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Any significant change in the military retirement system will have a major impact on both the serviceman and the military personnel management system. The DOD Study Group's proposed retirement changes outline much needed revisions to a system that has become archaic in view of changes in philosophy underlying military pay. However, further study is needed in the areas of a contributory system, increased multipliers for service beyond 20 years, annuity formulas for service less than 30 years, and the mechanics of transition from the existing to a new system.

A CRITIQUE OF THE PROPOSED MILITARY RETIREMENT SYSTEM

A research paper prepared for the Management Curriculum

by

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Today's military nondisability retirement system is an outgrowth of a patchwork of laws and customs, some dating from before the turn of the century. These were developed for a smaller career military force and based on the idea of delayed compensation as retirement pay. The recent dramatic change in military compensation, bringing it more into line with comparable civilian pay scales, has had a major impact on both the cost and thinking behind military retirement. Increased personnel costs reflect a basic change in today's military pay concept, i.e., work is paid for when it is performed, instead of deferring it to retirement. The recent and projected growth in retirees and retired pay costs indicates that this element in the annual budget will be in competition with other requirements for scarce DOD resources.

Additionally, the present nondisability retirement system is ineffective as a personnel management tool. It does not assist in maintaining the desired force profile, and it is inequitable because the individual is ineligible for any retirement benefits unless he has served a minimum of 20 years. The system arbitrarily rewards and motivates retirement at 20 years, and management has no effective control of the force past retirement eligibility. The present linear annuity formula creates strongest retirement incentive at 20 years of service, and additional service is only motivated by considerations of job satisfaction, promotion potential, and patriotism.

These shortcomings in the retirement system have generated four high-level reviews of the military retirement system in the past 5 years, the most

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recent of which was done within the Department of Defense. The proposals growing out of this study will be the basis of a legislative proposal to Congress for sweeping changes in the retirement system. The DOD Study Group proposal, which was based on an evaluation of an earlier proposal drafted by an interagency committee, aims to reduce military retirement systems cost and increase its effectiveness as a compensation element.

The DOD Retirement Study Group¹ evaluated the present military retirement system and the interagency committee proposed retirement system within the framework of the overall military personnel management and compensation systems. Several defects were noted in the present retirement system: no retirement benefits are vested in the individual before serving 20 years; retirement annuities are based on terminal pay; it is an inefficient method of attracting people into the service; appropriate separation payments are not available; the annuity formula does not provide a sufficient retention incentive beyond 20 years of service; and the cost of the system is high and rapidly increasing as a percentage of the DOD budget.

The provision that retirement benefits are not vested in the individual prior to 20 years' service is unfair to individuals who serve less than this period. While this may properly serve as a disincentive to individuals who might choose to leave active duty before serving 20 years, it nonetheless punishes those who have invested time and effort toward making the military a career and for one reason or another were unable to stay on active duty long enough to earn any retirement benefits.

Voluntary retirees can select the date of their retirement (for example: after a pay raise) and substantially increase their retired pay over a lifetime. But, mandatory retirees have no choice in their retirement dates, so being retired

pay on terminal pay can mean unequal treatment for the involuntary retiree.

The retirement system is an inefficient method for attracting people into military service and retaining people with short service. A cash payment (bonus, special, incentive pay) today is a more effective incentive than a retirement annuity in 20 years.

Appropriate separation payments for personnel not qualifying for retirement (except for officers who fail promotion selection) are not available to force out unnecessary personnel. This deficiency prohibits and inhibits managers from separating personnel no longer required and, thereby, increases retirement costs.

The current annuity formula does not provide sufficient economic incentive to continue service after 20 years. Additional benefits earned for service beyond 20 years are not geared to reflect the increased difficulty faced by older retirees as they seek second careers. Thus, the annuities available to members with long service are not competitive with other retirement systems.

Long- and short-range analyses of projected retirement costs for the present system show that it will initially increase, then level off, and ultimately decline as a percentage of both the gross national product and the DOD budget.² Thus, if the present system is not too costly today, its cost in the future will probably be acceptable as well. Nevertheless, the DOD Study Group tried to determine whether the same or a better effect could be achieved at a lesser cost through a modified retirement system.³

After evaluating the deficiencies of the present retirement system, the DOD Study Group concluded that it must be revised to make it both a more effective management tool and eliminate the inequities it fosters among members of the service community.

A New Military Retirement System.⁴

The DOD Retirement Study Group proposed military nondisability retire-

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ment system is designed to eliminate the deficiencies in the current system by providing for the creation of a two-step annuity which pays an immediate, reduced annuity at 20 years of service and a deferred, full annuity at 30 years of service; an increased annuity for service during the 25th through 30th years; integration of the social security and military retirement annuity at age 65; separation payment made available for members with 5 or more years of service; save pay and transition provisions to provide current members' equity in the current system; and reallocation of resources to more efficient use within the compensation system.

Reduction in 20-Year Annuity. A two-step annuity plan was advocated in recognition of the military's need to maintain youth and vigor in the force. This requirement forces the service member to begin a second career and limits his earning capability in comparison to his civilian contemporaries. Thus, the annuity serves two purposes: as a supplementary payment during the retiree's second career and as a retirement pay when he is no longer in the work force. The two-step annuity was developed, retaining the feature of retirement with an immediate annuity at 20 years because retirement at a relatively early age has long been a valuable tool for the military in attracting and retaining the men it has needed.

Under the proposal, the immediate annuity, available after 20 years of service, is reduced by 15 percent. While the basic 2½ percent a year is retained as the multiplier, a 20-year retiree would receive only 35 percent of his basic pay instead of the 50 percent he receives now. At the time the retiree would have served 30 years, he begins to receive the full 50 percent annuity. The interagency committee plan differed from this proposal by including age as a factor in the formula and providing a larger reduction in the immediate

annuity. They recommended that the immediate annuity be reduced 2 percent for each year the member was under age 60 for retirement between 20 and 24 years of service and 2 percent for each year the member was under 55 for retirement after 25 years of service. The DOD Study Group revised this provision to recognize 30 years of service as a full military career because the law makes it difficult for members to remain beyond 30 years; they also felt the reduction provisions were too harsh and would not provide an adequate supplemental income.

Increased Annuity for 25 Through 30 Years. Both the DOD Study Group and the interagency committee systems retain the current annuity multiplier, 2½ percent, up through 24 years of service and increase the multiplier to 3 percent for the 25 through 30 years of service. The maximum annuity available is thus increased from 75 to 78 percent. Even though most military members retire before 25 years of service and will not benefit, this recommendation would make the military's retirement program more competitive with other liberal retirement systems. Additionally, the interagency committee recommended an increased annuity of 2 percent from 31 through 35 years of service to provide a maximum of 88 percent which equates to the maximum percentage for the Federal civil service retirement. The DOD Group deleted this provision because 30 years is considered a full military career, and the law prohibits all but a very few from serving beyond 30 years.

Averaging of Base for Annuity. The DOD Study Group recommended a high 1-year average pay be used as the basis for computing retirement pay. This provision removes the inequality associated with use of terminal pay without reducing the annuity unnecessarily. Also, it reflects more accurately the member's

pay at time of retirement and precludes gaining full benefit from pay raises just prior to retirement. The interagency committee recommended use of the high 3-year average currently used by civil service. This provision was revised to a high 1-year average. The short nature of the military career provides pay raises for promotion, longevity, and cost of living more frequently than every 3 years. Only pay earned after this system is implemented would be considered.

Integration of Social Security and Military Retirement Annuities. Both the interagency committee proposal and the DOD Study Group system recommend combining military retirement and social security annuities at age 65. (Presently, these benefits are separate.) This would be accomplished by reducing the military member's retirement pay by one-half of the social security annuity attributable to military service. Such a reduction reflects the fact that the member and the Government make equal contributions and offsets the portion contributed by the Government. This provision will consider only social security earned after implementation and does not affect social security benefits resulting from coverage before entering or after leaving the military service.

Separation Payments. Both the DOD Study Group and the interagency proposals would provide separation payments for members involuntarily released after 5 years of service and voluntary departures from 10 through 19 years of service. These payments would give management a useful tool for encouraging excess personnel to leave the service by providing adequate equity payment to compensate members who are denied career designation and retention to retirement eligibility. The DOD Study Group alternative would provide a deferred annuity at age

60 for voluntary separatees who leave with 10 or more years of service. This is an equity payment for members who wish to stay past their initial obligation but not until retirement eligibility. The interagency committee proposal offers a choice of the deferred annuity or a lump sum payment equal to 5 percent of basic pay times years of service. The DOD Study Group eliminated the lump sum payment because it could serve as a disincentive to continued service. A readjustment payment in addition to an equity payment would be given to members who were involuntarily separated with over 5 years but less than 20 years of service. The DOD alternative would provide a readjustment lump sum payment of 5 percent of annual pay times the number of years of service in addition to the choice of receiving equity payments in either the form of an additional lump sum of 5 percent of annual pay times years of service or a deferred annuity at age 60. The interagency committee recommendation would make the equity payment only after 10 years of service. The DOD proposal recognizes the individual who was precluded from reaching 10 years of service.

Save Pay. The save pay provision guarantees all future retirees at least as much compensation as a similar member who retired under the current promotion system. This maintains the career member's equity in the retirement system. This is essential if the retirement system is to retain its credibility as an equitable compensation device.

Transition. The DOD Study Group proposed a 20-year transition period to determine the extent of the annuity reduction for current force members based on the number of years served under the new system before retirement eligibility. The interagency committee proposal is based on complete implementation after 10 pay raises. The DOD

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transition is more gradual and would eliminate the trauma and opposition associated with change. However, it would not be fully implemented for 20 years.

Resource Reallocation. Some of the savings generated by the new retirement system will be reallocated within the system. Various bonuses and special incentive pays will be used by management to attract and retain the proper number of men possessing various skills required to man the desired military force.

REVISIONS TO THE PROPOSED RETIREMENT SYSTEM

The military retirement system proposed by the DOD Study Group has been evaluated, but before it is translated into a legislative proposal the following ideas should be more thoroughly explored: the retirement system should be a contributory one; social security should be eliminated from the retirement system; age is a necessary factor in the annuity formula; the increased multiplier should be applied at 21 years of service; and the transition period should be revised to 10 years.

Contributory System. The most glaring deficiency in the DOD Study Report is the omission of even any discussion on military members' contribution to the retirement system. This is a highly controversial issue and should have been objectively and thoroughly discussed.

General Benade has stated that under the proposed program the retirement system would remain free of any contributory system for members on active duty.⁵

This statement is misleading to both the military and the general public, as the military now make implicit contributions, and explicit contributions are included in the new plan. Under the current system, servicemen implicitly contribute 6.5 percent of their base pay

congressional decision to offset basic pay increases.

Several advantages are to be gained by designating the system a contributory one. The contribution would be vested and returned in full to the member or his survivor should he leave military service before becoming eligible for retirement. The member's payment would be a visible, acknowledged one, paralleling the Civil Service System and thus would serve to silence critics who feel military retirement is too generous because it is "free." The cost of military retirement would be paid as it is earned, rather than at a future date. This method would give a more accurate picture of costs incurred during a period of national emergency rather than as an unpopular peacetime expenditure. Also the contribution would be a stable one and not subject to annual increases. A contribution rate of 6.5 percent would appear adequate to cover the costs of the system.⁶ This percentage contribution should also include the member's contribution to social security, if the link is to be retained.

The Congress has asked the Department of Defense to consider a contributory retirement system, and the First Quadrennial Review of Military Compensation recommends that military personnel contribute to their retirement.

The DOD Retirement Study Group's new retirement system should be revised to provide for a contributory system. Such action will acknowledge and advertise the individual's existing contributions and establish a mechanism to operate the system.

Elimination of social security would also require a revision of survivor benefit laws. Since the civil service contributory retirement system covers liberal survivor benefits, it is reasonable to assume a similar package could be legislated for the military.

The career military man can complete 20 to 30 years of military service,

and still achieve the 40 quarters needed for social security benefits coverage during his second career years. Will the career man gain additional benefits from paying an increasing percentage of his pay into social security when the Government does not match his contribution, or could he invest that money elsewhere and gain a higher return?

A thorough study should be conducted to determine if the career service member's contribution to social security is the best use of these resources. Also, new avenues should be explored to determine if contributions to the military retirement system could be transferred to the social security program when noncareer members leave the military.

The DOD and interagency reports indicate the Social Security Agency and the Veteran's Administration were contacted, but there is no evidence a thorough analysis was conducted in these areas. A total elimination of the social security program from the military retirement system is a viable alternative that must be carefully considered.

Increased Multiplier. The increased multiplier (3 percent) should be applied at 21 years of service instead of 25 years. The DOD report points out that the current retirement system lacks the proper incentive to motivate members to remain on active duty after 20 years of service. Thus, after 20 years of service, further service has been motivated primarily by considerations of job satisfaction, promotion prospects, and patriotism rather than economic considerations.

An increased multiplier (3 percent) from the 21st through the 30th years of service would provide an incentive to continued service at the time most personnel retire. It would also compensate for the increased difficulty the military man will have in finding a good second career as he gets older by pro-

viding an increased retirement annuity. The maximum annuity with an increased multiplier would be increased to 80 percent at 30 years of service. An increased multiplier (3 percent) at 25 years of service appears to be too little, too late. The prospects of pursuing a second career are greatest for the military man as he approaches the 20-year point, and thus it is at this point that an increase in the multiplier would have its maximum impact.

Include Age in the Annuity Formula. Age should be retained as a part of the annuity formula. The DOD Study Group recommended deletion of age from the proposed retirement annuity formula, substituting years of service in its place. This, they argued, would recognize a full military career as 30 years of service, not affect annuities drastically and would yield a simpler formula.

While years of service provide the standard for military compensation, this need not eliminate age as a threshold for retirement eligibility. Other retirement systems offering a retirement annuity are adjusted according to retirement age. The proposed transition period will provide an opportunity for members to adjust to this new idea of integration of years of service with age. It is a complex but logical system.

Deletion of age from the formula may produce a counterincentive to those on which the system is based. Thus, an annuity formula that does not consider age offers a greater immediate incentive for retirement to younger members of the same grade and length of service. It also produces an inequality on the expected lifetime basis, as older retirees will receive a shorter lifetime payment stream than younger retirees who performed the same service. If one of the military manager's aims is to retain younger members in the service for longer periods of time, then retaining age in the annuity formula will

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be a motivator in the right direction. Thus, the DOD Study Group proposal should be revised as follows: reduce the first step retirement annuity for less than 30 years of service by 1 percent for each year the retiree is under 60, with a maximum reduction of 15 percent. For 30 years or more service, pay the full annuity at retirement.

Shorten Transition Period. A 20-year transition period is unnecessary and inefficient. The transition period is surely one of the most important features of the new proposal because it preserves the equity of active duty members in the present retirement system. This provision is most necessary for members who have attained retirement eligibility or who are now nearing retirement since they are most affected by the change and least able to change their status if dissatisfied with the revision.

The 20-year period recommended by the DOD Study Group seems unnecessarily long, as it provides protection for members who have just entered the service and have little to lose from the proposed changes. Twelve years of service has been designated the dividing line for career designation, and those members with 10 or more years of service will be entitled to an annuity under the new provisions. Thus, a maximum of 10 years for transition would provide a long enough period for a gradual movement to the new system but short enough time to meet objectives of the new system within the foreseeable future. A 5-year transition period was recommended by the First

Quadrennial Review of Military Compensation, but it is not acceptable because the rapid change would not preserve the equity of all career personnel.

The 10-year transition could be accomplished by decreasing the income for 20 years' service at a rate of 1.5 percent per year over a 10-year period.

* * * * *

The DOD Retirement Study Group proposed military retirement system, as modified by the alternative proposals herein, will be a more effective and efficient system by providing tools for force management; reallocating compensation to more effectively attract, motivate, and retain members; and by eliminating identified inequalities in the system as well as reducing the cost of the retirement system.

BIOGRAPHIC SUMMARY



Comdr. Maria S. Higgins, U.S. Navy, did her undergraduate work at Wesleyan College and has earned an M.A. degree from George Washington University in personnel administration and an M.S. degree

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FOOTNOTES

1. *Report to the Secretary of Defense by the DOD Retirement Study Group* (Washington: U.S. Dept. of Defense, 1972), p. 8-20.

2. *Ibid.*, p. 14.

3. *Ibid.*

4. *Report to the Secretary of Defense*, p. 20-39.

5. *Commander's Digest*, 26 October 1972, p. 5.

6. U.S. Dept. of Defense, Military Compensation Policy Board, *Modernizing Military Pay: Proposed U.S. Naval War College Study Committee Compensation* (Washington: 1969), v. IV, V.7