Reform

On the basis of its general findings regarding the military retirement system and its extensive analysis of force structure and cost, the Fifth QRMC made some general observations. In narrowing the range of feasible alternatives for changing the retirement system, the Fifth QRMC took into account the following operating principles:

- Any resulting retirement system should be as good or better than an average composite of the best, large private-sector retirement systems
- A viable level of monthly retired pay should be retained throughout a retiree's lifetime
- A portion of the retired pay cost avoidance would be needed to create a profile with equal or better force effectiveness than the base case because a reduced retirement benefit would affect the required force structure.<sup>125</sup>

The Fifth QRMC staff selected four basic retired pay adjustment alternatives:<sup>126</sup>

1. *Reduced COLA/Early Withdrawal.* Annually adjust retirement payment by 50 percent of the CPI instead of 100 percent until age 62. This alternative provides retirement early withdrawals for those under the new system who stay at least to the end of 20 YOS (1.6 times annual basic pay at 20 YOS, 0.4 at 23 YOS, and 0.5 at 27 YOS).
2. *Reduced Multiplier/Early Withdrawal.* A multiplier of 1.75 percent vice 2.50 percent of basic pay per YOS, that is, 35 percent vice 50 percent at 20 YOS, 43.75 percent vice 62.50 percent at 25 YOS, and 52.5 percent vice 75 percent at 30 YOS. This alternative, which is paid only to retirees under the new system, provides retirement early

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<sup>123</sup> *Fifth Quadrennial Review of Military Compensation*, vol. 1, I-11-I-17.

<sup>124</sup> *Fifth Quadrennial Review of Military Compensation*, vol. 1, I-36.

<sup>125</sup> *Fifth Quadrennial Review of Military Compensation*, vol. 1, I-35.

<sup>126</sup> *Fifth Quadrennial Review of Military Compensation*, vol. 1, I-17.

withdrawals to all who stay at least to the end of several YOS (2.1 times annual basic pay at 20 YOS, 0.6 at 23 YOS, and 1.0 at 27 YOS).

3. *Reduced Early (Pre-30 YOS) Benefit/Early Withdrawal.* Retirement benefit percentage of basic pay is tapered (–3 percent per year) from 35 percent at 20 YOS to 75 percent at 30 YOS. This alternative, which is paid only to retirees under the new system, provides a retirement early withdrawal (2.1 times annual basic pay at 20 YOS) to all who stay at least to the end of 20 YOS.
4. *Combination/Early Withdrawal.* This alternative reduces the COLA to 75 percent until age 62, reduces the pre-30 YOS retiree benefit by 3 percent per year (tapered from 35 percent at 20 YOS to a maximum 75 percent at 30 YOS), and allows a retirement early withdrawal for two times annual basic pay for officers and three times for enlisted personnel for all under the new system who stay at least through the end of 20 YOS.

The Fifth QRMC examined the long-term impact of these alternatives on the four service force profiles, concluding that proposed legislation to modify the current retirement system by reducing retired pay must require, as an integral part of the new system, reallocation of part of the reduced retirement lifetime earnings (deferred compensation) to a more current timeframe. The early withdrawal amount would be paid whether or not a member retired at this point, raising service concerns about whether service members would choose to take the early withdrawal lump sum and then immediately retire. The Fifth QRMC minimized these concerns, noting that many service members have a problem meeting their family responsibilities at about the time of retirement eligibility.<sup>127</sup>

The Fifth QRMC acknowledged that retired pay adjustment would have a greater influence on the profile of the enlisted force than that of the officer force, and that, moreover, retired pay could not be adjusted without a “force-profile degradation,” in an amount to be determined by the relative change in the existing value of incomes of all YOS groups.<sup>128</sup>

The Fifth QRMC examined the possibility of lengthening or extending the YOS necessary to become eligible for an immediate annuity, but found that an extension would have a higher overall cost without meeting the services’ requirements. The Fifth QRMC stated that the most effective retired pay reallocation method must place the proper level of compensation incentive at the right YOS (20 YOS) to draw and retain the required number of quality careerists.

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<sup>127</sup> *Fifth Quadrennial Review of Military Compensation*, vol. 1, I–17.

<sup>128</sup> *Fifth Quadrennial Review of Military Compensation*, vol. 1, I–26.

According to the Fifth QRMC, “expending the existing compensation by reducing retired pay too early reduces efficiency.”<sup>129</sup>

In addressing other standard provisions that make up a retirement system, the Fifth QRMC again found that there were good and sufficient reasons for keeping the existing system noncontributory. The Fifth QRMC examined early vesting from 5–12 YOS, both in conjunction with the existing system and with several alternative retirement structures, finding that it had both a cost increase and a negative force-strength impact because it created a younger and less experienced career force. This effect, while the same for both enlisted and officer personnel, was more pronounced for the enlisted members. The Fifth QRMC did not find any significant benefit to integrating the existing service retirement system with social security.<sup>130</sup>

Lastly, on the issue of a COLA mechanism, the Fifth QRMC concluded that, in view of the less-than-reliable history of CPI projections, it would be undesirable to use the postretirement COLA as the primary adjustment. By flattening the slope of the rate at which retired pay increased (2.5 percent per YOS), the COLA provided a disincentive for a service member to remain in the force. The COLA thus had a greater effect than any of the other kinds of retired pay adjustments on the 21 to 30 YOS force population. Further, the Fifth QRMC determined that fluctuations between active-duty wage growth, capped in the past with subsequent catch-ups, and retiree COLAs, not capped until the early 1980s, created inequities. The Fifth QRMC recommended instead a continuous, smooth, in-service pay adjustment process, blending COLA and pre-30 YOS adjustments.<sup>131</sup>

## Conclusions and Recommendations

The Fifth QRMC made a number of major recommendations for strengthening the uniformed services retirement system. In general, it recommended maintaining the basic purpose of the existing system without modifying it in ways that might degrade the mission readiness of the uniformed services. The Fifth QRMC regarded force impact considerations, not cost avoidances alone, as foremost in evaluating retirement-system alternatives. The Fifth QRMC recommended four primary alternatives:

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<sup>129</sup> *Fifth Quadrennial Review of Military Compensation*, vol. 1, I–26.

<sup>130</sup> *Fifth Quadrennial Review of Military Compensation*, vol. 1, I–15.

<sup>131</sup> *Fifth Quadrennial Review of Military Compensation*, vol. 1, I–22.

1. Reduced multiplier/early withdrawal
2. Reduced COLA/early withdrawal
3. 3 percent pre-30 YOS/early withdrawal
4. Combination/early withdrawal<sup>132</sup>

The Fifth QRMC proposed paying, at the time of retirement, an appropriate early withdrawal amount from the total remaining earned retirement benefit. These early withdrawals would be funded from the annual accrual payments to the retirement trust fund. In order for this arrangement to work, the services not under the DoD would initiate accrual payments to a separate Department of the Treasury retirement trust fund for service members. Once a service member became eligible for early withdrawal, as much as 75 percent of the member's unused early withdrawal would become available to the service member as a low-rate, interest-only loan, or otherwise would accumulate interest at the applicable rate earned by the retirement trust fund until the time of retirement.<sup>133</sup>

The Fifth QRMC also recommended structuring modifications to the current system to reduce or overcome the force impact of past implementation of the Hi-3. To that end, the Fifth QRMC recommended giving service members on active duty at the time of the modified retirement system's implementation the option of computing their initial retired pay under the current system; those current service members with 12 or fewer YOS would be given the option to elect the modified system in toto.<sup>134</sup>

Regarding other features of its proposed system, the Fifth QRMC recommended making no modification to the current system that would change vesting to either an earlier time or a later time, or both. The system would remain noncontributory for the service member, with no explicit integration with social security undertaken.<sup>135</sup> With regard to offsets, the Fifth QRMC recommended studying the implications for mobilizing DoD nondisabled retirees who are under the age of 60, receiving VA disability payments, and retired for fewer than 10 years. Lastly, the Fifth QRMC recommended continuation of full inflation protection for disability retirement and survivor benefits.<sup>136</sup>

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<sup>132</sup> *Fifth Quadrennial Review of Military Compensation*, vol. 1, I-35.

<sup>133</sup> *Fifth Quadrennial Review of Military Compensation*, vol. 1, I-35.

<sup>134</sup> *Fifth Quadrennial Review of Military Compensation*, vol. 1, I-36.

<sup>135</sup> *Fifth Quadrennial Review of Military Compensation*, vol. 1, I-35.

<sup>136</sup> *Fifth Quadrennial Review of Military Compensation*, vol. 1, I-36.



The Fifth QRMC analysis explained its proposed four primary alternatives for restructuring and strengthening the current retirement system as follows:<sup>137</sup>

1. *Reduced Multiplier/Early Withdrawal*

Advantages are that this alternative

- has the largest near-term DoD cost avoidance as a result of the 1.75 percent multiplier alternative, which has a 15.4 percent reduction in the normal cost percentage (NCP);
- has a long-term 16.6 percent reduction in trust fund outlays;
- is the most cost-efficient for reallocation;
- creates an early withdrawal surge in future trust fund payments lesser than and shorter than the surge of the combination alternative (the combination alternative has the highest early withdrawal surge);
- is easily implemented without creating equity problems with the current force.

Disadvantages are that this alternative

- results in the most severe force impact without any early withdrawal;
- does not restore the force profile in the early/mid-career (5–20 YOS) as well as the combination alternative;
- requires multiple early withdrawal payments, which is less desirable; and
- has no short-term savings.

2. *Reduced COLA/Early Withdrawal*

Advantages are that this alternative

- is the second most cost-efficient reallocation alternative because of its 50 percent COLA adjustment;
- reduces the current NCP by 14 percent; and
- reduces long-term trust fund outlays by 13.6 percent.

Disadvantages are that this alternative

- makes possible near-term cost avoidances with significant force impact, if the current force is not grandfathered;
- creates an early withdrawal surge that lasts the longest and is the largest;

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<sup>137</sup> *Fifth Quadrennial Review of Military Compensation*, vol. 1, I-35–I-36.

- has the undesirable aspect of great economic uncertainty for both the government and the service member because of its 50 percent COLA alternative;
- is a poor choice as a primary method for modifying the retirement system;
- presents equity problems for the current force in the implementation and transition stages; and
- does not restore the career force profile as well as other alternatives and thus requires multiple early withdrawals.

3. *Three percent Pre-30 YOS/Early Withdrawal*

Advantages are that this alternative

- has about the same reallocation cost efficiency as the combination alternative;
- only requires one reallocation—a single early withdrawal at the end of 20 YOS; and
- is easily implemented (no equity problems with current force), like the reduced multiplier alternative.

Disadvantages are that this alternative

- results in the least cost avoidance in all categories for both the near and long term;
- creates a current NCP reduction of 8 percent;
- has no near-term trust fund cost avoidances;
- has the smallest (11 percent) long-term trust fund cost avoidances after the early withdrawal surge; and
- does not restore the required career force profile because of the heavy draw to the 21 to 30 YOS part of the career force.

4. *Combination/Early Withdrawal*

Advantages are that this alternative

- reduces the current NCP by 14 percent and has the largest long-term trust fund outlay reduction (18 percent);
- creates the largest long-term NCP reduction (about 20 percent); and
- most correctly shapes the career force profiles.

A disadvantage is that this alternative

- raises equity problems with a small transitory force impact, if the COLA is not grandfathered and if the members with fewer than 12 YOS choose the modified system.

In proposing these alternatives, the Fifth QRMC cautioned that any alternative that reduces the retirement benefit immediately affects the DoD budget by reducing the annual accrual payment. In its analysis, only alternatives that affect indexing (COLA) could produce an immediate reduction in the U.S. Treasury retirement trust fund outlays. Other alternatives require 25 years to affect trust-fund cost avoidances.<sup>138</sup>

## **SIXTH QUADRENNIAL REVIEW OF MILITARY COMPENSATION (SIXTH QRMC), 1988**

### **Introduction**

The Sixth Quadrennial Review of Military Compensation (Sixth QRMC), initiated on January 1, 1987, by order of the president of the United States, conducted a comprehensive evaluation of the reserve compensation system and reported options and recommendations for improving it.<sup>139</sup> Unlike the Fifth QRMC, the Sixth QRMC generally excluded study of regular compensation and retirement benefits. Instead, the Sixth QRMC sought to

- determine the extent to which the current reserve retirement system effectively supported manpower objectives, structures, and policies, and
- evaluate costs and benefits of alternatives.

Primary data sources for the Sixth QRMC analysis included the Reserve Components Common Personnel Data System and the 1986 Reserve Components Surveys.<sup>140</sup>

Changes in law affecting the determination of the retired pay base in calculating retired pay (1980) and the indexing of retired pay (1986) resulted in a significant reduction in the value of both active and reserve retirement benefits for new members who were affected by these changes (see Evolution of the Military Retirement Reform Issue). The Military Retirement Reform Act of 1986 (often referred to as Redux) enacted cuts in retired pay for future retirees,

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<sup>138</sup> *Fifth Quadrennial Review of Military Compensation*, vol. 1, X-1-X-6.

<sup>139</sup> U.S. Department of Defense, Office of the Secretary of Defense, *Sixth Quadrennial Review of Military Compensation, Executive Summary*, and vol. 1B, *National Guard and Reserve Retirement* (Washington, DC, August 1988), iii.

<sup>140</sup> *Sixth Quadrennial Review of Military Compensation*, vol. 1B, xxii.

requiring the secretary of defense to submit a report on reserve retirement to Congress, together with any proposals for modification of the system.<sup>141</sup>

Most reservists are part-time members of the Selected Reserve employed full-time in the civilian economy. Some reservists, primarily officers, serve with the active components, while others are on active duty or full-time duty in the National Guard, providing full-time support to the reserve components. Retired pay for both regular and reserve members is directly linked to basic pay.<sup>142</sup> Under the system existing in 1988, a reserve member had to complete at least 20 YOS and be at least 60 years of age to be eligible to receive reserve retired pay, calculated by multiplying the reservist's YOS by 2.5 percent and multiplying the resulting fraction by basic pay.<sup>143</sup>

A key concern of the Sixth QRMC was the cost of reserve retirement. Since FY1985, military retirement was funded on an accrual basis instead of the traditional current-cost basis. Under the 1985 law<sup>144</sup> creating the accrual funding system and eliminating pay-as-you-go funding for military retirement, a military retirement fund, established in the U.S. Treasury, received monthly payments on accruing liabilities from the DoD and yearly amortized payments on the unfunded liabilities from the U.S. Treasury.<sup>145</sup> Under the accrual method of funding military and retirement survivor benefits, the future costs of military retirement must be taken into account in forming service budgets and, consequently, in military manpower plans and policies. Thus, beginning in FY1987, two separate percentages of basic pay had to be calculated for members on full-time duty with either the active or reserve components and members of the ready reserve not serving full-time.<sup>146</sup>

Legislative changes to the system in 1980 and 1986<sup>147</sup> created three categories for determining future costs of reserve retirement and the relative value of retired pay for reservists. The new system was based on the date the reservist first entered a uniformed service:

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<sup>141</sup> *Sixth Quadrennial Review of Military Compensation, Executive Summary*, and vol. 1B.

<sup>142</sup> *Sixth Quadrennial Review of Military Compensation, Executive Summary*, 17.

<sup>143</sup> *Sixth Quadrennial Review of Military Compensation*, vol. 1B, xx; and *Sixth Quadrennial Review of Military Compensation, Executive Summary*, 117.

<sup>144</sup> Pub.L.No. 98–94 of 1984.

<sup>145</sup> *Sixth Quadrennial Review of Military Compensation*, vol. 1B, xx–xxi.

<sup>146</sup> *Sixth Quadrennial Review of Military Compensation*, vol. 1B, xxi.

<sup>147</sup> Military Personnel and Compensation Amendments of 1980 (Pub.L.No. 96–343) and Redux of 1986.

1. Members who joined before September 8, 1980, had their retired pay calculated as a percentage of the basic pay scale in effect when the member was first entitled to draw retired pay.
2. Members who first entered on or after September 8, 1980, and before August 1, 1986, had their retired pay calculated as a percentage of the average of their highest 36 months of basic pay. This reduced the percentage of pay set aside in the Military Retirement Fund from 27.7 percent to 25.3 percent, a 9 percent reduction.
3. Members who entered on or after August 1, 1986, had their retired pay adjusted using a different method to maintain its value against inflation, thereby further reducing the relative cost and value of reserve retirement. The percentage of basic pay set aside for this group was 22.8 percent, a total reduction of 18 percent from that of members who first entered service before September 8, 1980.<sup>148</sup>

Although the manpower force in most of the reserve components was aging, the Sixth QRMC found it difficult to assess the impact of this trend on the readiness of reserve components. The sizable group of members who joined the armed forces during the Vietnam War period affected the age distribution of all part-time reservists. The Sixth QRMC focused on assessing the structure of the manpower force once this major group had passed through the system. Sixth QRMC projections indicated a continuing aging trend into the next century, with the trend stronger in the enlisted force than in the officer force. Projections also indicated that by the year 2000, the percentage of the part-time Selected Reserve enlisted force with more than 20 YOS would double.<sup>149</sup>

Sixth QRMC projections indicated rapid change in the officer-to-enlisted ratio among those receiving reserve retired pay, with reserve retirement becoming a major factor in retaining enlisted members with critical leadership and technical skills. The Sixth QRMC concluded that mid-career reserve service needed an incentive to maintain the reserve components at required strength beyond eight years of service. In the Sixth QRMC's view, reserve retirement provided this incentive, as evidenced by continuation rates through the first 20 YOS and especially after that point, when continuation rates became much higher than active rates as a result of increasing retirement points and retired pay at age 60.<sup>150</sup>

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<sup>148</sup> *Sixth Quadrennial Review of Military Compensation*, vol. 1B, xxi; and *Sixth Quadrennial Review of Military Compensation, Executive Summary*, 118.

<sup>149</sup> *Sixth Quadrennial Review of Military Compensation, Executive Summary*, 124–25; and *Sixth Quadrennial Review of Military Compensation*, vol. 1B, xxvii.

<sup>150</sup> *Sixth Quadrennial Review of Military Compensation*, vol. 1B, xxvi; and *Sixth Quadrennial Review of Military Compensation, Executive Summary*, 123–24.

Nevertheless, in order to maintain required manpower force structure and personnel with needed leadership, technical qualifications, and experience, the Sixth QRMC concluded that a retention incentive remained necessary because of current and projected manpower force-management problems caused by the existing reserve retirement system. According to the Sixth QRMC, reservists have a strong incentive to continue as long as possible in the absence of personnel policies setting maximum tenure points or actively selecting out some members, thereby contributing to an aging force. In addition, promotion stagnation reduces retention before 20 YOS. The Sixth QRMC's assessment suggested that the existing system provided no flexibility to offset these trends. The Sixth QRMC also noted that the current retirement system fails to deal with an increasing rate of involuntary transfers to the retired reserve—an increase likely to continue as members who initially entered the military during the Vietnam era complete 20 or more YOS.<sup>151</sup>

The Sixth QRMC determined that the cost of reserve retirement is very close to that of average private-sector plans.<sup>152</sup> However, those drawing reserve retired pay typically include about three officers for every enlisted member, leading some observers to question the utility of reserve retirement as a retention incentive for the enlisted force. Sixth QRMC projections, based on existing continuation rates, indicated that the officer-to-enlisted ratio among those receiving reserve retired pay was rapidly changing, resulting in a very different population of reserve members drawing retired pay. The Sixth QRMC sought to compare the relative costs of reserve retirement with the cost and effectiveness of system alternatives.<sup>153</sup>

The Sixth QRMC reviewed previous proposals for possible changes to the reserve retirement system, including reducing the value of reserve retirement, creating a penalty for those who cease active participation before 30 YOS, lowering the age of eligibility for reserve retired pay or providing a lump-sum payment option before age 60, or eliminating reserve retirement altogether.<sup>154</sup> In examining alternatives to the current reserve retirement system, the Sixth QRMC established that the desirable system must

- be fully compatible with the active-duty retirement system, with active duty and reserve service creditable in either system;

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<sup>151</sup> *Sixth Quadrennial Review of Military Compensation*, vol. 1B, xxviii; and *Sixth Quadrennial Review of Military Compensation, Executive Summary*, 125.

<sup>152</sup> *Sixth Quadrennial Review of Military Compensation*, vol. 1B, xxi–xxii.

<sup>153</sup> *Sixth Quadrennial Review of Military Compensation*, vol. 1B, xxii.

<sup>154</sup> *Sixth Quadrennial Review of Military Compensation*, vol. 1B, xxix.

- be sufficiently attractive to aid in recruiting members with prior active-duty service, without being so competitive as to cause undesired attrition from the active components;
- be structured to support the accomplishment of reserve manpower objectives in the near term;
- provide the option for members who first entered a uniformed service before the enactment of any proposed alternative to elect the alternative system or remain under the current system;
- be sufficiently flexible to meet the needs of all seven reserve components;
- provide an incentive to continue to serve beyond 20 years, an incentive increasing until 30 YOS;
- provide for replacing some percentage of lost reserve compensation for members who have qualified for retirement at age 60 but can no longer participate;
- be relatively simple in application, so that the modified or optional system can be readily communicated to and understood by reservists; and
- be cost neutral or at least reduce long-term retired pay costs.<sup>155</sup>

Alternatives that the Sixth QRMC considered and rejected included:

- *Increased Current Compensation in Lieu of Reserve Retirement.* The Sixth QRMC found that this alternative would be more expensive than reserve retirement. Substitution of current compensation would reduce the proportion of members with very long service—a change that is warranted—but it would also be likely to reduce the proportion of members in mid-career, a change that would have an adverse impact on readiness.
- *Reductions in Value of Reserve Retirement.* The Sixth QRMC concluded that this alternative would exacerbate the problems of the current retirement system while increasing costs by increasing accession requirements. This alternative would not eliminate force-distribution problems because members who have completed 20 YOS would still be likely to stay for as long as possible in order to increase their retirement benefit.<sup>156</sup>
- *Actuarially Neutral Early Annuity.* *Actuarially neutral* is defined as offering a reduced early retirement annuity in lieu of an existing annuity. The Sixth QRMC found that the principal flaw with this alternative was that the annuity amount represented a very high percentage of monthly drill pay for many members. The more daily retirement points held by a member electing this option, the higher would be the payment, inducing

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<sup>155</sup> *Sixth Quadrennial Review of Military Compensation*, vol. 1B, xxviii–xxix; and *Sixth Quadrennial Review of Military Compensation, Executive Summary*, 125–26.

<sup>156</sup> *Sixth Quadrennial Review of Military Compensation, Executive Summary*, 128.

unwanted personnel losses, with higher losses among members with higher-point totals as a result of past active duty.<sup>157</sup>

### Key Features of the Proposed Reform

In its review of reserve retirement, the Sixth QRMC assessed the system's effectiveness in supporting manpower requirements by attracting and retaining qualified reservists. Previous studies of reserve compensation had found reserve retirement too expensive and inefficient in supporting these needs of the reserves. The Sixth QRMC targeted reserve retirement as a major factor in the retention of both officers and enlisted members with needed leadership and technical skills. The relative inflexibility of the existing reserve-retirement system is a significant disadvantage, bypassing members who have completed the YOS requirement for retirement pay but are under the age of 60.<sup>158</sup>

After examining a number of possible alternatives to the current, age-60 system, the Sixth QRMC decided on an actuarially neutral, two-tier early annuity based on YOS rather than on the age of the member when the first tier of the early annuity starts. The Sixth QRMC adopted this two-tier system as its recommended alternative.<sup>159</sup> The two-tier option was designed to support the following goals:

- Early entry into military service (18 to 23 years of age), either active or reserve
- Continuous satisfactory reserve component service
- Increased retention of members with fewer than 20 YOS
- Increased attraction of members with active-service experience, who have left active duty for policy or other reasons

According to the Sixth QRMC, the two-tier alternative would provide an optional early annuity at any point after initial qualification for retirement through completion of 20 YOS. The annuity under the first tier would be a flat percentage of the retired pay base calculated under the Hi-3 averaging method. The second-tier annuity would begin at age 62, with a retirement-point reduction for election of this option. Retired pay before and after age 62 would be annually

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<sup>157</sup> *Sixth Quadrennial Review of Military Compensation*, vol. 1B, xxx; and *Sixth Quadrennial Review of Military Compensation, Executive Summary*, 131.

<sup>158</sup> *Sixth Quadrennial Review of Military Compensation*, vol. 1B, 6–40.

<sup>159</sup> *Sixth Quadrennial Review of Military Compensation*, vol. 1B, xxxi; and *Sixth Quadrennial Review of Military Compensation, Executive Summary*, 128.



adjusted for inflation, based on the increase in the CPI minus 1 percent. A one-time catch-up at age 62 would be made to the first-tier annuity. The amount of the first-tier monthly annuity would be constant for all members in the same grade who elect the two-tier option at the same YOS point, regardless of their age. Although the two-tier system would be optional for all current members, it would replace the age-60 annuity for future entrants.<sup>160</sup>

The Sixth QRMC designed the Two-Tier option to provide an incentive to continue service through 30 years, for those who are able to do so. According to the Sixth QRMC, the option has the advantage of being easy to understand and to communicate to reserve members.<sup>161</sup> Moreover, it would be compatible with, not competitive with, the active-duty retirement system and sufficiently attractive to aid in recruiting members with prior active duty, who no longer desired to pursue an active-duty career.<sup>162</sup> The two-tier option would also more effectively support the manpower-force profiles desired by all reserve components, providing a means to replace some percentage of the reserve compensation lost by members who have qualified for retirement at age 60 but can no longer participate.<sup>163</sup>

The Sixth QRMC concluded that incorporation of the recommended two-tier option into the current reserve retirement system would result in a more effective plan at lower cost, although costs would be higher in the near-term. Outlays for retired pay from the military retirement fund would increase because of the required early-annuity payments. This increase would peak in 13 years after enactment. After 19 years, outlays from the fund would be less than under the existing system, according to Sixth QRMC calculations. Near-term increased outlays from retired pay would be partially offset by decreased accession costs and lower initial entry-training costs. These same decreases would increase long-term savings.<sup>164</sup> Thus, according to the Sixth QRMC, although implementation of this option would initially increase outlays from the military retirement fund, these increased outlays would peak at just over \$200 million early in the twenty-first century. At the highest level, this would represent less than a 1 percent increase in outlays from the fund. Long-term costs for reserve retirement would be substantially reduced.

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<sup>160</sup> *Sixth Quadrennial Review of Military Compensation*, vol. 1B, xxxi; and *Sixth Quadrennial Review of Military Compensation, Executive Summary*, 128–29.

<sup>161</sup> *Sixth Quadrennial Review of Military Compensation*, vol. 1B, 6–41.

<sup>162</sup> *Sixth Quadrennial Review of Military Compensation*, vol. 1B, 6–41.

<sup>163</sup> *Sixth Quadrennial Review of Military Compensation*, vol. 1B, xxxi; and *Sixth Quadrennial Review of Military Compensation*, vol. 1B, 6–41.

<sup>164</sup> *Sixth Quadrennial Review of Military Compensation*, vol. 1B, 6–41.

These savings would be immediately reflected by a reduction of about \$132 million per year in the DoD accrual payments into the fund.<sup>165</sup>

The Sixth QRMC recommended the development of legislation to amend chapter 67 of title 10, United States Code, to provide an optional early annuity at any point after initial qualification for retired pay with 20 years of satisfactory service. A second tier would commence at age 62. All members not electing an early annuity would receive retired pay and benefits beginning at age 60 as provided under current law. Members electing the two-tier option, as well as those remaining under the current system, would receive medical benefits at age 60. The two-tier system would be mandatory for all new entrants into the armed forces.<sup>166</sup> Because of the complexity of the Survivor Benefit Plan (SBP) program, the Sixth QRMC did not study the integration of the SBP with the two-tier option. However, the Sixth QRMC considered development of equitable SBP modifications an important part of legislation to implement the two-tier option.<sup>167</sup>

The Sixth QRMC also examined the costs and advantages of extending certain benefits to retired reservists in the gray area, that is, those members of the retired reserve who do not receive retired pay but will be entitled to retired pay at age 60. These members had important benefits but were precluded from participating in military activities available to reservists in either an active or retired status. During the period between the point when they transfer to the retired reserve and the time when they begin to draw retired pay, some reservists feel excluded and cut off from the service and from the military life they have led for most of their working years. The Sixth QRMC concluded that expanded benefits for gray-area retirees would recognize their long and dedicated service,<sup>168</sup> proposing that the two-tier option, if implemented, would effectively eliminate the issue of gray-area retirees. Under the two-tier option, the Sixth QRMC recommended that all retired reservists under age 60, who were receiving first-tier retainer pay or eligible for retired pay at age 60, have the same benefits as members of the Selected Reserve.<sup>169</sup>

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<sup>165</sup> *Sixth Quadrennial Review of Military Compensation*, vol. 1B, xxxii.

<sup>166</sup> *Sixth Quadrennial Review of Military Compensation*, vol. 1B, xxxii; and *Sixth Quadrennial Review of Military Compensation, Executive Summary*, 134.

<sup>167</sup> *Sixth Quadrennial Review of Military Compensation*, vol. 1B, xxxii.

<sup>168</sup> *Sixth Quadrennial Review of Military Compensation, Executive Summary*, 138.

<sup>169</sup> *Sixth Quadrennial Review of Military Compensation*, vol. 1B, xxxv.

## Conclusions and Recommendations

Focusing primarily on compensation for part-time members of the Selected Reserve, the Sixth QRMC concluded that fundamental restructuring of the compensation system was not warranted, except for the reserve retirement system. The Sixth QRMC recommended revising the reserve retirement system to increase retention of mid-career personnel and long-service members. The Sixth QRMC recommended as an alternative to the current age-60 retirement system, the two-tier option, which would provide an optional early annuity at any point after initial qualification for reserve retired pay with 20 YOS. In the Sixth QRMC's assessment, this alternative would result in a reserve retirement system better able to support reserve manpower objectives. Moreover, the two-tier option would be capable of supporting objectives immediately after enactment and sufficiently flexible to meet the needs of all reserve components.

The size of the first-tier annuity is not to be large enough to discourage further paid participation or to attract to the reserves active members who would not otherwise have separated. Thus, the Sixth QRMC recommended the development of legislation to implement this system. Those who were members of a uniformed service before enactment of the recommended change would have the option of electing the early annuity, but, after its enactment, the two-tier system would be mandatory for all new members.<sup>170</sup>

## DEFENSE ADVISORY COMMISSION ON MILITARY COMPENSATION (DACMC), 2006

### Introduction

Chartered in March 2005, the mission of the Defense Advisory Committee on Military Compensation (DACMC) was to review the current military pay and benefits structure and to identify ways to better sustain recruitment and retention of a high-quality, cost-effective, and ready military force. In April 2006, the DACMC issued its report, *The Military Compensation System: Completing the Transition to an All-Volunteer Force*.<sup>171</sup>

In making its case for changing the military retirement system, the DACMC criticized the current active-duty nondisability retirement system, which has been in place for more than 50

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<sup>170</sup> *Sixth Quadrennial Review of Military Compensation*, vol. 1B, 6-40-6-42.

<sup>171</sup> Defense Advisory Committee on Military Compensation, *Completing the Transition to an All-Volunteer Force* (Arlington, Virginia: DACMC, April 2006).

years. By civilian sector standards, this system is generous, providing an immediate and substantial, inflation-protected lifetime annuity for service members who leave after completing at least 20 YOS. The DACMC emphasized that this system is costly. An average annual accrual for military retirement is equal to 27 percent of basic pay, according to DoD actuarial estimates. This annual accrual cost amounted to an estimated \$12.8 billion for active-duty members in FY2004.<sup>172</sup>

The DACMC explained that the current military retirement system has two primary purposes:

1. To provide income for military members in their old age
2. To encourage members to leave the military at between 20 and 30 YOS, if they do not have further promotion potential, thereby preventing stagnation in the ranks<sup>173</sup>

However, the DACMC pointed out that the current system is inequitable, inefficient, and inflexible because it does not allow most members to receive a retirement benefit, it defers too much compensation, and it inhibits force management.<sup>174</sup> Those members who complete fewer than 20 YOS receive no retirement benefit. Thus, the system provides strong incentives to serve for at least 20 years and retire shortly thereafter. The annuity is equal to 2.5 percent of the average of the member's Hi-3 for each year served up to 30 YOS.

After eight to 12 YOS, members become locked into a typical 20-year career, even if both the member and the service would have been better off if the member had left before completing 20 years. As a result of this institutionalized pattern of a 20-year career, career lengths in ground forces and combat arms have been too short and uniform. At the completion of 20 YOS, the typical retiring age is between 38 and 40 for enlisted members and between 42 and 44 for officers. The prospect of an immediate, substantial annuity for those who leave after completing 20 YOS offers a powerful incentive for those who have completed eight to 12 YOS to remain in service only until the retirement point, even though it may be in the service's interest for certain members to continue to serve on active duty.<sup>175</sup>

Over the decades, military force managers have developed the perception that any member who reaches the 10- to 12-year point should be offered the opportunity to continue so

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<sup>172</sup> DACMC, *Completing the Transition to an All-Volunteer Force*, 20.

<sup>173</sup> DACMC, *Completing the Transition to an All-Volunteer Force*, xix–xx, 16–18.

<sup>174</sup> DACMC, *Completing the Transition to an All-Volunteer Force*, 20.

<sup>175</sup> DACMC, *Completing the Transition to an All-Volunteer Force*, xix–xx, 16–18.

that they may vest at 20 YOS and that not to offer the possibility of 20-year vesting would be inequitable. As a result, the military retains some members through 20 YOS even though it may be in the service's best interest to separate them earlier.<sup>176</sup> Although most personnel losses occur at the completion of the initial four-year term of service (with the exception of pilots, who incur a longer obligation in return for the service's investment in pilot training), the next most frequent departure point is at 20 years, when retirement is vested.<sup>177</sup>

In making its case for change, the DACMC discussed the main deficiencies of the current military retirement system,<sup>178</sup> which is designed to induce voluntary separations of members who complete 20 YOS, rather than to contribute to the old-age income needs of most members who serve. Most members actually fail to complete the 20 YOS required to receive a retirement annuity. Less than 15 percent of enlisted members and no more than 47 percent of officers become vested in the nondisability retirement system, qualifying for retirement benefits.<sup>179</sup> Those who serve in the army and the marine corps are less likely to become vested in the retirement system than those who serve in the air force or navy. Those who fail to complete 20 YOS receive no retirement benefits. Even after retiring from active duty, enlisted members with uniquely military skills, such as combat arms, are at a high disadvantage in entering the civilian labor market. Officers and enlisted members with transferable skills such as engineering or aviation suffer less or no income loss. Hence, the current system contributes to the old-age income needs of only a fraction of active-duty members.<sup>180</sup>

According to the DACMC, the current system, through its immediate lifetime annuity, provides an inefficiently high amount of deferred compensation. The DACMC suggests providing an equivalent retention incentive, at lower cost, to stay through 20 years, using current, rather than deferred, compensation. For example, the military would offer the enlisted member a lump-sum bonus of \$87,500 at 12 YOS, conditional on remaining in service for eight more years through the completion of 20 YOS. If the member has a 10 percent personal discount rate, this alternative would provide the same financial incentive as the current retirement system for that

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<sup>176</sup> DACMC, *Completing the Transition to an All-Volunteer Force*, 18.

<sup>177</sup> DACMC, *Completing the Transition to an All-Volunteer Force*, 18, 20.

<sup>178</sup> John T. Warner, *Thinking about Military Retirement* (report, CRM D00 13583.A1/Final, Center for Naval Analyses, Alexandria, Virginia, January, 2006); and DACMC, *Completing the Transition to an All-Volunteer Force*, 20.

<sup>179</sup> DACMC, *Completing the Transition to an All-Volunteer Force*, 17–18.

<sup>180</sup> DACMC, *Completing the Transition to an All-Volunteer Force*, 21–22.

member to stay through 20 YOS, with less than half of the cost to the government.<sup>181</sup> Because individuals tend to prefer current rather than deferred income, it is generally more costly to increase retention through deferred compensation as compared with current compensation. For example, the value of the retirement annuity to a service member vested at 20 YOS is relatively high, as shown in table 15.<sup>182</sup>

YOS in which Annuity Is Discounted	Present Value to Member (10 percent discount rate)		Present Value of Cost to Government (3.25 percent discount rate)	
	Enlisted	Officer	Enlisted	Officer
20	\$187,000	\$360,000	\$417,000	\$763,000
12	\$87,500	\$168,000	\$323,000	\$590,750

Source: Defense Advisory Committee on Military Compensation (DACMC), *Completing the Transition to an All-Volunteer Force*, Arlington, Virginia, April 2006, 25.

The DACMC also observed that the current military retirement system inhibits force management by offering a powerful incentive for those who stay beyond eight to 10 YOS, completing 20 YOS, while offering an equally strong incentive to leave shortly after completing 20 YOS. This typical 20-year career is too short and uniform for a force with widely varying lengths of military occupations, training costs, and needs for “youth and vigor.” Lacking any incentive for highly experienced members to stay beyond 30 YOS, careers beyond 30 YOS are rare under the current system. The DACMC suggested that bonuses and other special pays might induce members in certain occupations to remain in service beyond the 20-year point.<sup>183</sup> In the DACMC’s view, these special programs only highlight the case for adopting a more flexible system.<sup>184</sup>

According to the DACMC, TRICARE, the military health benefit, while “a valuable component of the military compensation package,” has shortcomings. For example, junior and mid-career active-duty members are unlikely to value the retiree health benefit provided both for

<sup>181</sup> DACMC, *Completing the Transition to an All-Volunteer Force*, 24.

<sup>182</sup> DACMC, *Completing the Transition to an All-Volunteer Force*, 23–24.

<sup>183</sup> For example, the DoD has offered buy-outs from the retirement system to unvested members.

<sup>184</sup> DACMC, *Completing the Transition to an All-Volunteer Force*, 25–27.

pre-age-65 retirees and for post-age-65 retirees under TRICARE For Life as a deferred, in-kind benefit. Moreover, this benefit is costly to the DoD. For example, although 72 percent of military retirees worked for employers providing health insurance in 2002, TRICARE usage by the more than 3 million eligible retirees under age 65 and their dependents rose from 66 percent in 2002 to 75 percent in 2005.<sup>185</sup>

The pre-age-65 retiree who switches to TRICARE from a civilian employer program gains the difference in the premium as well as any bonus from the employer, while much of the DoD's benefit accrues to the employer instead of the retiree. The result is a high cost to the DoD, a relatively modest benefit to pre-age-65 retirees, and a subsidy to civilian employers. Therefore, the DACMC recommended that this migration from civilian health programs to TRICARE be discouraged.<sup>186</sup> The DACMC warned that, if there are no changes in TRICARE premiums or cost sharing for retirees under age 65, usage rates will rise to almost 90 percent by FY2011, making the DoD the primary insurer for all of its retirees.<sup>187</sup>

### Key Features of the Proposed Reform

In the DACMC's view, an alternative to the current system with the following features would address the system's shortcomings directly

- Earlier vesting of at least some components of the system
- Less deferred compensation, particularly in the second career period between leaving active duty and full withdrawal from the labor force
- Greater flexibility to encourage more diverse career lengths<sup>188</sup>

The prominent features of the DACMC's modernized retirement system outlined above would include a defined benefit pension beginning at age 60, a government contribution to a TSP-like account with earlier vesting, and offsetting compensation in the form of cash payments at various years or separation pay during the transition to a second career.<sup>189</sup>

The DACMC expects to achieve cost reductions by eliminating the immediate annuity at 20 YOS, thereby freeing a significant amount of resources for allocation to the TSP benefit and

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<sup>185</sup> DACMC, *Completing the Transition to an All-Volunteer Force*, xxvii.

<sup>186</sup> DACMC, *Completing the Transition to an All-Volunteer Force*, xxvii–xxviii.

<sup>187</sup> DACMC, *Completing the Transition to an All-Volunteer Force*, 78–79.

<sup>188</sup> DACMC, *Completing the Transition to an All-Volunteer Force*, 27.

<sup>189</sup> DACMC, *Completing the Transition to an All-Volunteer Force*, 28.

to retention bonuses and separation pays. Currently, service members who complete 20 or more YOS receive an annuity from the year in which they leave military service until age 60. The DACMC refers to this reallocation as offsetting compensation because this compensation offsets the loss of the immediate annuity as a retention incentive. The cost to the government of offering up-front offsetting compensation is lower because current compensation is generally valued more highly than deferred compensation. The DACMC illustrates the impact of this reallocation on the individual service member in table 16.<sup>190</sup>

<b>Table 16. Retirement Payments under the Current System (undiscounted)</b>		
<b>Enlisted</b>		
<b>Age 40 to 60</b>	<b>Age 60 to 77</b>	<b>Total</b>
\$381,229	\$324,045	\$705,274
<b>Officer</b>		
<b>Age 40 to 60</b>	<b>Age 60 to 77</b>	<b>Total</b>
\$573,611	\$750,107	\$1,323,718
Note: In this example, the enlisted member retires at age 40 with 20 YOS; the officer retires at age 47 with 23 YOS.		
Source: Defense Advisory Committee on Military Compensation (DACMC), <i>Completing the Transition to an All-Volunteer Force</i> , Arlington, Virginia, April 2006, 31.		

The DACMC plans a modernized retirement system providing the potential for greater flexibility in force management. The new system diversifies career lengths within the force, compared with lengths of a career in the current retirement system. Even greater force-staffing benefits would be derived from combining earlier vesting, a financial incentive for longer careers, and reassessment of high-year-of-tenure (“up-or-out”) policies for appropriate occupations.

Furthermore, the alternative framework eliminates the current system’s all-or-nothing cliff vesting, which currently reduces flexibility in various ways. The services are reluctant to separate members who have reached mid-career because these separated members would be left with no retirement at all. In some cases, this reluctance of the services results in shortened careers because the services do not retain members for second or third terms of enlistment if

<sup>190</sup> DACMC, *Completing the Transition to an All-Volunteer Force*, 31.



there is reason to believe that they will not be needed for a full 20-year career. In other cases, the immediate annuity paid at the 20-year point reduces incentives for longer careers.<sup>191</sup>

By allowing earlier vesting, the DACMC aims for a modernized military retirement system, with increased flexibility and equity. In addition to providing a reasonable retirement package at separation at all points beyond the 20-year vesting point, the updated retirement system would provide a financial incentive for longer service. For those who continue, the reformed system would provide the incentive structure to support some members through 20 YOS, as well as the flexibility to not support continuation of other members when it is in the interest of both the service and the member to reach an agreement to separate earlier. However, buy-outs would be completely voluntary and would be offered only after other management actions, such as retraining members for needed skills, have been exhausted.<sup>192</sup>

With regard to the comparative costs and benefits of the current and proposed retirement structures, retirement costs are the sum of accrual costs (e.g., the defined benefit deferred annuity and the government's contribution to the TSP and for separation pay) and the steady-state estimate of the annual outlays for retention bonuses, if applicable. In the DACMC's assessment, all of its proposed alternatives have lower retirement costs and greater benefits relative to the current system. According to the DACMC, the benefits of completed, 10, 20, and even 30 YOS would be greater under its proposed alternatives than the current system. For example, the current system offers no benefits at 10 YOS and vests no annuity until 20 YOS. Benefits under the DACMC's alternatives would include a defined benefit annuity that begins at age 60, a government contribution to a TSP-like account, separation or transition pay, and gate pay.<sup>193</sup>

## Conclusions and Recommendations

In the longer term, the DACMC recommended that the military retirement system be restructured under a vision that increases its overall flexibility and efficiency. Recommended features would include earlier vesting of retirement and incentives to serve beyond a 20-year or even 30-year career in some occupations. With the aim of promoting the potential benefits of longer careers, the DACMC recommended reassessing high-year-of-tenure policies, which

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<sup>191</sup> DACMC, *Completing the Transition to an All-Volunteer Force*, 32.

<sup>192</sup> DACMC, *Completing the Transition to an All-Volunteer Force*, 32–34.

<sup>193</sup> DACMC, *Completing the Transition to an All-Volunteer Force*, 118–21.

require members of a certain rank to separate by fixed YOS points. The structure recommended by the DACMC for a modernized military retirement system would include the following three tiers:<sup>194</sup>

Tier 1. *Early Vesting of a TSP-like Account.* This tier would include a government contribution to a TSP or 401(k)-like plan, adding a percentage of basic pay, such as 5 percent, to the member's contribution. Government contributions would begin to accumulate immediately after a member enters active duty, vesting no later than the tenth YOS, but not before the fifth YOS. The member who remains on active duty would have the flexibility to receive the government contribution in cash once the member has vested, in lieu of the TSP contribution.

Tier 2. *Defined Benefit Pension.* This tier would include a retirement annuity that begins at age 60, computed under a formula similar to the current retirement annuity. It would vest at the completion of 10 YOS. The formula would be extended through 40 YOS, so that a member serving 40 years would receive 100 percent of the Hi-3 average of basic pay. The retirement health benefit would continue to vest at the completion of 20 YOS, with immediate benefits offered to those who separate after completing 20 or more YOS.

Tier 3. *Additional Offsetting Compensation Incentives to Produce Desired Retention.* The DACMC would allow this tier to provide additional offsetting compensation incentives in various forms, including one or more of the following:

- Short-term transition or separation pay for those who leave military service after the vesting point, where the amount and duration of the pay is a function of pay grade and YOS at separation
- Additional pay in the form of a multiple of basic pay payable at key YOS milestones such as 10, 15, 20, 25, and 30 years, with the member receiving this pay or bonus on completing the YOS
- An increase in basic pay or bonuses targeting a broader span of the career, rather than targeting only YOS milestones<sup>195</sup>

The DACMC would provide the first two tiers of its modernized military retirement system uniformly across the services, whereas the third tier (the additional offsetting compensation incentives) would vary across services and within services, according to occupation or other criteria. This proposal would enable the services to achieve force management and staffing goals. The DACMC also recommended reassessing high-year-of-tenure policies in order to further enhance career management.<sup>196</sup>

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<sup>194</sup> DACMC, *Completing the Transition to an All-Volunteer Force*, 34.

<sup>195</sup> DACMC, *Completing the Transition to an All-Volunteer Force*, 34–35.

<sup>196</sup> DACMC, *Completing the Transition to an All-Volunteer Force*, 35–36.

The DACMC's modernization of the retirement system would be intended to accomplish three goals:

1. Increase management flexibility, thereby permitting greater variation in career lengths through earlier vesting and continued incentives for longer careers
2. Permit those who provide substantial service but fewer than 20 YOS to leave with some retirement benefits
3. Increase the efficiency of the retention incentive by replacing the portion of the annuity that members receive from separation to age 60 with an up-front cash payment, either at a YOS milestone or in the form of a raise in basic pay or a bonus<sup>197</sup>

To recapitulate, the DACMC's recommended retirement system increases force-management flexibility, provides for greater variation in career lengths, and vests members who serve fewer than 20 years.<sup>198</sup> Although the DACMC recommended that the current force, at the time of transition to a new system, be fully grandfathered, it also suggested that members should have the option to choose to participate in the new system, possibly by agreeing to an additional service obligation.<sup>199</sup>

The DACMC's retirement-related recommendations focused on improvements to the nondisability retirement system and health benefits for retirees, emphasizing that these proposals would apply only to new service entrants, not to anyone currently serving or already retired. The DACMC proposed civilian-style changes to the military retirement system such as

- replacing the current 20-year cliff vesting with earlier vesting for military retirement at 10 YOS;
- adopting a robust TSP or 401(k)-like contributory plan;
- delaying retirement annuity that begins at age 60; and
- providing retention incentives at critical career gates.

For example, the DACMC recommended, for greater management flexibility, that the services in the near future should have the authority to buy out members with more than 10 YOS who are not yet vested. Members eligible for these voluntary buy-outs presumably would be those in occupations with changed circumstances resulting in an excess supply of qualified members. A buy-out system would allow selected members the opportunity to accept a cash

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<sup>197</sup> DACMC, *Completing the Transition to an All-Volunteer Force*, 35–36.

<sup>198</sup> DACMC, *Completing the Transition to an All-Volunteer Force*, 103.

<sup>199</sup> DACMC, *Completing the Transition to an All-Volunteer Force*, xxii, 35–36.

payment in exchange for leaving active duty before vesting in the current retirement system at 20 YOS. The DACMC suggested that one way to establish a buy-out system would be to adopt a plan similar to the voluntary separation pay recently proposed by the navy. Under the voluntary separation pay proposal, the services would be able to target members in specific occupations and year-groups with excess supply and offer the individuals a cash incentive to leave prior to vesting in the retirement system.<sup>200</sup>

In the longer term, the DACMC recommended that the military retirement system be restructured to increase its overall management flexibility and efficiency. This proposal would include earlier vesting of retirement and incentives to serve beyond a 20- or even 30-year career in some occupations. The DACMC recommended reevaluating high-year-of-tenure policies so that members might realize the potential benefits of longer careers.<sup>201</sup>

In summary, the DACMC's recommended architecture for a new retirement system would include:

- a government contribution to a TSP or 401(k)-like plan that adds a percentage of basic pay, in the range of 5 percent, to the member's contribution. Government contributions would begin to accumulate immediately on entrance to active duty and would vest no later than the tenth YOS (but not before the fifth YOS). After vesting, the member who remains on active duty would have the flexibility to receive the government's new contribution in cash, in lieu of the TSP contribution.
- a retirement annuity that begins at age 60, computed under a formula similar to the current retirement annuity. The annuity would vest at the completion of 10 YOS.
- extension of the annuity formula through 40 YOS, so that a member serving 40 years would receive 100 percent of the Hi-3 average of basic pay.
- continuation of vesting of the retirement health benefit at the completion of 20 YOS.
- additional offsetting compensation, in the form of current rather than deferred compensation, sufficient to achieve force-shaping goals. This additional compensation might take various forms, including
  - transition pay of limited duration for those who leave military service after the vesting point, where the amount and duration of the pay is a function of the pay grade and YOS at separation.
  - additional pay or a bonus that is a multiple of basic pay and payable at key YOS such as 10, 15, 20, 25, and 30 years. The member would receive this pay, sometimes called gate pay, on completing the relevant YOS.

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<sup>200</sup> DACMC, *Completing the Transition to an All-Volunteer Force*, xx, 33–34.

<sup>201</sup> DACMC, *Completing the Transition to an All-Volunteer Force*, xx–xxi, 34.

- an increase in basic pay or bonuses.<sup>202</sup>

With regard to health care for military retirees, the DACMC recommended the following:

- Restore the premium and cost-sharing provisions for TRICARE Prime beneficiaries under age 65 to more competitive levels commensurate with premiums and cost sharing in civilian employer plans
- Allow the premium and cost-sharing provisions (that is, deductibles and co-payments) to grow, once adjusted, at the same rate as the annual cost-of-living adjustment to the military retirement annuity
- Fund the TRICARE plan for pre-age-65 retirees on an accrual basis, similar to retirement pay and the TRICARE for Life programs<sup>203</sup>

According to the DACMC, funding the entire retiree health program on an accrual basis would result in decisions regarding active-duty personnel strengths that more accurately reflect their long-term cost. Further, greater transparency regarding the costs of the health-care program in the budget would help to focus attention on managing those costs. The DACMC also recommended examining the management incentives for controlling health-care costs to ensure more efficient force management.<sup>204</sup>

## CONCLUSION

For the most part, the five major studies maintained the status quo of eligibility for retirement at 20 YOS minimum and a pension plan beginning at age 60, with varying formulas for retired pay. Most of the studies proposed beginning vesting at about 10 YOS, with the exception of the Fifth Quadrennial Review of Military Compensation (Fifth QRMC), which recommended continuing the current vesting at 20 years.

The President's Commission on Military Compensation (PCMC) recommended that old-age annuities for military members with 10 or more YOS be computed by multiplying Hi-3 average basic pay by specific multipliers. Under the PCMC plan, a person with more than 10 YOS also would receive deferred compensation trust fund payments and a deferred annuity at age 60 or 62.

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<sup>202</sup> DACMC, *Completing the Transition to an All-Volunteer Force*, xxi–xxii, 34–35.

<sup>203</sup> DACMC, *Completing the Transition to an All-Volunteer Force*, xxviii–xxix.

<sup>204</sup> DACMC, *Completing the Transition to an All-Volunteer Force*, xxviii.

The Fifth QRMC recommended structuring modifications to the current system to reduce or overcome the force impact of past implementation of the Hi-3. To that end, the Fifth QRMC recommended giving service members on active duty at the time of the modified retirement system's implementation the option of computing their initial retired pay under the current system; those current service members with 12 or fewer YOS would be given the option to elect the modified system in toto. The Fifth QRMC categorized its proposed four primary alternatives for restructuring and strengthening the current retirement system as follows: Reduced Multiplier/Early Withdrawal, Reduced COLA/Early Withdrawal, Three percent Pre-30 YOS/Early Withdrawal, and Combination/Early Withdrawal.

Focusing primarily on compensation for part-time members of the Selected Reserve, the Sixth Quadrennial Review of Military Compensation (Sixth QRMC) concluded that fundamental restructuring of the compensation system was not warranted, except for the reserve retirement system. The Sixth QRMC recommended revising the reserve retirement system to increase retention of mid-career personnel and long-service members. The Sixth QRMC recommended as an alternative to the current age-60 retirement system, the two-tier option, which would provide an optional early annuity at any point after initial qualification for reserve retired pay with 20 YOS. In the Sixth QRMC's assessment, this alternative would result in a reserve retirement system better able to support reserve manpower objectives. Moreover, the two-tier option would be capable of supporting objectives immediately after enactment and sufficiently flexible to meet the needs of all reserve components. The size of the first-tier annuity is not to be large enough to discourage further paid participation or to attract to the reserves active members who would not otherwise have separated. Thus, the Sixth QRMC recommended the development of legislation to implement this system. Those who were members of a uniformed service before enactment of the recommended change would have the option of electing the early annuity, but, after its enactment, the two-tier system would be mandatory for all new members.

With the aim of promoting the potential benefits of longer careers, the Defense Advisory Commission on Military Compensation (DACMC) recommended reassessing high-year-of-tenure policies, which require members of a certain rank to separate by fixed YOS points. The DACMC recommended delaying retirement annuity. The DACMC's proposed defined benefit pension would include a retirement annuity that begins at age 60, computed under a formula similar to the current retirement annuity. It would vest at the completion of 10 YOS. The formula

would be extended through 40 YOS, so that a member serving 40 years would receive 100 percent of the Hi-3 average of basic pay.

According to the PCMC, many military members (who have been grandfathered) remain on active duty to qualify for retirement at 20 YOS. The PCMC's proposed system is designed to appeal to younger first-term members attracted by deferred compensation, retirement vesting at 10 years, and severance pay at five years. Thus, the PCMC recommended that current retirement rules and policy should continue to apply to those with four or more YOS, serving their second enlistment, or serving beyond their initial period of obligated service at the date of enactment. The Fifth QRMC recommended making no modification to the current system that would change vesting to either an earlier time or a later time, or both. The DACMC recommended replacing the current 20-year cliff vesting with earlier vesting for military retirement at 10 YOS, as well as incentives to serve beyond a 20-year or even 30-year career in some occupations.

While proposing different payment formulas, all studies assumed severance pay for involuntary separation. Although the existing system provided severance pay only to officers (depending on the service and regular or reserve status), the PCMC recommended extending severance pay to enlisted members and standardizing the amounts for regular and reserve officers in the four services. The PCMC would make severance payments to officers and enlisted members who are mandatorily separated for nondisability reasons with five or more YOS equal to one-quarter of a month of basic pay for each YOS up to 10 years and one-half of a month of basic pay for each YOS from 11 to 30 years. Severance pay should in no case exceed one year's basic pay, nor should it be paid to anyone otherwise eligible for an immediate annuity.

Seven of the nine cited study proposals, including the five major studies, provided social security offsets. With the sole exception of the First Quadrennial Review of Military Compensation (1967), all of the studies before the Fifth QRMC concluded that the system should be noncontributory.

The PCMC agreed with previous military retirement study recommendations that social security benefits should be considered in setting the level of retired military pay. The PCMC's recommended offset formula would produce a 50 percent offset for a member with a 40-year career. Those who work fewer than 40 years would have proportionately smaller offsets. In case of rapid increases in social security benefits, the retiree's military annuity would never be reduced by more than 50 percent. The PCMC recommended that, at age 65, or age 62 if social

security is elected early, military retirement pay be reduced by 1.25 percent of the initial social security primary benefit for each YOS. In no case should the reduction exceed 50 percent of an individual's military retirement paycheck.

The Fifth QRMC recommended that no explicit integration with social security be undertaken. With regard to offsets, the Fifth QRMC recommended studying the implications for mobilizing DoD nondisabled retirees who are under the age of 60, receiving VA disability payments, and retired for fewer than 10 years.

The PCMC recommended that no military old-age annuities should be paid to former military members while they are employed by the federal civil service. The PCMC recommended complete portability between the military and civil service retirement systems. In the PCMC's view, payment of a deferred military compensation should not infringe on a retired military member's civil service employment or subsequent receipt of a civil service annuity. This PCMC recommendation was intended to eliminate double dipping, as well as the so-called "Catch 62," which refers to the problem of former military members who count military service toward civil service retirement losing credit for military service on reaching age 62.

The Fifth QRMC proposed paying, at the time of retirement, an appropriate early withdrawal amount from the total remaining earned retirement benefit. These early withdrawals would be funded from the annual accrual payments to the retirement trust fund. In order for this arrangement to work, the services not under the DoD would initiate accrual payments to a separate Department of the Treasury retirement trust fund for service members. Once a service member became eligible for early withdrawal, as much as 75 percent of the member's unused early withdrawal would become available to the service member as a low-rate, interest-only loan, or otherwise, would accumulate interest at the applicable rate earned by the retirement trust fund until the time of retirement.

The DACMC recommended early vesting of a TSP-like account, which would include a government contribution to a TSP or 401(k)-like plan, adding a percentage of basic pay, such as 5 percent, to the member's contribution. Government contributions would begin to accumulate immediately after a member enters active duty, vesting no later than the tenth YOS, but not before the fifth YOS. The member who remains on active duty would have the flexibility to receive the government contribution in cash once the member has vested, in lieu of the TSP contribution. The DACMC also recommended short-term transition or separation pay for those



who leave military service after the vesting point, where the amount and duration of the pay is a function of pay grade and YOS at separation. It also recommended additional pay in the form of a multiple of basic pay payable at key YOS milestones such as 10, 15, 20, 25, and 30 years, with the member receiving this pay or bonus on completing the YOS.

Almost all of these studies, with the exception of the one done by the President's Private Sector Survey on Cost Control (1983), assumed grandfathered retirement benefits, using the full CPI as an adjustment mechanism.<sup>205</sup> The Defense Manpower Commission (DMC) concluded that the methods of establishing the initial amount of the annuity and making postretirement adjustments should be changed in order to maintain the purchasing power of retired pay. The DMC found that the various methods of adjusting annuities are all sensitive to two factors— inflation and the method of making the first increase in an annuity. Under the DMC's proposal, future inflation would not be a factor in establishing the initial annuity, which would include, if warranted, a catch-up payment to compensate (but not overcompensate) for lost purchasing power.

Like previous military-retirement studies, the PCMC advocated CPI protection to deferred annuitants, from the time they leave active duty until the time they begin receiving their deferred annuity. For deferred annuities, the PCMC would raise the income base by the percentage increase in the CPI from the date the person left active duty to the date he or she attains age 62, 60, or 55. The PCMC would establish a deferred compensation trust fund for each member who completes five YOS. At the completion of 10 YOS, the PCMC would vest the amount in the account to the military member. The Fifth QRMC recommended continuation of full inflation protection for disability retirement and survivor benefits.

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<sup>205</sup> United States, Department of Defense, *Fifth Quadrennial Review of Military Compensation*, vol. 1, *Uniformed Services Retirement System* (Washington, January 1984), I-3, I-4.

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# APPENDIX

**CHART 1. MAJOR MILITARY RETIREMENT REFORM PROPOSALS, 1976–2006**

Major Study	Retirement Eligibility	Formula for Retired Pay	Contributory	Vesting	Severance Pay	Social Security	Transition and Save Pay	Adjustment Mechanism
<b>Defense Manpower Commission (DMC), 1975–76</b>	Between 20–30 YOS based on time in combat or noncombat jobs (1.5 credits for each year in combat job, one point per year in noncombat pay). For those in combat arms occupations, an immediate annuity, after 20 YOS; for all others, an immediate annuity after completing 30 YOS.	Two-tier system: Maximum: 80 percent of highest three years of basic pay on attaining 30 retirement points; 2.66 percent per retirement point; Reduction: permanent actuarial reduction in retired pay for member who retires with 30 points and elects to receive retired pay before the 30-YOS point.	No.	At least 10 YOS; deferred annuity at age 60.	Yes. Vested members voluntarily separated receive deferred annuity effective at age 65 based on Hi-3 times per-point retirement multiplier times YOS; adjusted periodically based on CPI. Involuntarily separated vested members with 10 YOS receive immediate cash payment for readjustment and either a deferred annuity or a second immediate cash payment equal to the readjustment pay, at member’s option.	No offset. Formula for retired pay should consider social security benefit.	Changes would be prospective; would not apply to those already in the service.	Periodic two-part adjustment based on CPI and a catch-up payment.
<b>President’s Commission on Military Compensation (PCMC) (Zwick Commission), 1978</b>	Based on age and YOS.	(1) 2 percent for one to five YOS, 2.25 percent for six to 10 YOS, and 2.75 percent for 11 to 35 YOS; (2) Maximum: 90 percent of Hi-3 basic pay in past 10 YOS; member can convert a portion of retirement account to current income; when leaving active duty, member can opt for deferred or	No.	At 10 YOS.	Yes. After five YOS for involuntary separation, for officers and enlisted personnel.	Varying offset based on YOS (25 percent to 37.5 percent) to begin at ages 62 or 65.	With five or more YOS, may retire under old rules. A cash transition fund, like the Thrift Savings Plan (TSP), with annual government contributions, permits member to withdraw funds on separation.	CPI.

Major Study	Retirement Eligibility	Formula for Retired Pay	Contributory	Vesting	Severance Pay	Social Security	Transition and Save Pay	Adjustment Mechanism
		accelerated receipt of vested account.						
<b>Fifth Quadrennial Review of Military Compensation (Fifth QRMC), September 1982–January 1984</b>	One of four primary alternatives should be considered: (1) Reduced multiplier/early withdrawal; (2) Reduced cost of living adjustment (COLA)/early withdrawal; (3) 3 percent pre-30 YOS/early withdrawal; and (4) Combination/early withdrawal. The service member should have access to the early withdrawal after reaching the early withdrawal eligibility point.	At the time of retirement, provide payment of appropriate early withdrawal amount from the total remaining earned retirement benefit. Structure current system to reduce or overcome the force impact of past implementation of the Hi-3. Give service members on active duty option to compute their initial retired pay under current system. Limit option to elect modified system in toto to those current service members with 12 or fewer YOS.	No.	Keep existing system: no vesting short of 20 years of active service (20 creditable YOS for the reserve components), except in the case of disability retirement.	No changes.	No offset. No integration with social security.	Allow option to compute initial retired pay under current system or to elect modified system in toto if member has 12 or fewer YOS.	Provide a continuous and smooth in-service pay adjustment process with reduced COLA and continue full inflation protection for disability retirement and survivor benefits.
<b>Sixth Quadrennial Review of Military Compensation (Sixth QRMC), 1988</b>	Early annuity available on completion of 20 YOS. At age 60, all reservists receiving retired pay or first-tier retainer pay would be eligible for the same benefits as are all military retirees.	Two-tier early annuity system based on YOS rather than on age. First Tier: flat percentage of retired pay under Hi-3 and one-time catch-up at age 62; Second Tier: At age 62. Two-tier system optional for current members, mandatory for future entrants.	No.	Allow reserve members to receive YOS credit for inactive-duty training.	No change.	No offset specified.	Members not electing an early annuity would receive retired pay and benefits beginning at age 60.	CPI minus 1 percent for retired pay before and after age 62.

Major Study	Retirement Eligibility	Formula for Retired Pay	Contributory	Vesting	Severance Pay	Social Security	Transition and Save Pay	Adjustment Mechanism
<b>Defense Advisory Commission on Military Compensation, April 2006</b>	Greater flexibility to encourage diverse career lengths. A defined pension plan beginning at age 60, in keeping with the reserve pension benefit.	Retirement annuity beginning at age 60, extending through 40 YOS, and computed under a formula similar to current retirement annuity. Offsetting compensation could take the form of cash payments at various YOS milestones or separation pay during the transition to a second career. Eliminating immediate annuity at 20 YOS would free significant resources to be allocated to the TSP benefit, retention bonuses, and separation pays. Member with 40 YOS would receive 100 percent of Hi-3 average of basic pay.	No.	Earlier 10-year vesting of some components of the system, eliminating the current all-or-nothing, 20-year cliff vesting.	Yes. Transition or separation pay of limited duration for those who leave military service after the vesting point. Additional pay in the form of a multiple of basic pay at key years-of-service milestones such as 10, 15, 20, 25, and 30 years. The member receives this pay or bonus on completing the relevant YOS.	No offset. Formula for retired pay should consider social security benefit.	Less deferred compensation, particularly in the “second career” period between leaving active duty and full withdrawal from the labor force. A cash transition fund, like the TSP, with annual government contributions of 5 percent of basic pay per year.	CPI.

Source: U.S. Department of Defense, Office of the Secretary of Defense, “Appendix E, Mobilization Aspects of the U.S. Military Retirement System,” in vol. 1A, *Supporting Appendixes to Uniformed Services Retirement System (A–G), Fifth Quadrennial Review of Military Compensation*, Washington, DC, January 1984, B–6–B–12; U.S. Department of Defense, Office of the Secretary of Defense, *Sixth Quadrennial Review of Military Compensation, Executive Summary*, Washington, DC, August 1988; and Defense Advisory Committee on Military Compensation, *Completing the Transition to an All-Volunteer Force*, Arlington, Virginia, April 2006.



**CHART 2. OTHER MILITARY RETIREMENT REFORM PROPOSALS, 1948–83**

Major Study	Retirement Eligibility	Formula for Retired Pay	Contributory	Vesting	Severance Pay	Social Security	Transition and Save Pay	Adjustment Mechanism
<b>Hook Commission, 1948</b>	Officers: (1) At age 60 with 20 or more (YOS); (2) At any age with 30 or more YOS. Enlisted Members: (1) At age 50 with 20 or more YOS; (2) At any age with 30 or more YOS; (3) Service may allow retirement at 25 YOS according to needs.	At a rate of 2.5 percent per year not to exceed 75 percent of basic pay.	No.	No, but with provision for severance pay for involuntary separation.	(1) YOS 0 to 4: One-half month's basic pay times total years of active service. (2) YOS 5 to 9: 2.5 months' basic pay plus one month's basic pay times number of years of active service over five; (3) YOS 10 and over: 7.5 months' basic pay plus 1.5 months' basic pay times number of YOS over 10, not to exceed two years' basic pay.	No offset.	Five-year phase-in period from enactment, allowing member to elect either Hook Plan or current service retirement plan.	None.
<b>First Quadrennial Review of Military Compensation (First QRMC), 1967–69</b>	Step 1: Retire at 20 YOS with immediate annuity ranging from 24 percent at 20 YOS to 51 percent at 30 YOS. Step 2: Annuity is paid based on inverse function (age 55 at 30 YOS to age 60 at 20 YOS), or when the age requirement is met after Step 1 retirement.	Step 1: Percentage of High 1 salary based on 20 to 40 YOS. Step 2: Increase retired pay up to 9 percent based on YOS and age by inverse function.	Yes, 6.5 percent of a salary determined by a formal comparability standard for setting pay levels.	Yes, member is vested to the amount of contribution.	Yes, lump sum after 10 YOS. No formula specified.	Integration formula needed to provide equal benefit to members with same time in service. Contribution to retirement to include social security. Retirement offset by 50 percent of social security benefit.	Five-year phase-in.	CPI.

Major Study	Retirement Eligibility	Formula for Retired Pay	Contributory	Vesting	Severance Pay	Social Security	Transition and Save Pay	Adjustment Mechanism
<b>Interagency Committee (IAC), 1971</b>	Reduced annuity for members retiring with fewer than 30 YOS, based on age and YOS; increased to full amount when members attain age threshold.	Through year 24, 2.5 percent; for years 25 to 30, 3 percent per year; for years 31 to 35, 2 percent per year. Maximum: 88 percent of highest three years of basic pay. Reduction: 2 percent reduction in retired pay for each year under the age threshold of age 60 for 20 to 24 YOS, or age 55 for 25 YOS. Reduction is lifted when member reaches age threshold. Example: for retirement with 20 YOS at age 42, usual retired pay is reduced by 36 percent (2 percent times 18 years under the age 60 threshold); the reduction is lifted at age 60.	No.	Yes, at 10 YOS; deferred annuity at age 60 or lump sum.	Yes, lump sum over five YOS (5 percent of final basic pay times YOS) for involuntary separation, officer and enlisted personnel.	Yes, 50 percent offset at age 60.	Transition accomplished within 10 pay raises following implementation.	CPI.
<b>Retirement Modernization Act (RMA), 1972</b>	Reduced annuity for members retiring with fewer than 30 YOS (two-step annuity); increased to full amount when member would have attained 30 YOS.	At 2.5 percent per year through year 24; 3 percent per year for years 25 to 30. Maximum: 78 percent of highest one year of basic pay. Reduction: For retirement with fewer than 30 YOS, multiplier is reduced 15 percentage points. Reduction is lifted at point where member would have attained 30	No.	At 10 YOS; provides deferred annuity at age 60.	Vests after five YOS. Deferred annuity starting at age 60, plus one lump-sum readjustment payment; or two lump-sum payments (one for equity and one for readjustment).	Yes, 50 percent offset when old-age annuity received.	Based on number of years under new system before 20 YOS.	CPI.

Major Study	Retirement Eligibility	Formula for Retired Pay	Contributory	Vesting	Severance Pay	Social Security	Transition and Save Pay	Adjustment Mechanism
		YOS. Example: For retirement with 20 YOS, the usual 50-percent multiplier is reduced to 35 percent initially; increased to 50 percent 10 years after retirement. Maximum: 80 percent of highest three years of basic pay on attaining 30-year retirement.						
<b>Third Quadrennial Review of Military Compensation (Third QRMC), 1975–76</b>	Reduced annuity for members retiring with fewer than 30 YOS (two-step annuity); increased to full amount when member would have attained 30 YOS.	At 2.5 percent per year through year 24; 3 percent per year for years 25 to 30. Maximum: 78 percent of highest one year of basic pay. Reduction: For retirements with fewer than 30 YOS, multiplier is reduced 15 percentage points. Reduction is listed at point where member would have attained 30 YOS. Example: for retirement with 20 YOS, the usual 50 percent multiplier is reduced to 35 percent initially; increased to 50 percent 10 years after retirement.	No.	At 10 YOS; provides deferred annuity at age 60.	Yes. Vests after five YOS. Deferred annuity starting at age 60 plus lump-sum readjustment payment; or two lump-sum payments (one for equity and one for readjustment).	None.	Based on number of years under new system before 20 YOS.	CPI.

Major Study	Retirement Eligibility	Formula for Retired Pay	Contributory	Vesting	Severance Pay	Social Security	Transition and Save Pay	Adjustment Mechanism
<b>Aspin Retirement Proposal, 1976</b>	Voluntary retirement at age 55 with 30 or more YOS; age 60 with 20 to 29 YOS.	(1) 1.5 percent for one to five years, 1.75 percent for years six to 10, and 2 percent for 20 over 10 years; (2) Based on highest three-years' average of regular military compensation (RMC); (3) Voluntary; no retired pay until: (a) age 62 with five to 19 YOS, (b) age 60 with 20 to 29 YOS, or (3) age 55 with 30 or more YOS; (4) Involuntary; immediate annuity reduced by one dollar for each two dollars of other earnings until age threshold.	No.	Vests after five YOS based on aforementioned rules.	None.	No offset.	Based on number of years under new system before 20 YOS.	CPI with minor changes.
<b>Uniformed Services Retirement Benefits Act (USRBA), 1979</b>	Two-tier early withdrawal system.	First tier at completion of 20 YOS, second tier begins at age 60; vested to all members completing 10 plus YOS (but 20 percent to 25 percent reduction for 20-year career completed to existing system and 10 percent to 15 percent reduction for 30-year career, depending on grade). Maximum: 76.25 percent of Hi-2 basic pay.	No.	At 10 years.	Yes. Severance pay after five YOS for involuntary separation, officer and enlisted personnel.	Varying offset based on YOS to begin at ages 62 or 65.	Members on active duty on date of enactment have choice of old or new system.	CPI.

Major Study	Retirement Eligibility	Formula for Retired Pay	Contributory	Vesting	Severance Pay	Social Security	Transition and Save Pay	Adjustment Mechanism
<b>Office of the Secretary of Defense, 1979</b>	Payment of 20 months' basic pay between YOS 10 and YOS 15 (maximum schedule is 10 months' basic pay at YOS 10 and two months' basic pay in YOS 11 to 15).	Two-tier system. First-tier annuity: begins immediately on retiring for those who complete 20 YOS; second-tier annuity: begins at age 60. No annuity for those who complete 10 to 19 YOS (first-tier annuity); age 60 (second-tier annuity). Annuity multiplier: $.375 + .2125 + .025x$ (YOS-20) (first-tier annuity); $.0275x$ (YOS-10) (second-tier annuity).	No.	At 20 YOS (first-tier annuity); at 10 YOS (second-tier annuity).	Yes. Vests after five YOS. Deferred annuity starting at age 60, plus one lump-sum readjustment payment; or two lump-sum payments (one for equity and one for readjustment).	No offset at age 65 (first-tier annuity); $.0125 \times \text{YOS} \times$ (social security benefit attributable to military service) (second-tier annuity).	Based on number of years under new system before 20 YOS.	CPI.
<b>President's Private Sector Survey on Cost Control (Grace Commission), Task Force of Department of the Air Force, 1983</b>	(1) Immediate annuity available only after 30 YOS; (2) Deferred annuity payable at age 60 for 20 to 29 YOS.	(1) 1.3 percent of Hi-3 average Basic Military Compensation (BMC) per YOS; (2) Maximum: 39 percent of Hi-3.	No.	No.	No change.	No offset.	(1) Persons in Service at implementation receive 2.5 percent of basic pay for prior service; 1.3 percent of BMC for subsequent years. (2) Persons with more than 10 YOS retain right to immediate annuity at 20 YOS.	None.
<b>President's Private-Sector Survey on Cost Control (Grace Commission), Task Force of Office of Secretary of Defense, 1983, Alternative 1 (OSD 23B)</b>	No changes.	Offset one dollar of retired pay for every two dollars earned in retirement above two-thirds of service retired pay for persons under age 62. Four-year stepped transition from one-for-four to one-for-two.	No.	n.a.	n.a.	37.5 percent maximum social security integration (1.25 percent per year for 20 to 30 YOS.	?	

Major Study	Retirement Eligibility	Formula for Retired Pay	Contributory	Vesting	Severance Pay	Social Security	Transition and Save Pay	Adjustment Mechanism
		Replaces dual compensation restrictions.						
<b>President’s Private-Sector Survey on Cost Control (Grace Commission), Task Force of Office of Secretary of Defense, 1983, Alternative 2 (OSD 24A)</b>	No changes.	(1) 2.5 percent for each YOS; maximum: 75 percent of Hi-3 average basic pay; (2) Reduce retiree annuity of those leaving before 30 YOS at 0.5 percent per month.	No.	Yes, at 12 YOS with annuity payable at age 65, or as early as age 55 but reduced by 0.5 percent per month short of age 65.	None for persons with more than 12 YOS.	Maximum offset of 37.5 percent (1.25 percent per year).	All persons with more than 12 YOS remain under existing system, all others in the new system.	CPI at start of immediate annuity, but not until age 55 for deferred benefit from 12 to 19 years early vesting.

n.a. = not available.

Source: U.S. Department of Defense, Office of the Secretary of Defense, “Appendix E, Mobilization Aspects of the U.S. Military Retirement System,” vol. 1A, *Supporting Appendixes to Uniformed Services Retirement System (A–G), Fifth Quadrennial Review of Military Compensation*, Washington, DC, January 1984, B–6–B–12; and U.S. Department of Defense, Office of the Secretary of Defense, *Sixth Quadrennial Review of Military Compensation, Executive Summary*, Washington, DC, August 1988.