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THE MILITARY RETIREMENT PLAN:  
AN ANALYSIS, REVIEW, AND REVISION

By

Donald L. Haverkamp

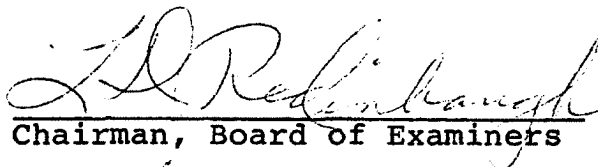
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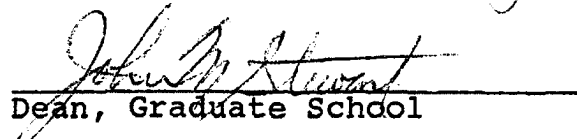
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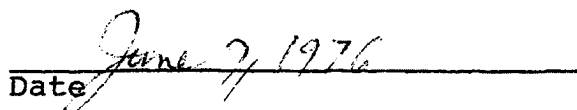
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## Chapter 1

### INTRODUCTION

Military people, both active and retired face a continual bombardment of proposals to change key features of their present retirement plan.<sup>1</sup>

Federal budget experts are continually wrestling with a problem that is putting new strains on the Government's budget, which will make it difficult to hold down in the years to come. The constraint is the exploding cost of federal retirement programs. Considered to be out of control by many Congressional members,

. . . pension costs for retired military and civil service personnel have jumped 500 percent since 1965, while the number of beneficiaries has grown only 116 percent.<sup>2</sup> (See figures 1 and 2.)

Federal retirement costs are nearly 17 billion dollars this year (see figures 3 and 4)<sup>3</sup> and could approach 45 billion dollars annually within ten years.<sup>4</sup> To put it in perspective, the

. . . annual military retirement costs in the last ten years have grown from about the price of a single

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<sup>1</sup>"New Group Probes Pensions," Air Force Times, 36 (February 16, 1976), p. 19.

<sup>2</sup>"Pensions for Federal Workers: \$17 Billion and Soaring," U.S. News & World Report, LXXIX (October 13, 1975), p. 85.

<sup>3</sup>Ibid.    <sup>4</sup>Ibid.

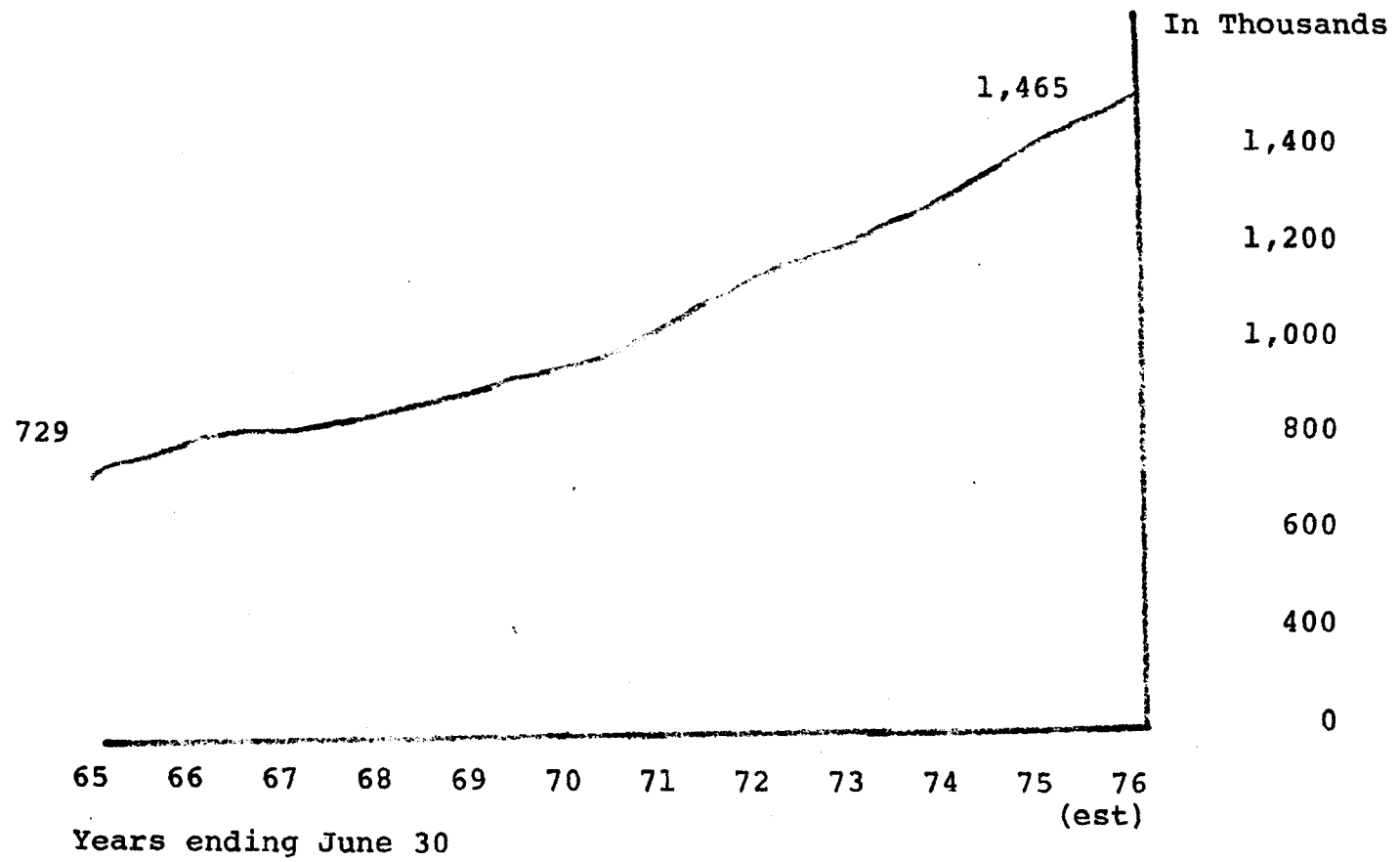


Figure 1

Civil Service Employees: Number Drawing Retirement Benefits

Source:

"Pensions for Federal Workers: \$17 Billion and Soaring," U.S. News & World Report, LXXIX (October 13, 1975).

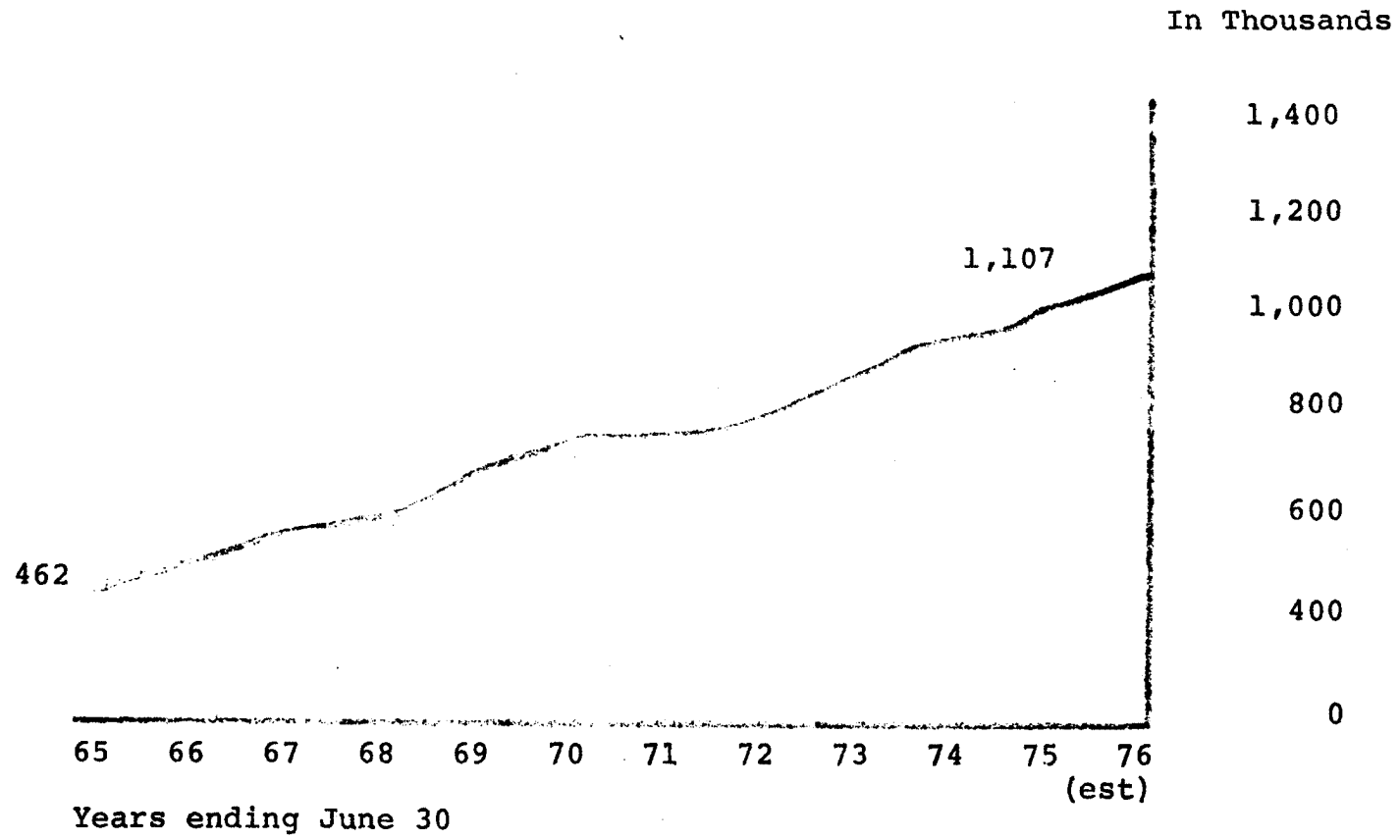
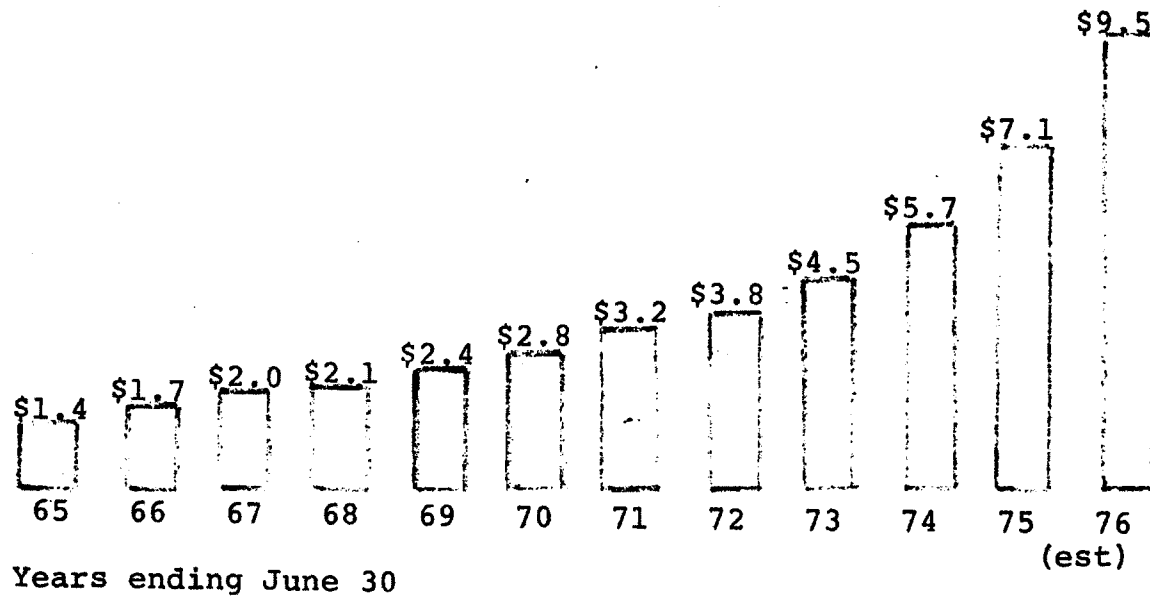


Figure 2

Military Personnel: Number Drawing Retirement Benefits

Source:

"Pensions for Federal Workers: \$17 Billion and Soaring,"  
U.S. News & World Report, LXXIX (October 13, 1975).



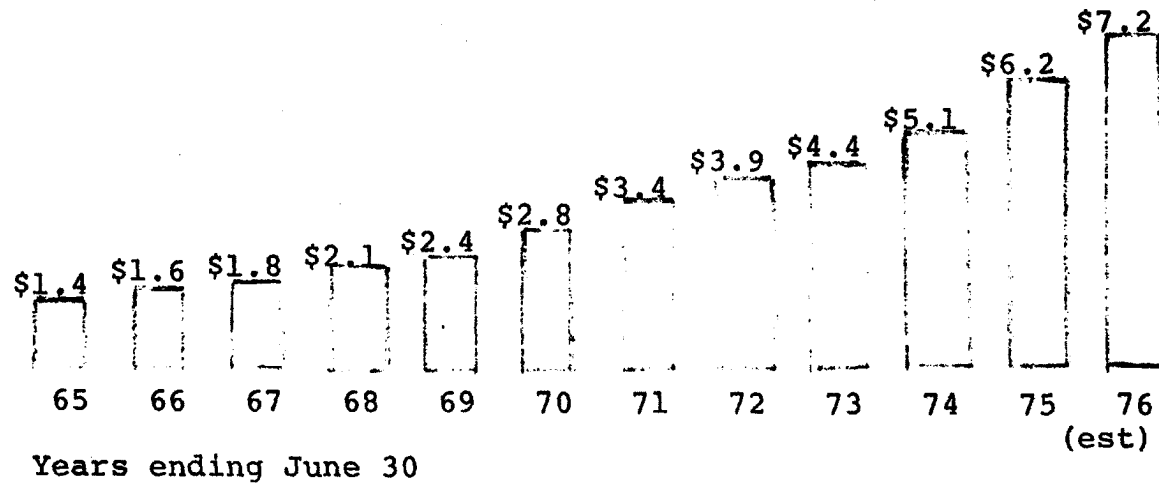
Note: All figures in billions of dollars

Figure 3

Civil Service Employees: Benefits Paid

Source:

"Pensions for Federal Workers: \$17 Billion and Soaring,"  
U.S. News & World Report, LXXIX (October 13, 1975).



Note: All figures indicate billions of dollars

Figure 4

Military Personnel: Benefits Paid

Source:

"Pensions for Federal Workers: \$17 Billion and Soaring,"  
U.S. News & World Report, LXXIX (October 13, 1975).

aircraft carrier to more than the Navy's entire annual shipbuilding program.<sup>5</sup>

Those costs are expected to expand by 400 percent in the next 30 years.<sup>6</sup> This fact alone is causing great concern over how future costs will be met.

The present military retirement plan is an unfunded (no money is on deposit to meet obligations when they come due) program facing a 155 billion-dollar liability.<sup>7</sup> Several factors are contributing to the soaring costs of military retirement, including: (1) increasing numbers of retirees (60,000 per year since 1962), (2) inflation, (3) cost-of-living increases; and (4) unusually liberal benefits. Congress is not the only interested party that is unhappy with the present retirement programs. Defense officials feel that military pay and retirement benefits are not serving to attract and retain personnel in a draft-free military system. Those still on active duty are concerned that they will lose many of the retirement benefits which were promised years ago when they entered the armed services. Their fears are well-founded, as reductions in benefits for future retirees are being sponsored by two influential Congressmen, both members of respective Armed Services Committees: Senator John C. Stennis and Representative F. Edward Hebert. Retired service members are unhappy that they have not benefitted from the rapid rise in active pay

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<sup>5</sup>"Furor Over Military Retirement Pay," U.S. News & World Report, LXXVII (October 14, 1974), p. 106.

<sup>6</sup>Ibid.    <sup>7</sup>Ibid.



scales. Retirement pay is tied to the Government's Consumer Price Index, and not to active duty rates. Present retirees are trying to get this changed. Bureaucratic change will not come quickly, but all parties agree that the present system cannot endure.

Congress will have a difficult time taking benefits away from Federal workers, representing a block of over three million votes. Also, strong opposition from employees' unions will make itself felt.

## Chapter 2

### THE PRESENT MILITARY RETIREMENT PLAN

#### History

Established by the Continental Congress, the first pension plan for the military provided officers who remained in the service for the duration of the war half pay for seven years after the war, while enlisted members remaining for the duration were promised a bonus of \$80.<sup>1</sup> Mandatory conscription was not practical during our early history, so pensions were established to induce enlistments and to encourage volunteers to remain in the service. Because wages paid to the armed services were meager, the Continental Congress thought it equitable to provide a pension system with liberal payments and broad coverage, an idea of compassion and generosity which has continued without interruption.

Pensions were quickly expanded to include veterans who were severely or permanently disabled. Later, pensions were given to widows, dependent children, and dependent parents of those killed in action in military service. Pensions were then awarded to veterans that became disabled after a war, even if the disability could not be traced to

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<sup>1</sup>Alfred G. Buehler, "Military Pensions," The Annals of the American Academy, 227 (May, 1943), p. 130.

the war. Eventually, age became a measure of disability.

Military pensions are one form of compensation to war veterans and their dependents after the termination of military service. Congress soon began to realize that a distinction was required between retirement allowances and a pension for military service. Retirement allowances were for those in the regular military establishment pursuing a military career; pensions were for those who enlisted or were drafted only for the duration of a war.

This realization led to the passage of the first United States Military Retirement Act by Congress in 1861,<sup>2</sup> a major provision of which allowed personnel to leave the armed services at full pay after 40 years of active duty. The Military Retirement Act officially supplemented the system of numerous pension plans which were in effect to reward veterans.

The Military Retirement Act remained virtually unchanged until the turn of the century. Since 1900, however, a number of significant changes have been made in the military nondisability retirement system. Some of the changes which were enacted applied differently to the various branches within the military as well as applying differently to officers and enlisted members. Shortly after 1900, the law allowed for retirement after a 30-year career, replacing

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<sup>2</sup>"Furor Over Retirement Pay," U.S. News & World Report, LXXVII (October 14, 1974), p. 106.

the original 40-year military obligation to be eligible for retirement benefits. This was the only change that applied evenly to all military members during the next 48 years. In 1935, voluntary retirement of Army officers with 15-29 years of service was authorized. That authority was repealed in 1948 when the present voluntary retirement authority for Army and Air Force officers with 20 years of active service (including ten years of active commissioned service) was enacted.<sup>3</sup> The Navy was authorized similar action earlier in 1946.

Changes concerning enlisted members also were passed. In 1945, the current law authorizing retirement of Army and Air Force enlisted personnel after 20 years of service was enacted.<sup>4</sup> Note: The Air Force was a part of the Army until September, 1947, when the Air Force became a separate branch. In 1961, Navy and Marine Corps enlisted personnel were authorized to transfer to the Fleet Reserve after 16 years of service with one half of their basic pay.<sup>5</sup> In 1925, the law was changed to require 20 years of active service for retirement. In all cases, retirement after 20 years of service has always been considered a privilege and not a right.

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<sup>3</sup>Roger T. Kelley, The Proposed New Military Nondisability Retirement System, A Brochure Prepared by the Department of Defense (Washington: United States Government Printing Office), p. 1.

<sup>4</sup>Ibid.    <sup>5</sup>Ibid.

### Eligibility for Retirement

All members of the armed forces are eligible for retirement benefits after completing 20 years of honorable, active service. To retire as an officer, at least ten years must be served as a commissioned officer.

### Contributions

The military retirement plan is an unfunded non-contributory system. "The total cost of the retirement program is borne by the Government."<sup>6</sup>

## RETIREMENT BENEFITS

### Annuity Formula

Military retirement benefits are calculated using the basic formula of: 2 1/2 percent times years of service times basic pay. This equates to 50 percent of basic pay at 20 years' service, up to a maximum of 75 percent of basic pay at 30 years' service.

### Social Security

Military personnel contribute to Social Security, and at the age of 62, can receive old-age pensions in addition to military retirement benefits. The armed forces did not come under the Social Security System until 1957, and for a

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<sup>6</sup>"Pensions for Federal Workers: \$17 Billion and Soaring," U.S. News & World Report, LXXIX (October 13, 1975), p. 85.

great number of people, the years of military service prior to this date will not be counted toward the Social Security benefit entitlement.

#### Cost-of-Living Adjustment

In 1963, Congress tied Federal retired pay to the Government's Consumer Price Index to compensate for inflation.

Federal pensions are raised automatically when the Consumer Price Index jumps 3 percent or more above its level at the time of the previous cost-of-living increase and holds there for three consecutive months.<sup>7</sup>

The checks to beneficiaries reflect the increase two months later.

To repay them for purchasing power lost in the five-month wait, an additional one percent increase - known as a "kicker" - is tacked on to the pension.<sup>8</sup>

#### Vesting

Military service members are the largest single group of "public employees" in the country covered by a retirement system that provides no vesting of pension rights before completion of 20 years.<sup>9</sup>

#### Survivor Benefits

Financial protection for survivors of retired Uniformed Services members is assured by Public Law 92-425,

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<sup>7</sup>Ibid.    <sup>8</sup>Ibid.

<sup>9</sup>"New Group Probes Pensions," Air Force Times, 36 (February 16, 1976), p. 19.

known as the Survivor Benefit Plan (SBP). Survivor income is provided for widows, widowers and dependent children up to 55 percent of the retired pay of retirees. Enrollment with maximum coverage in SBP is automatic for retirees with spouses or dependent children unless the member elects a lesser coverage or declines participation. Members who do not have a spouse or dependent child can either join the plan at the time of retirement naming another person as beneficiary, or participate later if the retiree acquires a spouse or child after retirement.

The cost of the Survivor Benefit Plan is shared by the member and the Federal Government, with the Government paying a substantial part. The cost to retirees is withheld from the retirement checks.

Changes in member cost will occur when retired pay is increased to reflect changes in the Consumer Price Index, and the withholding will be increased accordingly.<sup>10</sup>

Survivor payments are also tied to the Consumer Price Index and will be increased to keep pace with increases in the Index.

The Survivor Benefit Plan provides income protection for four classes of beneficiaries, including: (1) spouse only; (2) spouse and dependent child or children; (3) dependent child or children only, and (4) another person with an

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<sup>10</sup>Survivor Benefit Plan for Retired Members of the Uniformed Services, Department of Defense Pamphlet  
(Washington: Government Printing Office, 1973), p. 4

insurable interest in the retiree. The class of beneficiary to be protected determines the cost of the program to the retiree.

The basic intent of the SBP is to provide protection for a spouse who will survive a retired member of the Uniformed Services.

For the purpose of SBP, a surviving spouse eligible to receive SBP payments is a widow or widower who was either:

- (1) Married to a retiree at the time of his or her retirement,
- (2) Married to the deceased retiree for at least two years before his or her death, or
- (3) The parent of a child born of the marriage to the deceased retiree.<sup>11</sup>

To provide the maximum protection (55 percent of retired pay) for a spouse-only survivor, the member contributes 2 1/2 percent of the first \$300 of retired pay, plus 10 percent of the remainder. This cost formula provides the cost per month to the retiree based on his or her retired pay base amount, usually determined by the retiree's rank at the time of retirement (see table 1).

Retirees with a spouse and children can provide family income protection under a broadened Survivor Benefit Plan. To be eligible, a child must be the retiree's dependent, be unmarried and under 18 years old, or under 22 if attending a full-time education or training course. This

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<sup>11</sup>Ibid.



Table 1

## Survivor Benefit Plan: Spouse Only

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Examples of monthly payments and reductions in retired pay for Spouse-Only SBP.

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Retired Pay Base Amount	Monthly Payment For Spouse Only	Monthly Cost to Retiree
\$ 100.00*	\$ 55.00	\$ 2.50
200.00*	110.00	5.00
300.00	165.00	7.50
350.00	192.50	12.50
400.00	220.00	17.50
450.00	247.50	22.50
500.00	275.00	27.50
550.00	302.50	32.50
600.00	330.00	37.50
650.00	357.50	42.50
700.00	385.00	47.50
750.00	412.50	52.50
800.00	440.00	57.50
850.00	467.50	62.50
900.00	495.00	67.50
950.00	522.50	72.50
1,000.00	550.00	77.50
1,100.00	605.00	87.50
1,200.00	660.00	97.50
1,300.00	715.00	107.50
1,400.00	770.00	117.50
1,500.00	825.00	127.50
1,600.00	880.00	137.50
1,700.00	935.00	147.50
1,800.00	990.00	157.50
1,900.00	1,045.00	167.50
2,000.00	1,100.00	177.50
2,100.00	1,155.00	187.50

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\*Can be used only if full retired pay is less than \$300 per month.

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Survivor Benefit Plan for Retired Members of the Uniformed Services, Department of Defense Pamphlet (Washington: Government Printing Office, 1973), p. 4.

broadened coverage costs the retiree the spouse-only cost, plus an average of .005 percent of the member's retired pay base amount.

The part of the reduction in retired pay that is the cost for dependent child protection continues only as long as there is at least one child remaining as an eligible beneficiary.<sup>12</sup>

SBP protection is provided for the retiree with a dependent child or children but no spouse. The eligibility requirements for children only are the same as for a spouse plus children. The cost formula for this class of beneficiary is based on the age of the retiree and the age of the youngest child, and averages about 3 percent of the retired pay base amount. The reductions from the retiree's pension continue as long as at least one eligible beneficiary remains.

A retiree with no spouse or dependent child can elect to participate in the program by naming a beneficiary under the SBP insurable interest provision. An insurable interest beneficiary is any person

. . . who has a bona fide financial interest in the continued life of the SBP participant, that is, who stands to realize some financial gain during the life of the retiree.<sup>13</sup>

The cost for an insurable interest beneficiary is quite high relative to the spouse-only cost. The cost formula is

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<sup>12</sup>Ibid., p. 11.    <sup>13</sup>Ibid., p. 12-13.

. . . 10 percent of the retiree's "full" retired pay, plus an additional 5 percent for each full five years the beneficiary is younger than the retiree. However, the total cost or reduction cannot exceed 40 percent of the retired pay.<sup>14</sup>

The payment received by the survivor is also changed. The beneficiary is entitled to 55 percent of the retired pay remaining after the cost of the SBP payment is deducted.

The Survivor Benefit Plan has two major areas of controversy. First, once a member elects participation in the program, most decisions are irrevocable. The only person allowed to change the original benefit selection is

. . . one who elects into the plan under the insurable interest provision and later switches the coverage to protect a spouse and/or child acquired after retiring.<sup>15</sup>

Second, the SBP payments to a surviving spouse are offset by Social Security payments beginning at age 62. The reasoning behind this provision is that both are Federal programs in which the Government pays a part of the cost.

Retired pay reductions for members of SBP are exempt from Federal income tax. Also, the value of the annuity is not counted for Federal estate tax purposes. Beneficiaries collecting SBP payments must include these in the gross income for Federal income tax calculations.

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<sup>14</sup>Ibid., p. 13.    <sup>15</sup>Ibid., p. 16.

## Chapter 3

### THE UNITED STATES CIVIL SERVICE RETIREMENT SYSTEM

#### Introduction

Like the Military Retirement Plan, the Civil Service Retirement System faces a huge unfunded deficit, presently \$100 billion<sup>1</sup>--and climbing. The program was originally established as a cost-sharing, self-supporting pension plan providing valuable retirement benefits and survivor protection.

In principle, Civil Service workers and the Government each contribute 7 percent of workers' pay. In practice, however, increases in benefits, large numbers of retirements, inflation, and an effort to reduce the unfunded liability have increased the Government's share of Civil Service costs to nearly

. . . 17 percent of payrolls. By 1985, Civil Service experts calculate the Federal share could be 32 percent of pay.<sup>2</sup>

Rapidly rising pension costs are attributable to two major factors: cost-of-living increases that contain an added escalator; and extremely liberal retirement benefits.

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<sup>1</sup>"Pensions for Federal Workers: \$17 Billion and Soaring," U.S. News & World Report, LXXIX (October 13, 1975), p. 85.

<sup>2</sup>Ibid.

On October 11, 1962, President Kennedy signed Public Law 87-793, which tied the Civil Service retirement benefits to the Consumer Price Index. Henceforth:

. . . any year that the Consumer Price Index goes up at least 3 percent, Civil Service pension benefits will go up by the same proportion.<sup>3</sup>

In addition to regular cost-of-living increases, the Civil Service retiree is paid a premium of 1 percent over the inflation rate. This adjustment actually overcompensates retirees. Since 1966, "price related increases have boosted pensions by 83 percent, while consumer prices have risen 63 percent."<sup>4</sup> The overpayment is compounded since all future raises are figured on top of the premium. Since the introduction of the cost-of-living increase, "more than \$10 billion of unfunded--unpaid for--liabilities have been added to future costs."<sup>5</sup>

Of the liberal retirement benefits afforded Civil Service retirees, the combination of age at retirement plus length of service is creating a new problem budget experts must face--that of early retirement. Employees of the Civil Service System can retire with a "full pension after 30 years of service and attaining the age of 55."<sup>6</sup> Once retired,

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<sup>3</sup>"New Trend in Pensions," Business Week, (June 1, 1963), p. 31.

<sup>4</sup>"Pensions for Federal Workers: \$17 Billion and Soaring," op. cit.

<sup>5</sup>"The Hidden Costs of Federal Pensions," Business Week, (April 27, 1974), p. 26.

<sup>6</sup>Ibid.

these former Civil Service employees are entitled to work at other jobs and still receive their Government retirement in full. Many in this category are electing early retirement in order to take advantage of this rule by working in private industry and earning sufficient credits for Social Security benefits which are then received in addition to their Civil Service retirement.

A 1972 survey by the U.S. Civil Service Commission found that 42.9 percent of all civil-service retirees received Social Security checks in addition to Government pensions.<sup>7</sup>

A trend toward earlier retirement of Federal employees has been noted over the last ten years, as evidenced by the fact that

. . . , the average age of voluntary federal retirees in 1963 was 64.3; it was 62.9 in 1969 and it is reported to have been 61.4 in 1973. Thus, in the last decade, three years--or nearly 5%--have been shaved off the average voluntary retirement age.<sup>8</sup>

#### Credit for Service

All periods of service as an employee of the Federal Government or the District of Columbia Government, are creditable toward retirement.<sup>9</sup>

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<sup>7</sup>"Pensions for Federal Workers: \$17 Billion and Soaring," op. cit.

<sup>8</sup>"The Hidden Costs of Federal Pensions," op. cit.

<sup>9</sup>United States Civil Service Commission, Bureau of Retirement and Insurance, Standard Form 105, "Certificate of Membership in the United States Civil Service Retirement System, Obligations, Benefits, and Privileges of Membership in the United States Civil Service Retirement System," (Washington: U.S. Government Printing Office).

Members of the armed forces are allowed service credit for retirement purposes for all periods of active and honorable service if these periods are completed before retiring from the military.

Military service may not be creditable if you draw military retired pay, or if it was performed after December 1956 and social security benefits are payable.<sup>10</sup>

### Eligibility for Retirement

To retire under the Civil Service Retirement System, employees must meet two general requirements:

1. Have at least five years of civilian service.
2. Have at least one year of civilian service under the Retirement System within the two year period preceding the separation on which your retirement is based.<sup>11</sup>

Civil Service members can select between two types of retirement: immediate or deferred. Employees who meet the general requirements, are at least 55 years of age, have at least 30 years of service, and meet all special requirements (if any), may retire and collect an immediate annuity (see table 2). The deferred retirement option was established for employees who meet the general requirements, but are separated from the Civil Service System for any reason before they are eligible for an immediate annuity. Members in this category will collect an annuity at age 62, unless

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<sup>10</sup>Ibid.    <sup>11</sup>Ibid.

Table 2

Type of Retirement	Minimum Age	Minimum Service (Years)	Special Requirements
Optional	62	5	None
	60	20	None
	55	30	None
Discontinued Service	Any* age	25	Your separation must be involuntary and not for misconduct or delinquency
	50*	20	Your separation must be involuntary and not for misconduct or delinquency
Disability	Any age	5	You must be totally disabled for service in the position you occupy
Age	70	15	Separation is compulsory

\*Annuity is reduced if under age 55.

Above table extracted from Standard Form 105, United States Civil Service Commission, "Certificate of Membership in the United States Civil Service Retirement System, Obligations, Benefits, and Privileges of Membership in the United States Civil Service Retirement System," (Washington: U. S. Government Printing Office).



they elect to receive a refund of their retirement contributions.

#### Employee Contributions

All employees of the Civil Service System contribute 7 percent of their salary to the annuity fund.<sup>12</sup> This present retirement contribution rate has been in effect since 1969, when former President Nixon raised the rate from the previous level of 6 1/2 percent that was set in 1956.<sup>13</sup>

#### Voluntary Contributions

Employees wishing to increase their retirement annuity may voluntarily contribute funds in addition to the regular contributions. Payments for voluntary contributions must be in multiples of \$25 and cannot exceed 10 percent of an employee's total basic pay. There is no requirement for payments to be made at specified intervals.

Civil Service members making voluntary contributions will be paid, in addition to the regular annuity, \$7 plus 20 cents for each full year over age 55 at the time of retirement for each \$100 of contributions.<sup>14</sup>

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<sup>12</sup>"The Hidden Costs of Federal Pensions," op. cit.

<sup>13</sup>I. S. Addicks, "Civil Service Retirement System," Monthly Labor Review, 79 (October, 1956), p. 1163.

<sup>14</sup>Standard Form 105, op. cit.

Voluntary contributors can withdraw these funds anytime upon request prior to terminating employment or before they receive an additional annuity based on their voluntary contributions.

#### Refund of Contributions

If employment is terminated for any reason, and they do not become reemployed with Civil Service within 31 days from the date of separation, Civil Service employees can obtain a refund of all contributions to the Retirement Fund except the Government's share.

#### Interest on Contributions

Interest when it is payable, is computed at the rate of 4% to December 31, 1947, and at 3% thereafter, compounded annually.<sup>15</sup>

Employees with less than one year of service will not receive any interest on refunded contributions. Members with more than one year but less than five years will receive interest at the computed rate to the date of employment termination. Those employees with more than five years of Civil Service employment will receive interest on the personal contributions made prior to December 31, 1956; however, the refund paid will not include interest on contributions made subsequent to that date.

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<sup>15</sup>Ibid.

Retirement Annuity

A retiring employee's pension is calculated using two variables: length of service and "high-3" average salary.

The "high-3" average salary is

. . . the highest pay obtainable by averaging your rates of basic pay in effect during any 3 consecutive years of civilian service, with each rate weighted by the time it was in effect.<sup>16</sup>

Employees are guaranteed a return at least equal to their contributions from the Retirement Fund.

Basic annuity formula. Civil Service retirees' annuities are calculated as follows:

(a) Take: 1 1/2% of the "high-3" average pay and multiply the result by 5 years of service;

(b) Add: 1 3/4% of the "high-3" average pay multiplied by years of service between 5 and 10;

(c) Add: 2% of the "high-3" average pay multiplied by all service over 10 years.

Instead of using the 1 1/2%, 1 3/4%, and 2%, substitute 1% of the "high-3" average pay, plus \$25, for any or all of these percentages if such a substitution will produce a higher annuity.<sup>17</sup>

Limitation on basic annuity. The maximum retirement pension allowed Civil Service retirees is 80 percent of the retiree's "high-3" average pay.

Unused Sick Leave

Employees that stay healthy during their working

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<sup>16</sup>Ibid.    <sup>17</sup>Ibid.

years are rewarded during retirement. All unused days of sick leave are credited toward an employee's length of service for annuity computation, with the stipulation that the unused sick leave cannot be used when calculating an employee's "high-3" average pay or for meeting the minimum length of service for retirement eligibility.

#### Annuity Reduction

Members of the Civil Service System who retire before the age of 55 will have their annuity reduced by 1/6 of 1 percent for each full month (2 percent a year) they are under age 55.<sup>18</sup>

#### Social Security

Civil Service employees do not contribute to Social Security,<sup>19</sup> and thus are not eligible for old-age benefits upon retiring from the Civil Service System.

#### Survivor Benefits

Survivor annuity to widow or widower. A retiree's spouse is automatically entitled to a survivor annuity equal to 55 percent of the retiree's basic annuity at the time of his/her death, unless the retiree specifically elects to receive an

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<sup>18</sup>Ibid.

<sup>19</sup>"Pensions for Federal Workers: \$17 Billion and Soaring," op. cit.

annuity without survivor benefit. The retiree's cost for<sup>27</sup> this survivor protection equates to 2 1/2 percent of the retiree's annuity for the first \$3,600, plus 10 percent of any portion of the annuity over \$3,600.<sup>20</sup>

Benefits payable to a surviving widow or widower begin on the day following the retiree's death and continue until the last day of the month in which the widow or widower dies or remarries before the age of 60.

A surviving spouse, to qualify for a survivor annuity, must have been either married to the retiree for at least two years immediately preceding the retiree's death, or be the parent of a child born out of the marriage to the retiree.

Survivor annuity to children. The children of a Civil Service retiree can qualify for a survivor annuity if they are: under age 18; unmarried; over age 18 if incapable of self-support to a disability that occurred before the age of 18; or under age 22 and enrolled as a full-time student at a recognized educational institution.<sup>21</sup>

If the retiree is survived by a spouse, each child is entitled to a survivor annuity equal to the lesser of: (a) 60 percent of the retiree's "high-3" average pay divided by the number of eligible children; (b) \$2,700 divided by the number of eligible children; (c) \$900.

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<sup>20</sup>Ibid.    <sup>21</sup>Ibid.

If the retiree is not survived by a spouse, each child is entitled to a survivor annuity equal to the lesser of: (a) 75 percent of the retiree's "high-3" average pay divided by the number of eligible children; (b) \$3,240 divided by the number of eligible children; (c) \$1,080.<sup>23</sup>

A child's survivor annuity begins on the day following the retiree's death and continues until the child dies or no longer meets the qualifying criteria. Children of a deceased retiree, if they meet the qualifying requirements, are eligible for a survivor annuity regardless of the type of annuity selected by the retiree.

Survivor annuity to person with an insurable interest. A retiree, if unmarried and in good health, may select a person with an insurable interest to receive a survivor annuity upon the retiree's death. The day following the retiree's death, the person named as an insurable interest survivor will receive 55 percent of the retiree's reduced annuity until the named person dies.

The annuity of a retiree electing an annuity with survivor benefit to named person having an insurable interest will be reduced by a percentage amount based on the age difference of the retiree and the person named as having an insurable interest (see table 3).

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<sup>23</sup>Ibid.

Table 3

## Survivor Benefit Plan Deductions

Age of Person Named in Relation to that of Retiring Employee	Reduction in Annuity of Retiring Employee
Older, same age, or less than 5 years younger	10%
5 but less than 10 years younger	15%
10 but less than 15 years younger	20%
15 but less than 20 years younger	25%
20 but less than 30 years younger	30%
25 but less than 30 years younger	35%
30 or more years younger	40%

Above table extracted from Standard Form 105, United States Civil Service Commission, "Certificate of Membership in the United States Civil Service Retirement System, Obligations, Benefits, and Privileges of Membership in the United States Civil Service Retirement System," (Washington: U.S. Government Printing Office).

## Chapter 4

### THE CALIFORNIA PUBLIC EMPLOYEES RETIREMENT SYSTEM

#### Introduction

The State of California has provided its employees with a retirement system since 1931. The Public Employees' Retirement System (PERS) is a fully funded system with three main sources of funds: employee contributions, the State's contributions, and earnings from investments.

Total income for the year ending June 30, 1974 was \$991 million from the following sources:<sup>1</sup>

Source of Income	Percent	1973-74 Fiscal Year	Increase Over Prior Year
Member Contributions	28.1%	\$278,473,413	\$ +14,703,797
Employer Contributions	39.3%	389,779,803	+42,625,269
Income from Investments	32.6%	322,582,108	+42,142,928
TOTALS	100.0%	\$990,835,324	\$ +99,471,994

Increased contributions from member and employer shares were due primarily to the increased numbers and higher salaries of members. Compared to the prior year, however, the increases were less.

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<sup>1</sup>State of California Public Employees' Retirement System, Forty-third Annual Financial Report and Report of Operations, June 30, 1974, p. 14.



Membership in the Public Employees' Retirement System is divided into three groups: miscellaneous, safety, and state industrial members. Employees engaged in active law enforcement or fire suppression are classified as safety members. Employees involved with inmates of correctional institutions are state industrial members. All other employees are miscellaneous members, constituting over 90 percent of the total membership.<sup>2</sup>

#### Membership

All State employees are eligible for membership when they are hired except those who work less than half time, or temporary employees who work full time for less than six months.

Once a member, membership may continue even though employment is not continuous.

#### Contributions

The Public Employees' Retirement System is a fully funded system, insuring that funds will be on deposit to meet all obligations as they come due. The funds for these obligations are secured from employee contributions, State contributions, and investment income.

Employee contributions vary depending on whether the member is covered by Social Security. All State employees

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<sup>2</sup>Ibid., p. 9.

hired after November 1961 are automatically covered by Social Security. Prior to November 1961, Social Security coverage was optional for State employees. For members covered by Social Security, the contribution is 5 percent of that portion of their monthly compensation above \$313.<sup>3</sup> Example: On a monthly salary of \$800, the employee's contribution would be 5 percent of \$487 (\$800 minus \$313) or \$24.35 per month.<sup>4</sup>

Employees not covered by Social Security contribute 6 percent of that portion of their monthly compensation above \$150.<sup>5</sup> Example: On a monthly salary of \$800, the employee's contribution would be 6 percent of \$650 (\$800 minus \$150) or \$39.00.<sup>6</sup>

#### Refund of Contributions

Employees' contributions to the Public Employees' Retirement System are credited to each employee's individual account. Any member that terminates State employment before retirement age and does not take another job covered by the retirement system can have his contribution refunded. Employer contributions are not refunded, however.<sup>7</sup>

#### Interest on Contributions

All funds credited to an employee's individual

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<sup>3</sup>Retirement and Related Benefits for State Miscellaneous Members, (July 1, 1975), p. 8.

<sup>4</sup>Ibid.    <sup>5</sup>Ibid.    <sup>6</sup>Ibid.    <sup>7</sup>Ibid.

account draw interest at a rate established by the retirement system's Board of Administration. "As of July 1, 1975, the interest rate credited to employee accounts is 5 3/4%."<sup>8</sup>

### Retirement Benefits

Retirement age. The normal retirement age is 60. Employees may retire voluntarily at age 50 (beginning January 1, 1976), but their retirement annuity is reduced for each year under age 60. (See table 4.) Retirement is compulsory at age 67.

Table 4

#### Estimated Service Retirement Allowance as a Percentage of Final Compensation

2% at 60 Formula Benefits	
Age at Retirement	Allowance for Each Year of Service
60	2.000%
59	1.862%
58	1.734%
57	1.616%
56	1.510%
55	1.412%

Above figures extracted from Retirement and Related Benefits, Public Employees' Retirement System, State of California, p. 10, 11.

<sup>8</sup>Ibid., p. 9.

Annuity formula. The basic retirement formula is: "1/50th at age 60."<sup>9</sup> To calculate an employee's retirement annuity, multiply the number of years of credited service times 1/50th (or 2 percent) times an average monthly pay figure. The average monthly pay is derived from an employee's average pay during the last three years of service, unless the member notifies the system of a consecutive three-year period during which the member's pay was higher.<sup>10</sup> This three-year average is referred to as "final compensation."<sup>11</sup> The resultant figure represents the monthly annuity a member will receive assuming retirement age of 60 years and the member is not covered by Social Security.

Members of the retirement system that also contribute to Social Security will have their basic annuity reduced based on three factors: age at retirement, total years of service, and years of service under Social Security.

#### Cost-of-Living Adjustment

In 1968, the State added a provision for an annual cost-of-living adjustment to retirement annuities. Retired members have their accounts adjusted on April 1st of each year to reflect changes in the California Consumer Price Index. This index is the

. . . average of the Los Angeles-Long Beach and San Francisco-Oakland area cost-of-living indices,

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<sup>9</sup>Ibid.    <sup>10</sup>Ibid.    <sup>11</sup>Ibid.

published by the Bureau of Labor Statistics of the United States Department of Labor.<sup>12</sup>

Cost-of-living adjustments are subject to the following limitations: (a) No adjustment will be made in years for which the adjustment would be less than 1 percent; (b) Annuities will not be reduced; (c) Adjustments will not begin until the second calendar year following retirement, and will not exceed two percent per year.<sup>13</sup>

#### Service Credit

Additional service credit is afforded to members for unused sick leave. The conversion rate is .004 years of service for each day of unused sick leave. Employees with 250 days of unused sick leave are granted an additional year of service credit to be used in calculating their retirement annuity.

#### Reinstatement After Retirement

Members of the Public Employees' Retirement System who have retired and are receiving an annuity are not eligible for employment with the State of California unless they are first reinstated from retirement. Former employees that meet the requirements for reinstatement and return to employment will have their retirement annuities curtailed. After again retiring, these employees' retirement allowances

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<sup>12</sup>Ibid., p. 14.    <sup>13</sup>Ibid.

will include credit for both periods of service.

### Survivor Benefits

A survivor benefit plan is provided for members of the Public Employees' Retirement System having an eligible spouse or dependent children. To be eligible for benefits, a spouse must have been married to the member for at least one year prior to the member's retirement. If a member has no surviving spouse, benefits are payable to surviving unmarried children under age 18.

The survivor benefit plan is employer sponsored with no reduction in a member's retirement annuity. The benefits payable upon a member's death after retirement depend on whether the member was also covered by Social Security. Survivors of members covered by Social Security during employment with the State will receive one-fourth of the member's retirement annuity. For those not covered by Social Security, their survivors will receive one-half of the member's retirement allowance.

## Chapter 5

### CONGRESSIONAL CRITICISM

The present Military Retirement Plan is being closely scrutinized by Congress. Nearly every facet of the program is being studied by some Congressional committee or task force. The majority of these studies are concerned with finding ways to reduce the total cost, but some are looking for obvious flaws in the program that need attention. One such group, a recently formed Congressional task force, was formed to study federal, state and local government retirement systems. An area studied by this task force of great concern to military members is the question of vesting.

#### No Vesting

Under the current system, personnel that voluntarily leave the armed forces before completing 20 years of service forfeit all claims to pension rights. A Congressional task force studying the problem of vesting stated that:

Military service members are the largest single group of "public employees" in the country covered by a retirement system that provides no vesting of pension rights before completion of 20 years.<sup>1</sup>

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<sup>1</sup>"New Group Probes Pensions," Air Force Times, XXXVI (February 16, 1976), p. 19.

Many proposals are presently pending in Congress that would change this portion of the present Military Retirement Plan.

#### Imputed Contribution

Since 1965, a major controversy has been brewing in Congress concerning the question of whether the Military Retirement Plan is actually "free" to military members. Critics of the present retirement program center on two main issues: the high total cost and the non-contributory feature. Defenders of the program point to several Congressional and Defense statements indicating there is an imputed contribution of 6.5 or 7 percent. The issue finds the House of Representatives on one side and the Senate on the other. In 1969, the House of Representatives claimed "it had set pay levels lower than they would have been if it were not for the imputed contribution."<sup>2</sup> The Senate has never agreed with this argument.

The legislative history of the imputed contribution is not very clear. When Congress passed the Uniformed Services Pay Act of 1965, the House Armed Services Committee issued a report stating:

After determination was made of the level of pay (including allowances) considered appropriate for

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<sup>2</sup>"Retired Contribution Scored," Air Force Times, XXXVI (February 2, 1976), p. 6.



each military grade, account was taken of an imputed 6.5 percent contribution on basic pay (except for enlisted personnel with less than two years' service), and the amount of the estimated Federal income tax advantage (using 1965 tax rates) on the basic allowance for quarters and subsistence. In the history of all previous military pay legislation, no documentation of such adjustment has been provided for the record. . .<sup>3</sup>

The report even detailed the imputed contribution on bar charts.

Again the Senate Armed Services Committee expressed doubts about any imputed contribution, and issued Senate Report 544 which stated:

This committee is of the opinion that before any final conclusion is reached on this complex matter, additional information, refinement, and resolution of a number of policy issues are needed.<sup>4</sup>

This did not really answer the question, but left the issue in a status quo.

The implied contribution controversy was dormant until 1971, when the Nixon administration established an inter-agency committee to study military retirement. In July, 1971, the committee issued its first report stating that "basic pay has been held down in recognition of retirement costs."<sup>5</sup>

The Nixon administration's committee findings have been recently refuted by the General Accounting Office, which serves as the Congressional watchdog over the executive

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<sup>3</sup>Ibid.    <sup>4</sup>Ibid.    <sup>5</sup>Ibid.

branch. They could find no concrete evidence that Congress considered any "contribution" when setting military pay levels.

### Unfunded Liability

Presently the Military Retirement Program is financed annually from current appropriations. The Government does not have a pension fund with money set aside to meet its obligations as they come due, and currently faces a \$155 billion unfunded liability for its military retirement plan.<sup>6</sup>

### Cost-of-Living Adjustment

One of the most expensive features of the Military Retirement Plan is the cost-of-living increases that allow pensions to keep pace with inflation. As a bonus, an additional 1 percent premium or "kicker" is tacked on to each retiree's pension to repay them for purchasing power lost in the five-month wait for their cost-of-living adjustment to take effect. The five-month waiting period is derived from the fact that:

. . . federal pensions are raised automatically when the Consumer Price Index jumps 3 percent or more above its level at the time of the previous cost-of-living increase and holds there for three consecutive months. The checks to beneficiaries are altered to reflect the increases two months later.<sup>7</sup>

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<sup>6</sup>Ibid.    <sup>7</sup>Ibid.

Total Cost

The soaring cost of the Military Retirement Plan has Congress busily proposing changes in an attempt to bring it under control, while at the same time experts predict that over the next 30 years costs will expand by 400 percent.<sup>8</sup>

A major factor fueling the exploding cost is the rising number of retirees. Their numbers have risen from 400,000 in 1964 to 985,000 in 1975, with an estimate of 1.6 million by the year 2000.<sup>9</sup>

The majority of Congressional proposals to lower military retirement costs center on one theme--to reduce the benefits future retirees would receive.

Wage Comparability with Private Sector of United States Economy

In recent years Congress has placed great emphasis on establishing "military pay levels which bear a reasonable relationship to civilian wages for equivalent levels of work."<sup>10</sup>

A logical extension of this idea is the comparing of benefits of military and civilian retirees. Many members of Congress have concluded that the Military Retirement Plan provides its retirees with unusually liberal benefits. An

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<sup>8</sup>"Furor Over Military Retirement Pay," U.S. News & World Report, LXXVII (October 14, 1974), p. 106.

<sup>9</sup>Ibid.

<sup>10</sup>"Retired Contribution Scored," op. cit.

often cited example is the survey results that indicate less than 4 percent of companies with retirement programs make cost-of-living adjustments to their pension checks,<sup>11</sup> while none added a premium or "kicker."

### Liberal Benefits

Age of retirees. A strong criticism of Congressional members is the fact that military personnel are allowed to retire after 20 years of active service, regardless of age. This feature allows military members to retire an average of more than 20 years earlier than their civilian counterparts.<sup>12</sup>

Length of service. Another liberal benefit afforded military personnel that has drawn criticism is the option of retiring with as few as 20 years of active duty, and receiving a full pension of 50 percent of basic pay for life.

Annuities. Pensions provided for members of the armed forces are far more generous, on the average, than those provided by civilian employers. The average military pension

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<sup>11</sup>"Pensions for Federal Workers: \$17 Billion and Soaring," U.S. News & World Report, (October 13, 1975), p. 85.

<sup>12</sup>Roger T. Kelley, The Proposed New Military Non-disability Retirement System, A Brochure Prepared by the Department of Defense (Washington: United States Government Printing Office), p. 3.

is equal to 55 percent of final basic pay, while the average<sup>43</sup>  
civilian pension equates to 35 percent of their last five  
years' pay.<sup>13</sup>

Second careers. Two factors that provide military retirees with an excellent opportunity to enter another career are: age at retirement, and the fact that Government retirees are allowed to work at other jobs and still receive their military pensions. This has made it possible for some military retirees to draw three pensions when they finally quit working: their military pension, Social Security, and a pension earned during their second career in private employment.

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<sup>13</sup>Ibid.

## Chapter 6

### PROPOSED MILITARY RETIREMENT PLAN - A CONTRIBUTORY SYSTEM

#### Present Plan

Military personnel do not contribute to the present retirement plan. The total cost is paid for by the Government.

#### Proposed Plan

All members of the armed forces will contribute 7 percent of their basic pay to a pension plan. This contribution will be in lieu of Federal Social Security taxes.

Salary offset. Military pay scales will be increased an amount equal to the difference between 7 percent and the prevailing Social Security rate at the time the contribution provision becomes effective.

Estimated savings. Representative Les Aspin (Democrat-Wisconsin), a strong critic of the military, states that:

A seven percent contribution by military personnel could save a billion dollars in this year's budget and would accumulate a savings of \$34.7 billion by the year 2000.<sup>1</sup>

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<sup>1</sup>"Pension System Under Aspin Fire," Air Force Times, XXXVI (April 12, 1976), p. 8.

## ELIGIBILITY FOR RETIREMENT

Present Plan

All members of the armed forces are eligible for retirement benefits after completing 20 years of honorable active service. To retire as an officer, at least ten years must be served as a commissioned officer.

Proposed Plan

All members of the armed forces will be eligible for retirement benefits after completing 25 years of honorable, active service. Personnel will retire in the highest rank held honorably for at least six months.

## ANNUITY

Present Plan

Military retirement pensions are calculated using the basic formula: 2.5 percent times years of service times basic pay. This provides 50 percent of basic pay at 20 years' service, with a maximum of 75 percent of basic pay for 30 years' service.

Proposed Plan

Basic formula. Military retirement annuities will be calculated using the basic formula: 2.5 percent times the years

of service multiplied by the basic pay. This equates to 62.5 percent of basic pay at 25 years' service.

Incentive formula. To provide a stimulus for personnel to seek a 30-year "full career" to reduce the trend of early retirements, an incentive formula will become applicable for those serving beyond 25 years. Annuities will be calculated using the incentive formula: 3.5 percent times the years of service multiplied by the basic pay for 26 through 30 years of service. This incentive formula will provide a maximum annuity of 80 percent of basic pay for 30 years' service.

#### SOCIAL SECURITY

##### Present Plan

Military personnel contribute to Social Security, and at the age of 62, can receive old-age pensions in addition to their military retirement pensions.

##### Proposed Plan

Members of the armed forces will not contribute to Social Security, and will not be eligible for Social Security benefits based on military employment. Personnel presently contributing to Social Security will be eligible for old-age benefits based on their Social Security contributions before the implementation date of the new retirement plan.



## VESTING

Present Plan

Military service members do not have a vested interest in pension rights prior to completing 20 years of service.

Proposed Plan

Contributions, which will be credited to an individual account for each member of the military services, will be fully vested in all personnel after four years of service. Those separating from the military prior to completing four full years of service will have their contributions refunded, plus interest.

## INTEREST ON CONTRIBUTIONS

Present Plan

The Military Retirement Plan is a non-contributory retirement program, and thus no interest is paid.

Proposed Plan

Employee contributions refunded prior to being fully vested (less than four years of military service) will draw interest at the current maximum rate allowable for savings and loan institutions. Full vested contributions withdrawn before retirement will not draw interest.

## FUNDING

Present Plan

The Military Retirement Plan is an unfunded program. Retirement benefits are financed from current fiscal appropriations from the general budget.

Proposed Plan

"A funded retirement plan is a savings process followed by a lifetime pay-out system."<sup>2</sup> The proposed retirement plan will be a fully funded program with funds accumulating from three sources: employee contributions, interest on investments, and employer contributions.

Employee contributions. All military service members will contribute 7 percent of their basic pay to the pension fund.

Interest on investments. Contributions will be invested to secure the highest possible return on investment commensurate with an acceptable level of risk as determined by the pension fund trustees.

Employer contributions. The Federal Government will contribute a variable amount based on the difference between

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<sup>2</sup>William C. Greenough and Francis P. King, Benefit Plans in American Colleges (New York: Columbia University Press, 1969), p. 28.

current obligations and the pension fund balance. The Government's contribution will be reduced as the pension fund grows.

#### COST-OF-LIVING ADJUSTMENT

##### Present Plan

Federal retired pay is tied to the Consumer Price Index to compensate for inflation. Whenever the Consumer Price Index increases by 3 percent or more and holds there for three consecutive months, Federal pensions are automatically raised a corresponding amount. As a bonus, an additional 1 percent increase is added to the pension to repay retirees for their loss of purchasing power.

##### Proposed Plan

Military retired pay will be tied to the Consumer Price Index. Pensions will automatically be raised annually an amount equal to the rise in the Consumer Price Index for that year.

#### SURVIVOR BENEFITS

##### Present Plan

The Survivor Benefit Plan is intended to provide financial protection for a spouse who survives a retired military member. Enrollment in the plan with maximum coverage of 55 percent of the sponsor's retired pay is automatic

unless the retiree declines participation or elects lesser coverage. The cost of the program is shared by the Government and the retiree.

The Survivor Benefit Plan has two controversial issues. First, once a member elects participation in the program, most decisions are irrevocable. Second, the survivor benefit payments to a surviving spouse are offset by Social Security payments beginning at age 62.

#### Proposed Plan

The Survivor Benefit Plan will be continued in its present form with two exceptions:

(1) If a retiree is predeceased by his spouse, he can withdraw from the program.

(2) Survivor benefit payments will not be reduced by Social Security benefits received by a surviving spouse.

## Chapter 7

## CONCLUSION

Right now their pension scheme is based on nothing but promises. And with the system \$194 billion in the red, a lot of thought has been given to reducing future benefits.<sup>1</sup>

The preceding statement by Representative Les Aspin (Democrat-Wisconsin) should "wake up" the military to the fact that Congress is displeased with the present retirement plan, the associated benefits, and the rising total cost. Drastic changes are being discussed and proposed by several members of Congress. The entire retirement plan is being intensely studied by both Houses of Congress, by committees, subcommittees, and task force groups.

If the military is to retain a semblance of an attractive retirement program, meaningful proposals and alternatives must be submitted from within the "military establishment" that will meet with Congressional approval. This has been my theme throughout this paper.

Keying on the statement attributed to Representative Aspin--that the way to reduce the cost of the retirement program is to reduce future benefits--I have introduced

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<sup>1</sup>"Pension System Under Aspin Fire," Air Force Times, XXXVI (April 12, 1976), p. 8.

several proposals that would reduce retirement costs without reducing future benefits. The most drastic proposal is the introduction of a contributory retirement system.

Although a military retiree has enjoyed a long history of generous retirement benefits, it is time to realize that if today's future retiree is to continue enjoying generous benefits, he must share the cost burden while on active duty.

## Chapter 8

### RECOMMENDATIONS

As a result of my research, the following recommendations are being submitted concerning the Military Retirement Plan:

1. Abandon the present non-contributory retirement plan.
2. Establish a contributory retirement program, with an employee contribution rate of 7 percent of basic pay.
3. Extend the minimum years of service required for retirement eligibility from 20 to 25.
4. Continue the present annuity rate for each year of service of 2.5 percent for the first 25 years of service.
5. Introduce an incentive rate of 3.5 percent for each year of service for years 26 through 30.
6. Increase maximum annuities from 75 to 80 percent at 30 years' service.
7. Withdraw the military from the Social Security program.
8. Institute a program of full vesting of pension rights after four years of active service.
9. Pay interest on employee contributions refunded prior to completing four years of active service.

10. Establish a funded retirement program with three sources of funds: (1) employee contributions, (2) interest on investments, and (3) employer contributions.

11. Change the present law to allow the Government to invest retirement funds in interest-bearing investments.

12. Eliminate the 1 percent "kicker" from the cost-of-living raises.

13. Revise the Survivor Benefit Plan to allow retirees predeceased by their spouses to withdraw from the program, and eliminate the Social Security offset in survivor benefit payments received by a surviving spouse.



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