

**ASSESSMENT OF ALTERNATIVE MILITARY RETIREMENT PROPOSALS
AS A PERSONNEL MANAGEMENT TOOL**

by

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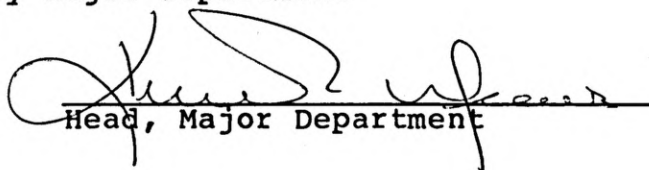
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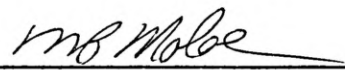
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"Nothing in the world can take the place of persistence. Talent will not! Nothing is more common than unsuccessful men with talent. Genius will not: unrewarded genius is almost a proverb. Education alone will not; the world is full of educated derelicts. Persistence and determination alone are omnipotent."

-unknown-

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ABSTRACT

The purpose of this professional paper is to critically analyze the non-disability military retirement system to provide recommendations for its future.

Having explained the historical development, a comparison of recently proposed alternative retirement systems is made. A survey is also conducted to assess attitudes of prospective Air Force Reserve Officer Training Corps officer candidates at Montana State University and the value they place on retirement as a motivation for entrance into active duty.

The study found: (a) studies so far conducted on military retirement have not dealt with the issue in a comprehensive manner; (b) cost containment and force levels are placed dichotomously; and (c) the current retirement system is not as much a prime factor for recruiting officer candidates as it is a retention tool.

Given this, it is recommended that: (a) the retirement system adopt a contributory plan and that base pay be increased to offset the member's cost of contributing to such a plan; and (b) the mandatory service requirement be reduced to 25 years with prorated benefits for those who separate before 25 years of service. It is also recommended that the Department of Defense may have to decide on its objectives of either a young force or members who pursue longer careers.

CHAPTER 1

INTRODUCTION

Throughout the past decade, military compensation has become an increasingly controversial topic. The institution of the All-Volunteer Force in 1973, and subsequent increases in compensation levels to establish comparability with civilian salaries has generated many questions concerning costs of military compensation.

The conversion from the draft to the All-Volunteer Force in 1973 created some novel problems for the military services, and also resulted in a growth in manpower costs and rising deficit figures. Since the military is no longer able to depend on conscription, it has become highly dependent on the conditions of the labor market to provide needed personnel. To attract and retain personnel to the military, changes in compensation policies and personnel practices have become necessary. Pay as well as retirement benefits were increased resulting in an alarming growth rate of military manpower costs that are estimated at \$55.5 billion for Fiscal Year 1985.¹ These growth rates in manpower costs have produced a residual effect on Department of Defense outlays. Thirty-eight percent of an estimated \$328.7 billion for Fiscal Year 1985 of the Department of

Defense budget authority is reserved for military compensation.² This is a sizable proportion of the Defense budget and has caused considerable concern over the necessity of such exorbitant compensation packages for our uniformed service members.

Military compensation, the focus of debate, is a system composed of a variety of components that produce the basic structure for remuneration to military members. It consists of: (1) Regular military compensation, which includes basic pay, housing allowance, subsistence allowance, and associated tax advantages; (2) A variety of special and incentive pays such as flight pay and hazardous duty pay; and (3) The supplemental benefits, of which retirement is the largest.³ These components are designed to accomplish the foremost purpose of the compensation system of the Uniformed Services which is,⁴

"to provide inducements and incentives which will help to attract and retain in the Nation's Uniformed Services, career motivated personnel with the intelligence, leadership, and dedication necessary to insure successful accomplishment of the United States security objectives."

Contemporary Issues

Military retirement has become a prominent issue in recent discussions over budget cutbacks. This is primarily because of the significant growth in the non-disability retirement outlays over the past decade and a-half. Rising inflation, wage growth in regular military compensation, an

increase in the retired population, and retired pay adjustment increases have resulted in budget outlay increases of \$11.9 billion for the past 10 years.⁵ These factors have brought considerable attention to bear on the effectiveness and efficiency of the retirement system. Representative Les Aspin, Chairman of the House Military Personnel and Compensation Subcommittee, has charged the retirement system with being "too generous."⁶ This and similar accusations leveled at the military retirement system has generated some serious questions regarding the current retirement system. More recently, David Stockman, former Director of the Office of Management and Budget, brought the issue to national attention when attacking the system and stating that,⁷

"Institutional forces in the military are more concerned about protecting their retirement benefits than they are about protecting the security of the American people. When push comes to shove, they'll [military members] give up on security before they'll give up on retirement."

In light of such criticism a recent study commission, the President's Private Sector Survey on Cost Control (a panel of corporate executives headed by J. Peter Grace and designed to analyze waste in the Federal Government, hereinafter referred to as the Grace Commission), has illustrated that the current retirement system is in need of reform. According to this report, the retirement system was determined to be much too generous and must be restructured

to become more effective in terms of annual outlays, and cutbacks will become necessary if the Reagan Administration is to meet their fiscal objectives of reducing the Federal deficit.⁸

Such reports by the Grace Commission, Administrative agencies, and many Congressional Leaders are lending some serious doubts as to the stability of the current retirement system. Service members are no longer confident that the military retirement system will remain intact.

If these changes are inevitable, alternate proposals must be carefully examined to determine the effects on military manpower requirements. Utilized as a management tool of recruitment and retention for the Department of Defense, the altering of the military retirement system will pose interesting challenges for this Department. This paper will address such concerns by examining cost proposals, and will also analyze these proposals to determine their effects on the recruitment of potential military members.

Purpose of the Study

The purpose of this professional paper is to critically analyze the non-disability military retirement system to provide recommendations for the future of the military retirement system.

The analysis of this paper will focus specifically on:
(1) a comparison of recently proposed alternative retirement

systems; and (2) attitudes of prospective officer candidates and the value they place on retirement as a motivation for entrance into active duty. This approach is based on the assumption that the non-disability retirement system is an important element of the total compensation package for military members. In this context, the retirement system should be one of the incentives to enter active duty.

The general concern over military retirement has focused largely on cost and the inefficiency and ineffectiveness of the current system. Those supporting the retirement system are concerned with the threat of change to retirement benefits. Answers to these questions may provide insight and offer solutions for development of a military retirement system which would benefit both our nation in a reduction of cost, and still ensure recruitment of qualified members the military is seeking.

Methodology

Research for this study is twofold. The first part compares the current retirement system with reform proposals. This analysis will illustrate intended objectives of each proposal, vis-a-vis its cost. The three reform proposals analyzed here are the Fifth Quadrennial Review of Military Compensation (QRMC V), the Congressional Budget Office, and the Grace Commission. This data will

deal with the following variables: (1) the objective of the proposal; (2) current level costs of each proposal; and (3) projected costs of each proposal in 1985 dollars through 2020. Such a comparison is expected to provide clues as to which system is most effective in respect to cost as well as attracting and retaining personnel.

The second part will examine the attitudes of Air Force Reserve Officer Training Corps (AFROTC) officer candidates at Montana State University (MSU) concerning the military retirement system. The major question is whether the retirement system is a prime consideration for entering the Air Force. The questionnaire administered to this sample is expected to shed some light on the degree of emphasis officer candidates place on retirement, and which retirement package is most attractive to these potential service members.

Based on the overall analysis of the information provided by this study, recommendations will be provided as to whether the current retirement system should be preserved, strengthened, restructured, or substituted. In doing so, the text of this paper will be as follows: Chapter Two will provide a detailed review of the legislative history of military retirement, and study commission reports in the past decade. Chapter Three is a description and analysis of the current military retirement system and the three proposals. Chapter Four will describe procedures and

summarize data from the survey instrument, and Chapter Five provides conclusions and recommendations based on this study.

NOTES

1. U.S. Congress, Congressional Budget Office, The Costs of Defense Manpower: Issues for 1977, Budget Issue Paper (Washington D.C.: Government Printing Office, January 1977), p. 71.
2. U.S. Congress, Congressional Budget Office, Reducing the Federal Deficit: Strategies and Options, A Report to the Senate and House Committees on the Budget, (Washington D.C.: Government Printing Office, January 1984), p. 48.
3. U.S. Department of Defense, Office of the Secretary of Defense, Fifth Quadrennial Review of Military Compensation, Executive Summary, (Washington D.C.: Government Printing Office, January 1984), p. I-2.
4. Ibid., p. I-3.
5. President's Private Sector Survey on Cost Control, Report on the Office of the Secretary of Defense, (Washington D.C.: Government Printing Office, Spring-Fall 1983), p. 215.
6. Brad Knickerbocker, "Military Pensions: A Political Minefield for Reformers," Christian Science Monitor, 18 July 1983, p. 3.
7. "Stockman Assails Military Pension in Senate Hearing," New York Times, 6 February 1985, sec. 4, p. 1.
8. President's Private Sector Survey on Cost Control, Report on the Office of the Secretary of Defense, Washington D.C.: Government Printing Office, Spring-Fall 1983), p. 215.

CHAPTER 2

LEGISLATIVE HISTORY AND RECENT STUDY COMMISSIONS

The current retirement system is in part the result of a 100 year effort at establishing a system that would provide an incentive for a military career and aid in the effort of recruiting and retaining needed personnel for the military.

A pension based solely on service (non-disability) has been the predominant source of controversy over the current retirement system.¹ Prior to and during the Civil War, the military was compelled to devise a mechanism whereby it could separate officers from service. At that time, the only method to retire an individual was if they had been disabled in war. The result of such a policy was a military composed of inept and incapable officers who could not perform their duties due to old age, and junior officers² exercising commands in the field beyond their rank. As a result, examining boards convened to contrive a system that would allow for the separation of older service members and the equitable promotion of more junior officers through the ranks.

The evolution of this preferred retirement system began with the first voluntary retirement statute which became law in 1861 (12 Stat. 287). This law became the antecedent for

the present day retirement system. The provisions of the act, being the first major non-disability retirement act, provided for the voluntary retirement of regular officers of all branches of the service after the completion of 40 years of active service at the discretion of the President. Subsequent acts in 1861 (12 Stat. 329), and 1862 (12 Stat. 594) allowed for the voluntary retirement for age and years³ of service.

Legislation of 1870 (16 Stat. 315 and 16 Stat. 321), 1907 (34 Stat. 1213), and 1916 (Pub. L. No. 64-241, 39 Stat. 1217) were instrumental in developing the model for the current retirement system. First, the 1870 legislation allowed for voluntary retirement of officers after 30 years of service and fixed retired pay at 75% of basic pay of the officers grade. The act of 1907 consolidated this formula to encompass the enlisted personnel and allow a 30 year voluntary retirement authority. In 1916, two new principles were offered to the officers and enlisted non-disability retirement system. The first change was to establish an up-or-out officer selection promotion plan, whereby officers were required to attain a higher grade or be separated from service. The second provision introduced the use of the annuity formula to determine computation of retirement benefits. These legislative acts and formulas, with minor adjustments, served as the basis of calculating benefits under the current retirement system and were instrumental in

the formation of pay and length of service formulas.⁴

The post World War I era created additional promotion and stagnation problems. With the large influx of officers during this period, the Navy revised this selection and retirement process to allow for voluntary retirement after 20 years of service. This 1938 law (Pub. L. No. 75-706, 52 Stat. 944) became the model for the present day 20 year⁵ retirement system.

A degree of standardization among the branches of the military was not evident until the advent of the Army and Air Force Vitalization and Retirement Equalization Act of 1948. This act allowed for the voluntary retirement of Army and Air Force officers after the completion of 20 years of active duty service. At least 10 of these years were required to be comprised of commissioned service. This act also created a new formula for retired pay to equal 2.5% of base pay times the number of years of service. This law was a novel development in the history of the military⁶ retirement system.

It was not until 1980, when "pay comparability" was instituted, that any major change in the retirement system was made. The Defense Officer Personnel Management Act of 12 December 1980 allowed for pay comparability, and established pay grades for military members that would be competitive with the private sector and thus allow the military the flexibility to compete with the private sector

labor market. This law dramatically increased levels of pay and retirement expenditures and made retirement benefits very competitive with the private sector.⁷ Fiscal year 1980 figures demonstrated that active duty military retirement benefits exceeded those in the private sector by \$800.⁸

1980 also saw a change in the computation of years of service. Prior to this, retired pay was calculated by number of years of service times 2.5% of terminal base pay. The new formula altered this to number of years of service times 2.5% of the average of the highest three years of base pay.⁹ Since this time, Congress has altered only one major provision in the retirement structure, that being inflation protection. However, the current retirement system is once again being subjected to the political winds of change as Congress and several study commissions attempt to reform it.

Study Commissions

One of the first study commissions asked to analyze contemporary retirement issues was the First Quadrennial Review of Military Compensation (QRMC I), which was the result of a 1967 statute mandating the Department of Defense to conduct periodic reviews of military compensation. This report was submitted in compliance with Section 1008(b) of Title 37, United States Code. It stated:¹⁰

"Whenever the President considers it appropriate, but in no event later than January 1967, and not less than once each four years thereafter, he shall

direct a complete review of the principles and concepts of the compensation system for members of the uniformed services. Upon completion of such review he shall submit a detailed report of such review with any recommendations he may have proposing changes in the statutory salary system and other elements of the compensation structure provided members of the Uniformed Services."

In accordance with the statute, QRMC I completed its report in 1969. The conclusions of the review were based on the assumption that a substantial number of the retirees sought second careers upon separation from active duty, and that as a result of the time spent in the military they were exposed to disparities in education and employment experience to their civilian counterparts. The report concluded that the military personnel system was designed to force members out with half their working lives remaining.¹¹ This aspect of forcing a member out into the civilian labor force resulted in considerable economic loss. These retirees were unable to compete with their civilian counterparts because of their seniority and experience disadvantages, and thus placed retirees in a lower wage earning bracket during a time of great financial need and responsibility.¹²

QRMC I did not propose that this analysis determine retirement amounts, but rather supported proposals to offer stronger incentives for longer careers. Consequently it set forth to reduce the annuity for those separating earlier in their careers to make full length military careers more economically attractive than shorter ones.¹³ But, the end

result of QRMCI failed to lead to any legislative proposals, and so the Interagency Committee (IAC) was formed in 1971 to capitalize on the previous analysis of military retirement.

The IAC report aimed at increasing retention incentives over the broad span of a member's military career. Some of the recommendations proposed by the IAC included providing benefits to members who completed 10 years of service to encourage junior members to prolong their commitment, requiring 20 years of service to qualify for immediate annuity upon retirement, and dramatic reductions of annuities for those who retired only after 20 years of service.
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The Retirement Modernization Act, the first legislative proposal to arise from study commissions was less far reaching and cost much more than the IAC plan. It Proposed:
(1) to provide an improved personnel management tool which would aid the Department of Defense in attaining a preferred experience distribution of the active force; (2) to correct certain inequities in the present system; and (3) to reduce retirement costs.
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While debate continued on retirement legislation, another study commission was created. In 1973, Congress created the Defense Manpower Commission to study short-term and long-term manpower requirements of the Department of Defense. The Defense Manpower Commission reported that the current

military retirement system did not support Defense manpower requirements, and that military retired pay should be restructured to provide a more effective management tool to obtain the desired force profiles under consideration.

Once again, the specific objective was extending the service commitment. The report was forwarded to the Third Quadrennial Review of Military Compensation in 1976, but was rejected.¹⁷ Instead, the Retirement Modernization Act was endorsed by the Third Quadrennial Review of Military Compensation, which was also not acted upon.

The Fourth Quadrennial Review of Military Compensation was scheduled to conduct hearings in 1977, but instead President Carter created the President's Commission on Military Compensation and tasked them with proposing a long-term plan for military compensation. This commission arrived at similar conclusion to those of the Defense Manpower Commission. According to the President's Commission on Military Compensation, three deficiencies existed in the retirement system. The current system was;

- (a) inequitable when compared to the private sector plans;
- (b) it inhibited effective and flexible force management by not providing an incentive for extended careers; and (c) it was inefficient since it had little effect on prospective recruitment of service members in their first enlistment.

Specific recommendations by the President's Commission on Military Compensation included benefits for those members

who left with less than 20 years of service to encourage more members to stay earlier in their careers, reducing benefits for those leaving after 20 years to encourage longer careers, and in return for reduced annuities, members would be offered an early cash withdrawal after as little as ¹⁹ ten years of service.

These recommendations were modified and set forth in the Uniformed Services Retirement Benefits Act proposed in 1979. Although the Act proposed cost savings and improvement in personnel management techniques, it was politically unattractive since these savings would not be realized for 20 years as a result of grandfathering clauses. Consequently, the legislation was never formally introduced in either house.

As seen above, the issue of how to combine promotion, retention, and cost saving considerations still remain illusive. All proposals so far, have in one form or another, only introduced means to extend military careers in order to realize cost savings without dealing with the means to retain qualified personnel. This poses serious problems for the military to effectively meet manpower requirements. To further study the issue three more important studies were conducted - The Fifth Quadrennial Review of Military Compensation, The Congressional Budget Office Study, and the Grace Commission. The following chapter discusses these.

NOTES

1. U.S. Department of Defense, Office of the Secretary of Defense, Fifth Quadrennial Review of Military Compensation, Volume I, (Washington D.C.: Government Printing Office, January 1984), p. VII-3.

2. Ibid., p. VII-2.

3. Congressional Budget Office, Modifying Military Retirement: Alternative Approaches, (Washington D.C.: Government Printing Office, April 1984), p. 4.

4. Ibid.

5. U.S. Department of Defense, Office of the Secretary of Defense, Fifth Quadrennial Review of Military Compensation, Volume I, (Washington D.C.: Government Printing Office, January 1984), p. VII-4.

6. U.S. Department of Defense, Office of the Secretary of Defense, Fifth Quadrennial Review of Military Compensation, Volume IA, (Washington D.C.: Government Printing Office, January 1984), p. A-5.

7. U.S. Government, United States Codes, Supplement V, 1980 Edition, (Washington D.C.: Government Printing Office, 1982), p. 936.

8. Boston Study Group, The Price of Defense, (New York: Library of Congress, 1979), p. 270.

9. Congressional Budget Office, Modifying Military Retirement: Alternative Approaches, (Washington D.C.: Government Printing Office, April 1984), p. 38.

10. U.S. Government, United States Codes, Supplement V, 1980 Edition, (Washington D.C.: Government Printing Office, 1982), p. 280.

11. U.S. Department of Defense, Office of the Secretary of Defense, First Quadrennial Review of Military Compensation, (Washington D.C.: Government Printing Office, 1 November 1967), p. II-4.

12. Ibid., p. II-10.

13. Ibid., p. VII-25.

14. Congressional Budget Office Background Paper, Defense Manpower: Compensation Issues for Fiscal Year 1977, (Washington D.C.: Government Printing Office, 2 April 1976), p. 29.

15. Defense Manpower Commission, Defense Manpower Commission Staff Studies, Volume V, Compensation and Retirement, (Washington D.C.: Government Printing Office, May 1976), p. C-1.

16. Ibid., p. C-4.

17. Congressional Budget Office, Modifying Military Retirement: Alternative Approaches, (Washington D.C.: Government Printing Office, April 1984), p. 34.

18. President's Commission on Military Compensation, Report of the President's Commission on Military Compensation, (Washington D.C.: Government Printing Office, April 1978), p. 26.

19. Ibid., p. 55.

CHAPTER 3

THE CURRENT RETIREMENT SYSTEM
AND ALTERNATIVE PROPOSALSCurrent Retirement System

The military compensation program, of which the current retirement system is an important part, attempts to fulfill mandated national security objectives by assuring the following needs are sustained: (1) to maintain young, vigorous, and mission ready forces capable of operating efficiently in both peace and war by providing for a continuing flow of officers and enlisted personnel through the services required personnel structures; (2) to establish the choice of a career in the uniformed services as a reasonably competitive alternative by providing a means of financial security after release from active or reserve duty for members and their survivors; and (3) to support a mobilization base of experienced personnel subject to recall¹ to active duty during time of war or national emergency.

The prevailing retirement system has been considered as one of the most generous available. Eligibility for retirement benefits are validated once a service member has completed 20 years of service. Upon completion of this commitment, the retiree is awarded an immediate permanent

annuity equal to 2.5% times the product of years of service and basic pay² (basic pay is but one portion of regular compensation, and is equivalent to approximately 70% of the total), to a maximum of 75% of basic pay for those retiring after 30 years of service.³ This computation is based on the highest three years of a members basic pay. Annuities for those entering the service prior to 8 September 1980,⁴ are computed on the member's terminal basic pay. Also, the retiree's annuities are adjusted annually by the change in the Consumer Price Index of the preceding year. One of the last features of the retirement system is that no retiree will suffer a reduction of retired pay when the retiree becomes eligible for social security.

The current statutory service requirement for military retirement is 30 years of service on active duty. But this does not exclude a member from petitioning to retire after 20 years of service and transfer to reserve status, with the understanding that the member is still subject to recall to active duty in the event of war. These requests are routinely approved and has resulted in the current retirement system being referred to as the "20 year retirement system". However, the 30 year statutory requirement remains the basis for the notion that a complete military career is 30 years.

The current military retirement system is composed of three aspects: disability retirement, non-disability reserve

retirement, and non-disability regular retirement. Of these three, the non-disability regular retirement system is the focus of most attention since it boasts 1.1 million out of a total of 1.4 million retirees, and accounts for over 80% of the overall cost of military retirement.⁵ The estimated cost for fiscal year 1985 is projected at \$17.5 billion for outlays of retirement pay.⁶ This figure comprises 5% of the total defense budget and is expected to increase gradually over the next fifteen years.

According to a recent Congressional Budget Office study, the composition of the retiree population consists of two-thirds enlisted personnel and one-third officers. Of this profile, the average enlisted retiree separates from service at age 42 after 22 years of service. Officers average retirement age is 46 with an average total of 25 years of service. The modal point of retirement for both groups is sometime after the completion of 20 years of service. The study also cited average retired pay for enlisted personnel at \$9,349, and officers total at \$21,189. Taking actuarial statistics into consideration, an enlisted person retiring after 21 years of service would receive \$247,652, and an officer retiring after 23 years would receive \$579,435 in retirement benefits before death. These figures represent a large outlay in dollars to support this retirement system, thus indicating the need to develop a sophisticated method of funding the program.

To support such a system, the Federal Government has adopted an intergenerational approach to fund the military retirement system. This approach charges a future generation of employees for the retirement benefits of current employees.⁸ This approach has also been subject to alterations. Beginning in Fiscal Year 1985, the Department of Defense will be required to fund service retirement using an advanced funding concept combined with accrual accounting techniques.⁹ This will require the Treasury Department to establish an interest bearing trust fund and amortize the current unfunded liability. This was implemented in part to guarantee a supplement to retirement outlays if these funds were not available. This move has become necessary to ensure timely payments of benefits without the need of annual appropriations. As studies of the retirement system continue to raise doubt as to its certainty, this should help put many retirees at ease knowing that benefits will be forthcoming.

Upon examining the objectives and structure of the current retirement system, effectiveness of the system can be analyzed by reviewing past performance. The predominant criticism of the retirement system has been that it has become much too expensive. This criticism is further compounded by other aspects such as early retirement with full benefits, full protection for inflation, the non-contributory nature of the system, inequities, the absence

of persons separating early, and the apparent lack of coordination with social security.¹⁰ Based on the results by QRMV these inequities could be corrected if the following principles of retirement were instituted:¹¹

(1) The system should be structured to meet legitimate defense requirements in support of our national security objectives by providing for a uniform flow through the personnel structure to maintain young and vigorous forces, to recognize long-term voluntary acceptance of a highly disciplined career, to maintain a mobilization force of experienced personnel, to provide for financial security in old age, and to recognize that the personnel system is a closed-entry system.

(2) The retirement system should support and compliment force management requirements of the services.

(3) The system should be integrated into the uniformed services compensation system and be structured to meet an income replacement function as well as income maintenance function acceptable to the nation.

The final evaluation of the current system is based on past, present, and future cost. In this respect, the current retirement system has experienced a sizable increase in cost and does not appear to decline in the future. The non-disability retirement outlays have increased over \$12 billion within the past 30 years.¹² This has been attributable to four causes: (1) inflation, which averaged

5% per year and caused 55% of the increase (\$6.6 billion); (2) wage growth, which averaged 1% per year, resulted in 21% of the increase (\$2.6 billion); (3) a retiree population increase of elevenfold caused 19% of the increase (\$2.1 billion); and (4) retired pay adjustments which caused 5% of the increase (\$0.6 billion).¹³

Thus, previous studies have demonstrated the inefficiency of the current system and the need for change. Any alterations must take into account the effect upon force profiles and whether it will satisfy manpower requirements. The following analysis will look at some alternatives (including the current retirement system) to determine which will be most effective in terms of cost and fulfillment of manpower requirements.

Fifth Quadrennial Review of Military Compensation

In accordance with federal law, QRMC V began conducting its review of the military compensation program in 1983. This commission focused its examination on the military retirement system. The option proposed by QRMC V was designed to duplicate the existing incentive to remain in the service for 20 years and to generate career retention that would be at least equal to the current system. This proposal has been highly favored since it was an in-house creation of the Department of Defense.

Findings by QRMC V proposed the following modifications

to the retirement system: (1) It was recommended that the basic purpose of military retirement not be changed, and that all subsequent evaluations of retirement system alternatives consider force level impact. Change driven by cost reduction/avoidance are detrimental to force profiles.

(2) The following must also be considered; reduced multiplier which is the annuity formula times years of service, reduced Cost of Living Allowances (COLA), 3% annuity for 30 years of service which may entice members to prolong careers, and a combination of any or all the above.

Also, any modification to the retirement system must provide, at the time of retirement, a payment of an appropriate early withdrawal amount from the total remaining earned benefits. (3) Modification to the current system

must be structured to reduce or overcome the force impact of the past implementation of the high three year average, and that members on active duty at this time retain the option of computing their retired pay under the current system.

This will also provide an option of electing the new system if the service member has 12 or less years of service, and include no change in vesting to either an earlier or later time.

(4) The system shall remain non-contributory and that no explicit integration with social security be undertaken.

(5) Finally, this report will disregard the Grace Commission proposal (see below) because of the reduction of the force

14
structure.

Estimates for this proposal show a slight increase in the career force and average service lengths of military personnel. This is primarily a result of the change in the annuity formula. By reducing the annuity before 30 years of service, members will be encouraged to stay longer. This conclusion has made QRMC V consistent with the findings in other studies.¹⁵ Cost savings under this plan are modest and may even show an increase in payment during 1990 and 1995 over the current system.¹⁶ Thus, this plan provides for excellent incentives to attain desired force profiles and manpower requirements. Conversely, cost savings will not be that apparent and aggregate savings over the next 30 years may be minimal.

Congressional Budget Office Study

This system was developed by the Congressional Budget Office incorporating many provisions of previous studies. This particular option is based on the premise of the "permanent half-COLA" (see below) and that adjustment by this method is needed to hold down costs and retired pay comparable to other plans.¹⁷

This option consists of the following provisions: (1) the formula for determining retired pay will remain the same as the current system; (2) the annuity base will be computed by the average of the highest three years of basic pay and that the annuity will be immediate upon separation; (3) the

formula will contain a two-tiered provision which will provide for a deferred annuity to age 62 for those members who completed 10-19 years of service; (4) all vesting will begin after 10 years of service; (5) grandfathering will apply to members with 10 or more years of service at enactment, but will not exclude any member from the half-COLA option; (6) it will provide for social security integration at 1.25% times years of service times primary social security benefits; and (7) inflation protection will consist of a half-COLA up to age 62 with a catch-up to full-¹⁸ COLA beyond that point.

This proposal will yield only slight reductions in cost at the expense of a decrease in the size and experience level of the career force. Compared to QRMC V, this proposal would cost an additional \$100 million in the 1985 Defense budget and would reduce the career force size by an additional 82,600 personnel.¹⁹ The attractive aspect of this proposal is that it would result in improved retention rates of younger members since it provides for vesting after 10 years of service.²⁰ In addition, this proposal will increase the services' flexibility to separate members voluntarily before the completion of 20 years of service.

President's Private Sector Survey on Cost Control

The final proposal comes from findings of the Grace Commission. President Reagan established the Grace

Commission by Executive Order No. 12396 on June 30, 1982, and named J. Peter Grace as Chairman: hence the name Grace Commission.²¹ The objective of the Commission was to examine governmental agencies and identify areas for increased efficiency and the possibility for cost reduction. The study took a total of 18 months to complete and involved 161 chief executive officers from major corporations. This proposal for retirement modification has been mainly contested by military members due to the fact that it proposes substantial cuts in the retirement program.

One of the agencies the study was asked to examine was the Department of Defense. Among the variety of programs investigated, the military retirement system was targeted as one of the least effective and most costly. Comparing the military retirement system with some of the top private sector plans, the Grace Commission reported that the benefits received by retirees far exceeded those available to the private sector and concluded for a reduction in cost.

²²
The Commission felt that,

"we cannot afford to pay a competitive wage during active duty years, and at the same time provide for a pension benefit that costs more than six times as much as the better private sector plans."

The major features of the Grace Commission plan are modeled after private sector practice. One of the key provisions proposed by this plan is that the current annuity formula of 2.5% be reduced to 1.6% of basic military compensation in order to lure more members to longer

careers, and to offer full benefits at age 62. Also, under this proposal members would be able to receive immediate, unreduced annuities only upon age 62, instead of completing 20 years of service as under the current system. Reduced annuities would be available at age 55.²³ Further, COLA's would be paid only after members began to receive their retirement annuities.²⁴ The final clause of the proposal would not allow for grandfathering of any personnel with respect to social security integration and COLA's, and active duty members with 10 or more years of service would be allowed to receive annuities upon retirement.²⁵

In comparison, this plan proposes more drastic changes than all other proposals. While it contains some of the features of earlier recommendations and has some elements in common with the other proposals, the Grace Commission proposal will result in much greater cost savings than the other proposals. Estimates for the plan anticipate that in five years after implementation, this proposal would reduce military retirement by \$42.5 million. This would mean a savings of \$13.5 million in the 1985 defense budget.²⁶ However a Congressional Budget Office study reported that these savings would be realized at the cost of a much larger reduction in the size of the career force by 11%, and a decline in the experience level by 7.9%.²⁷

The key provision of the Grace Commission report aimed at reducing cost, but at the expense of reduced numbers of

personnel. Cost savings has become important, but reform must also deal with force profiles.

Comparison of Alternatives

Utilizing the current retirement system as a comparative base, all the options presented in this paper pose substantial long-run cost savings, especially the Grace Commission plan (see Appendix A for comparisons). While projections based on the current retirement system costs in the year 2020 are estimated at \$21.5 billion, the Grace Commission proposal estimate stands at \$7.1 billion.²⁸ The Congressional Budget Office proposal would offer the next greatest cost savings, in which estimates for the year 2020 are \$17.8 billion.

In terms of impact on force structure, QPMC V provides for the greatest increase in numbers and average seniority (see Table 3-1).

Table 3-1. Long-Run Effects of Alternatives for Military Retirement.

DoD Total	Current System	QPMC V Option	CBO Option	PPSSCC Option
Career Force Number and Increment	1,080,289	+50,359	-32,225	-119,208
% Change	--	+4.7	-3.0	-11.0
Average Seniority (yrs)	12.1	12.3	11.8	11.1
% Change	--	+2.3	-2.3	-8.0

Congressional Budget Office, Modifying Military Retirement
Alternative Approaches, (Washington D.C.: Government
Printing Office, April 1984), p. 52.

This option projects an increase in the total size of the career force, largely because of the sizable cash benefits available to those who retire after 20 or more years of service, and the fact that a service member is only required to complete 20 years of service as is the case with the current system. It also increases the incentive for careers beyond 20 years. The least effective proposal in terms of force levels is the Grace Commission plan. Under this proposal, the Department of Defense could suffer a reduction of 200,00 personnel from the current levels, and see average ²⁹ years of service decline by one to two years.

Using the projected estimates of the Congressional Budget Office, and ranking the alternatives in terms of cost savings and career force changes, the following ordering emerges: (1) Through analysis of cost savings based on the projected estimates of the Congressional Budget Office, greatest savings would be realized through the Grace Commission proposal followed by the Congressional Budget Office proposal, QRMC V, and the current system; and (2) career force incentives are the strongest in QRMC V, followed by the current system, the Congressional Budget Office alternative, and the Grace Commission proposal.

As important as these figures are, they do not reflect any indication of the most preferred system in terms of recruitment. The next portion of this paper will analyze this question by looking at data collected from a sample

survey of prospective officer candidates for the United States Air Force. This analysis will demonstrate which of these alternatives are most preferred, and whether the retirement system is an important factor at all in career considerations.

NOTES

1. U.S. Department of Defense, Office of the Secretary of Defense, Fifth Quadrennial Review of Military Compensation, Executive Summary, (Washington D.C.: Government Printing Office, January 1984), p. IV-1.

2. Ibid., p. I-2.

3. Congressional Budget Office, Modifying Military Retirement: Alternative Approaches, (Washington D.C.: Government Printing Office, April 1984), p. 3.

4. Ibid.

5. Ibid., p. 8.

6. Ibid., p. 54.

7. Ibid., p. 4.

8. U.S. Department of Defense, Office of the Secretary of Defense, Fifth Quadrennial Review of Military Compensation, Volume I, (Washington D.C.: Government Printing Office, January 1984), p. VII-19.

9. Ibid., p. VIII-20.

10. Ibid., p. VIII-1.

11. Ibid., p. VIII-5.

12. Ibid., p. VIII-7.

13. Ibid.

14. U.S. Department of Defense, Office of the Secretary of Defense, Fifth Quadrennial Review of Military Compensation, Executive Summary, (Washington D.C.: Government Printing Office, January 1984), pp. IV-35-36.

15. Congressional Budget Office, Modifying Military Retirement: Alternative Approaches, (Washington D.C.: Government Printing Office, April 1984), p. 56.

16. Ibid.

17. Ibid., p. 61.

18. Ibid., p. 46.

19. Ibid., p. 61.

20. Ibid.

21. Congressional Budget Office, General Accounting Office Joint Study, Analysis of the Grace Commission's Major Proposal for Cost Control, (Washington D.C.: Government Printing Office, February 1984), p. 2.

22. President's Private Sector Survey on Cost Control, Report on the Office of the Secretary of Defense, (Washington D.C.: Government Printing Office, Spring-Fall 1983), p. 211.

23. Ibid., pp. 219-234.

24. Ibid., p. 220.

25. Congressional Budget Office, General Accounting Office Joint Study, Analysis of the Grace Commission's Major Proposal for Cost Control, (Washington D.C.: Government Printing Office, February 1984), p. 37.

26. Ibid.

27. Ibid., pp. 37-38.

28. Congressional Budget Office, Modifying Military Retirement: Alternative Approaches, (Washington D.C.: Government Printing Office, April 1984), p. 54.

29. Ibid., p. 52.

CHAPTER 4

SURVEY METHODS AND RESULTS

This chapter further examines military retirement as a tool of recruitment of prospective officer candidates. In order to accomplish this, a survey was designed to assess the attitudes of Air Force officer candidates to determine: (1) knowledge of the current retirement system; (2) career motives; (3) importance of the current retirement system; and (4) alternative retirement system preferences. The questionnaire consists of three parts (see Appendix B). Information from previous studies conducted nationally, such as the Air Force Reserve Officer Training Corps (AFROTC) On Campus Survey Report¹ and the 1984 Officer/Airman Exit Survey² was freely used to construct the current questionnaire.

The population for this study was comprised of officer candidates of the AFROTC unit at Montana State University (MSU). Of a total of 113 surveyed, 97 (86%) respondents completed the questionnaire. This population consisted of two groupings of officer candidates: those with prior service, and those with none. Of the 97 respondents, 14 indicated they had previous military experience, with an average of 6.21 years of service.

The data for the study was recorded from this questionnaire administered on 3 October 1985. The respondents were asked to complete the survey and return them to the Detachment office. All questionnaires were collected within one week of administration.

The average age of the prior service group was 27.43 years. Conversely, the 83 who indicated no previous military experience showed an average age of 19.98 years. The combined average age of the two groups was 21.04 years.

Analysis

The analysis conducted on this data consisted of simple means and percentages utilizing Lamda Asymmetrical statistic: a measure of association based on the proportional reduction of error.

Knowledge of the Retirement System

The first area of the analysis determined to what extent the population was aware of the provisions of the retirement package they were eligible for. This variable was analyzed through two approaches. The first approach examined totals. Of the total, 46% of the population did understand the current retirement system and benefits they were eligible for, while 54% indicated they did not.

The second approach broke the population down by prior service and non-prior service totals and used age as the correlating variable. Response to the question illustrated

that 71% of the prior service candidates understood the retirement system, while only 42% of the non-prior service candidates understood the system.

The results from this section indicate that concern for retirement or awareness of its provisions do not become evident until one has invested time in their military careers, and have reached a life circumstance when retirement benefits become an important factor.

Career Motives

This portion of the analysis examined raw data to identify the primary motive for entrance into this career. It shows as illustrated in Table 4-1, that flying was the primary motive for pursuing an Air Force commission while the retirement system was the least considered motive.

Table 4 1. Motivation for Entry Into the Air Force

Motive	Percentages of AFROTC Candidates
Job Security	18.5%
Patriotism	11.0%
Flying	38.0%
Educational Opportunities	13.5%
Retirement	3.0%
Pay and Military Privileges	12.0%
Travel Opportunities	4.0%

Further comparing this with previous data collected from an Air Force wide Survey, officer candidates were contrasted with active duty officers with 5-12 years of

service, using three different career motive areas (see Table 4-2). This comparison illustrates the disparity between attitudes of those currently on active duty and those aspiring to a commission. The study shows that active duty officers, at critical points in their careers choose retirement as the number one motive for career continuation.

Table 4-2. Comparison of Motives Between Officer Candidates and Active Duty Officers

Motives	% of Officer Candidates	% of Officers with 5-12 YOS*
Job Security	18.5%	54.0%
Retirement	3.0%	78.0%
Patriotism	11.0%	48.0%

YOS* (Years of Service)

Airlift, Is Retention a Problem, (Maxwell Air Force Base, Alabama: Air University Review, Summer 1985), p. 2.

Importance of the Retirement System

The emphasis of this section was to determine the value placed on the current retirement system as a recruitment incentive. Those officer candidates with prior service were compared to those with no prior service. The analysis also looked at the population as a whole to analyze their collective feelings toward retirement (see Table 4-3).

It is apparent that those officer candidates with time invested in the military not unexpectedly showed a much stronger desire for the retirement system as a career inducement. Contrarily, officer candidates with no prior

service demonstrated little concern for the retirement system as a career inducement. The Lamda Asymmetric coefficient for this question showed a .05 reduction in error in predicting the value.

Table 4-3. Value of the Current Retirement System.

Motives	% of Prior Service	% of No Prior Service	Total
Strong	64%	15%	22%
Indifferent	21%	35%	33%
Weak	14%	51%	45%

Retirement Alternative Preference

This section asked respondents to indicate their attitude towards military retirement reform alternatives. Utilizing percentages to indicate levels by which each alternative would reduce current retirement benefits, respondents were asked to indicate the effect each alternative would have on their decision to pursue a commission by responding to attitude characterizations on a Likert Scale. This section also used a comparison between those candidates with prior service, those without, and the total percentages of the two combined (see Table 4-4).

Once again, prior service and non-prior service candidates were compared. In both categories, the respondents favored the QRMC V option, and would consider a commission if this system were instituted. The Grace

Commission proposal was the least acceptable option of the three. The Lamda Asymmetric coefficient for these correlations were .02 for QRMC V, .07 for the Congressional Budget Office option, and .14 for the Grace Commission proposal.

Table 4-4. Preference of Retirement Alternatives in Pursuing a Commission by Percentages of Officer Candidates

Option	% of Prior Service	% of No Prior Service	Total
QRMC V*	43%	45%	44%
CBO*	36%	32%	34%
PPSSCC*	21%	20%	20%

QRMC V* (Fifth Quadrennial Review of Military Compensation)
 CBO* (Congressional Budget Office option)
 PPSSCC* (Grace Commission option)

Results

Primarily, results of the survey indicated that the current retirement system is not one of the more valuable tools of recruitment, but rather becomes more important as one progresses through their career. These assertions are fortified by results of the questionnaire in each of the three areas examined.

The overall analysis of the data clearly illustrates that this population, generally speaking, did not consider the retirement system an important factor in their decision to pursue a commission, yet they would reconsider if drastic

reductions were made to the existing system.

NOTES

1. Air Force Reserve Officer Training Corps, Plans and Programs Division, On Campus Survey Report, (Maxwell Air Force Base, HQAFROTC, Alabama: 18 December 1984), p. 23.
2. Airlift, Is Retention a Problem, (Maxwell Air Force Base, Air University Review, Alabama: Summer 1985), p. 2.
3. Ibid.

CHAPTER 5

CONCLUSIONS

Critics of the retirement system have stated that it costs too much, has been too liberal in its provisions, and has been at odds with efficient personnel management policies. This study has tested this criticism by examining alternative retirement systems. A prima facie argument is made in that none of the alternatives suggested dealt with the issue in a comprehensive manner. First, the Grace Commission report was conducted by private sector executives whose sole objective was to cut costs within the federal government. It demonstrated little understanding of personnel management needs within the public sector, especially the military. Second, most of the proposed modifications of the Fifth Quadrennial Review of Military Compensation were generated internally by Pentagon study groups. It showed little consideration for cost, as it concentrated on methods that would increase force size. What is needed is a balance between cost containment and sound personnel management policies.

Two other major conclusions could also be drawn from this study: (1) A secondary argument is made in that cost containment and force levels are placed dichotomously. In

other words, the alternative that advocates the greatest cost saving is also going to reduce force levels. (2) Third, the attitudinal survey does show that the retirement system is not a primary factor for recruiting officer candidates and is more of a retention tool.

These conclusions pose several dilemmas for the military. One, if the military is to adopt a plan that would generate considerable cost savings, is it willing to make the force level sacrifices necessary to meet these goals? Secondly, since dollars have become a primary concern, how will the military deal with personnel needs? Finally, where should personnel place the emphasis, recruitment or retention?

It is already seen that the military is willing only to compromise slightly on cost containment or force level issues. At this time, military retirement remains unchanged, subject only to minor alterations. While Congress has suggested that the military alter the system and reduce retirement costs for Fiscal Year 1986 by \$4 billion, the compromise was only a \$2.9 billion reduction with the guarantee that the current retirement system not be further altered which will enable the military to continue to provide benefits under the current system.

Retirement pay has become an important part of the total compensation package offered to career personnel in the military. Considering this and the factor of high cost, change in the system has become imperative.

Recommendations

It is apparent by now that the current military retirement system has been, and will continue to be, an important part of the military's personnel management program. But this will by no means exempt this program from some form of modification to meet increasingly demanding cutbacks.

Based on the study of military retirement, two recommendations may be made striking a compromise between cost and manpower requirements. The first option would consist of a frequently considered proposal of a contributory retirement system much in the same manner as the civil service pension program. This might mean a moderate increase in base pay. If military pay was slightly higher, military members may be more inclined to respond to such a retirement system. Through incremental adjustments in wage, and considerable reductions in the non-contributory retirement system, actual cost savings may still be achieved while retaining and recruiting qualified personnel.

The second option aims at altering the computation base of the retirement formula for benefits. This would mean reducing mandatory retirement age to 25 years of service, and increase voluntary retirement to 25 years of service to compel more members to consider longer careers. However, for those choosing to retire earlier than 25 years of

service a prorated retirement benefit may be paid, by having a minimum number of prescribed years of service. This option would allow for the retention of younger personnel.

Without doubt, the military will have to choose between an attractive pension system or a competitive pay system. The two concepts together are not compatible with an affordable personnel management policy. The policy in which attractive and expensive incentives are competing cannot exist, particularly when the military is faced with budget cutbacks.

Modification to the retirement system will be difficult. Members who have become accustomed to generous benefits will be unwilling to sacrifice them. However, that should not refrain the reform attempts, and it is imperative that some form of change be instituted. Proposed change in military retirement may also mean that choices will have to be made as to whether or not the military desires a young force, or would rather attract members to longer careers.

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APPENDICES

APPENDIX A

COMPARISONS

COMPARISON OF PAST STUDIES ON MILITARY RETIREMENT

Table A-1.

Study	Benefit	Vesting	Pay Base	Severance	Grandfather
QRMCI 1967	Reduced	Yes	High-1	Yes	Yes
IAC 1971	Reduced	Yes	High-3	Yes	Yes
DoD Retired Study Group 1972 (RMA)	Reduced	Yes	High-1	Yes	Yes
QRMCI II 1976	Reduced	Yes	High-1	Yes	Yes
DMC 1976	Reduced	Yes	High-3	Yes	Yes
PCMC 1978	Reduced	Yes	High-3	Yes	Yes
USRBA 1979	Reduced	Yes	High-2	Yes	Yes
QRMCI V 1984	Reduced	Yes	High-3	Yes	Yes
PPSSCC	Reduced	No	High-3	Yes	No

Department of Defense, Office of the Secretary of Defense,
Fifth Quadrennial Review of Military Compensation, Volume I,
 (Washington D.C.: Government Printing Office, 1984), p. VII-
 18.

COMPARISON OF RETIREMENT ALTERNATIVES

Table A-2.

	Fifth QRMC Reduced Annuity	CBO Synthesis (Modified Half-COLA)	PPSSCC (Annuity at age 62)
Change in Career Force (Percent)			
Size	+4.7	-3.0	-11.0
Average Seniority	+2.3	-2.3	-7.9
Increase in Incentive for Long Career (20+ years)	Strong	None	Strongest
Increase in Incentive for Journeyman Retention (4-12 years)	None	Strong	Strong
Adds Flexibility to Separate Involuntarily	No	Yes	Yes
Risks of Unanticipated Effects	Least	Larger	Largest

Congressional Budget Office, Modifying Military Retirement:
Alternative Approaches, (Washington D.C.: Government
Printing Office, April 1984), p. 64.

ESTIMATED OUTLAYS FOR RETIRED PAY, 1985-2020
(in millions of 1985 dollars)

Table A-3.

Year	Current System	Changes from the Current System		
		QRMV Option	CBO Option	PPSSCC Option
1985	17,515	+9	0	-68
1986	17,922	-79	-169	-328
1987	18,125	-266	-547	-543
1988	18,327	-358	-738	-735
1989	18,531	-438	-915	-861
1990	18,720	-507	-1,076	-981
1995	19,575	+701	-1,677	-1,907
2000	20,373	+451	-2,292	-4,777
2010	21,170	+340	-3,725	-10,644
2020	21,510	-503	-3,716	-14,463

Congressional Budget Office, Modifying Military Retirement: Alternative Approaches, (Washington D.C.: Government Printing Office, April 1984), p. 54.

APPENDIX B
QUESTIONNAIRE

QUESTIONNAIRE

I. Instructions:

1. Please read the purpose statement carefully.
2. Begin answering the questions in the general information section by placing the appropriate mark next to your response.
3. Once you have completed the general information section, go on to the career motivation and attitude section. This section will require you to circle a response which most closely reflects your feelings about the particular statement. Please read all responses and statements carefully.

II. Purpose Statement:

The following questionnaire is designed to determine attitudes of officer candidates of the Air Force Reserve Officer Training Corps at Montana State University concerning the current military retirement system. You are asked to retain your anonymity by not placing your name or any other identification on this questionnaire. You are under no obligation to complete this questionnaire, but your assistance would be greatly appreciated. This questionnaire is to be used for educational purposes only. Your candidness in responding to the survey is very important to the results of this study. If you would like to see the results, they will be made available upon request.

III. Questionnaire:

A. General Information:

Age _____? Academic Year?
CIRCLE ONE: Fr So Jr Sr Grad

What is your AS year?
CIRCLE ONE: 100 200 300 400

Length of previous military service if any? _____

Allocation? CHECK ONE:

_____ Pilot _____ Navigator _____ Missilier
 _____ Scientific/Technical
 _____ Engineering
 _____ Non-Technical
 _____ Legal _____ Medical
 _____ Have not received an allocation yet.

B. Career Motivation:

What is the most important factor in your choice to enter the Air Force? Please rank, 1 being most important, 7 least.

Job Security
 Patriotism
 Flying
 Educational Opportunities
 Retirement Benefits
 Pay and Military Privileges
 Other (List)

C. Attitudes:

Following are some statements about military retirement. Please indicate the extent to which each statement characterizes your feelings towards military retirement by circling the appropriate response under the statement. The symbols on the scale correspond to the following responses.

SA	A	N	D	SD
Strongly	Agree	Neutral	Disagree	Strongly
Agree				Disagree

I already understand the current military retirement system and the benefits I would receive if I complete the eligibility requirements.

SA	A	N	D	DS

I plan to Make the Air Force a career

SA	A	N	D	DS

The present military retirement system is one of the primary reasons I pursued a commission.

SA	A	N	D	DS

The retirement system is not important to me.

SA	A	N	D	DS

A 25% reduction in military benefits would not alter my decision to enter the Air Force.

SA	A	N	D	DS
_____	_____	_____	_____	_____

I would still consider a commission if my benefits were reduced by 50%.

SA	A	N	D	DS
_____	_____	_____	_____	_____

Altering the retirement benefits by 75% would not change my decision to enter the Air Force.

SA	A	N	D	DS
_____	_____	_____	_____	_____

When you have completed the survey, please return it to the Detachment office.