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Time to Meet the Challenge of Updating the Military Retirement System

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The defense budget is currently underfunded to compensate the professional all-volunteer U.S. force adequately and modernize the inventory of all the services. Military benefits and entitlements must be addressed to strengthen the force and ensure that those in uniform are not given fewer benefits in the future. Like the rising costs of Social Security, Medicare, and Medicaid, the cost of military health care, retirement, and education benefits threatens to absorb every defense dollar if left unchecked.

To provide an adequate defense, the nation has to achieve three vitally important objectives with respect to compensation and benefits for all who serve and have served in the armed forces:

- Ensuring continued recruitment and retention of the top-quality personnel the armed forces need,
- Honoring the country's obligations to members of the armed forces, and
- Applying taxpayer resources devoted to the nation's defense effectively.

The current system is not sustainable, nor does it provide the best array of options to men and women in uniform. Reforms are needed that honor the commitments that America has made to the members of the armed forces serving now and in the future—reforms that sustain a high-quality all-volunteer force and fairly compensate those who choose to serve the common defense. In short, our military men and women need choices and flexibility.

Priorities for the Retirement System. In 2010, the bipartisan, congressionally commissioned Quadrennial Defense Review (QDR) Independent

Panel outlined the scope of the underlying problem concerning military compensation. The panel explained, “[T]he recent and dramatic growth in the cost of the All-Volunteer Force cannot be sustained for the long term. *A failure to address the increasing costs of the All-Volunteer Force will likely result in a reduction in the force structure, a reduction in benefits, or a compromised All-Volunteer Force.*”¹

To combat this problem, the panel outlined several major changes that are necessary to maintain a stable and strong all-volunteer force in the current military personnel system. These include:

- “A change in military compensation, emphasizing cash in hand instead of deferred or in-kind benefits to enhance recruiting for those serving less than an entire career.”
- “Instituting a continuum-of-service model that allows service members to move fluidly between the active and reserve components and between the military, private sector, civil service, and other employment.”
- “To ensure a healthy All-Volunteer Force for the next two decades, the military's personnel management system should be revised to include modifying the up-or-out career progression,

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lengthening career opportunities to forty years, instituting 360-degree officer evaluations, and broadening educational experiences both in formal schooling and career experiences for officers heading toward flag rank.”²

The QDR Independent Panel was correct. Apart from the current concerns over federal spending and the debt, there are other vital reasons to rethink military retirement. The system simply has not evolved to keep pace with the changing nature of the workforce and modern life. Even the Pentagon recognizes the need for reform, as made evident by the July 21 release of an outline of a study conducted by the Defense Business Board.³

Modernizing Military Retirement. For decades, the Department of Defense has maintained the same basic structure for military retirement that existed before creation of the all-volunteer force in the 1970s. Clearly, the basic means for compensating military personnel under a conscription system will and should differ in profound ways from that of the all-volunteer force. Nevertheless, the military retirement system has never been modified in accordance with this fundamental change. It is outdated for several other reasons that need to be addressed. For example, the system:

Does not account for second careers. The current military was designed during an era when life spans were shorter and second careers for military retirees were relatively rare. The latter was because military skills did not lead to career opportunities in the private sector. Today, however, military skills are far more likely to be in demand in the private sector, making second careers with supplemental income and benefits much more common.

Limits investment options. Military retirement funds cannot be invested in high-yield equities and bonds. Like all government trust funds, assets in the

military retirement trust fund are invested in low-interest government bonds. These limited investment options make it more difficult for the federal government to provide benefits than it is for the private sector to provide commensurate retirement benefits.

Widens the expense gap between the military and the private sector. Military retirement costs the federal government more than retirement for the same individuals would cost private employers. Some analysts estimate that the government retirement contribution is 10 times greater than the private-sector average because military retirees can qualify for retirement at a very early age relative to the private sector. This imposes a significant burden on the defense budget and also means that under further reductions, relevant personnel expenditures cannot be sustained.

Affects personnel retention. The military retirement system pays generous benefits to those who serve for 20 or more years.⁴ This system weakens the retention of more experienced military personnel who have already hit the 20-year mark. As many as 76 percent of military personnel who achieve 20 years of service will leave before reaching 25 years of service. The available data suggest that in mid-career, 20-year retirement does in fact influence the retention of personnel. It is also important to point out, however, that although military benefits influence retention, 83 percent of military personnel will leave the service before the 20-year mark and fail to qualify for military retirement.

Is too inflexible. Finally, the military retirement system is too inflexible. For instance, it fails to permit compensation to respond to the special needs of those in high-risk combat positions or serving hardship tours. Currently, the only way to reduce the demands of the system is to cut personnel, but even

1. Quadrennial Defense Review Independent Panel, *The QDR in Perspective: Meeting America's National Security Needs in the 21st Century: The Final Report of the Quadrennial Defense Review Independent Panel* (Washington, D.C.: United States Institute of Peace Press, 2010), p. xiv, at <http://www.usip.org/files/qdr/qdrreport.pdf> (September 14, 2011). Emphasis added.
2. *Ibid.*, pp. xiv and xv.
3. Defense Business Board Task Force, “Modernizing the Military Retirement System,” July 21, 2011, at http://dbb.defense.gov/pdf/DBB_Military_Retirement_Final_Presentationpdf.pdf (September 14, 2011).
4. *Ibid.*

this comes with the condition of paying expensive separation bonuses.

Addressing the Issues. Congress and the Pentagon must carefully review and update the outdated military compensation system to reflect the demands of a highly mobile 21st century workforce. By offering greater differentiation in pay for those who serve less than a full career in uniform, Congress could actually provide even better benefits for military service members and their families—and retirees—due to a more solvent defense budget in the future. Retirement reform should move the military system from the existing defined-benefit plan to a defined-contribution plan.

Reform should include expanding the existing military Thrift Savings Plan (TSP). The TSP would allow tax-preferenced contributions to its savings and investment accounts and has much lower administrative costs than most other retirement savings options. The goal should be to offer better and more comprehensive benefits rather than forcing service members into the existing plan.

The reformed system should take the following factors into account:

- **Cover all who serve.** This expanded TSP-based system should apply to reserve component service members as well as active-duty service members.
- **Provide tax-deferred savings for retirement.** The more individuals and families save, the lower their taxes. Taxes would be paid on savings only when savings are used to pay for goods and services.
- **Provide special bonus packages for contributions to retirement accounts.** To maximize recruitment and retention, the military should be free to offer incentives to incoming service members in the form of payments into retirement accounts. Bonus packages should vary in term to allow for targeted recruitment for short-term and potential full-career recruits.
- **Provide disability retirement coverage through the Department of Veterans Affairs, if necessary, and a reformed Social Security system.** Proposed reforms would allow disabled service members to obtain quick and accurate decisions on their benefit applications. While disability military retirement would be eliminated for new entrants,

Veterans Affairs programs would offset this cut, and new recruits would also have access to a reformed Social Security.

- **Give the option to “grandfather” currently serving military personnel under the existing retirement system.** Grandfathered personnel would be allowed to retain the accrued benefits built up during their service under the existing system in addition to being able to join the new system.
- **Provide for survivors.** Upon death, the balances in the TSP account would become part of one’s estate and be transferred to a service member’s heirs.

Bringing the Military into the 21st Century. Unquestionably, the military retirement system is out of date, inflexible, unfair, and too costly. Comprehensive reform is needed. Some advocate preserving the basic structure of the existing system while making changes at the margin. The result, however, would only be modest savings. These limited savings would also come at the opportunity cost of perpetuating the structural weaknesses in the existing system while denying service members the advantages of a better alternative.

A form of defined contribution is a better alternative. Ultimately, this approach to reform would make the system more efficient and less costly while preserving the ability of the services to recruit and retain high-quality personnel. A failure to institute reforms would violate the commitment made by the government with those who have already joined the armed forces.

In light of the expressed intentions of the Obama Administration to reduce defense spending to its lowest level ever during wartime as a percentage of the economy, escalating costs—if not addressed—will hurt the military’s ability to carry out its numerous global missions to fight and win the nation’s wars, deter enemies, and reassure allies. Those who willingly risk their lives deserve better.

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