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A Policy Analysis of Reserve Retirement Reform

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Summary

The greater usage of the reserve components (RC) in an operational capacity to support missions such as those in Iraq and Afghanistan has led members and policymakers to pay more attention to the compensation and personnel systems that support RC management and how those systems compare to those supporting the active components (AC). The research presented in this report focuses on one aspect of RC compensation, the retirement system, which differs from the AC's. While both reward members who complete 20 years of service (YOS) with a retirement annuity based on years of service and basic pay, some say the current system is inequitable because a reservist who completes 20 creditable years of service may not draw retirement benefits immediately after retiring from the military, as an AC retiree can.

The report considers the myriad issues surrounding the debate over reforming the RC system and provides quantitative assessments of specific proposals to change the system. The proposals we evaluate were introduced by Congress between 2003–2006 but never legislated, and the idea beyond them, namely increasing the alignment of the RC and AC retirement systems, is a topic of ongoing debate. Thus, our analysis is intended to inform current as well as future debates about changing the RC retirement system.

The specific proposals we consider are bills introduced in the 108th and 109th Congress that aimed to decrease the age at which reservists may draw retirement benefits:

- H.R. 331 (108th Congress) provided benefits immediately upon retiring from the military with 20 or more YOS, regardless of one's age ("immediate annuity" proposal).
- S. 32, S. 38/H.R. 1169, H.R. 783 (109th Congress) decreased the age of first receipt from age 60 to age 55 ("age 55").
- S. 337/H.R. 558 (109th Congress) decreased the age of first receipt by one year for every two years served beyond 20 years: A reservist may retire at age 60 with 20 YOS, at age 59 with 22 YOS, and so forth to age 53 with 34 YOS ("sliding-scale").

The first proposal—the immediate annuity proposal—would perfectly align the RC retirement system with the AC system to the extent that under this proposal both would provide retirement benefits to vested personnel as soon as they left service. This is an idea that is often advocated by those who would like to see identical retirement systems. The other two proposals are more modest, although both move toward reducing the difference between when members can first draw benefits. The age-55 proposal would slip the retirement age from 60 to 55, while the sliding-scale proposal would reduce the age depending on years of service.

We employ a dynamic programming model of AC retention and RC participation, known as the dynamic retention model (DRM). We estimate the DRM using Defense Manpower Data Center Work Experience File (WEX) data that tracks through 2010 the individual careers of AC members—including for those who join, their time in the RC—for those who entered active service in either 1990 or 1991. We use the model estimates to simulate the effects of the proposals in a steady state. The DRM not only shows quantitative effects of the proposals on RC participation, but also the effects that might occur on AC retention.

In addition to the quantitative analysis, we consider the broader issues surrounding reserve retirement reform, including consideration of AC/RC retirement benefit equity as well as other goals of reserve retirement reform, such as personnel management flexibility. We also discuss reserve retirement reform in the broader context of AC retirement reform, and we identify approaches to implementing military retirement reform that might overcome the obstacles that have hampered past efforts.

Key Findings on the Congressional Proposals

We briefly summarize the main findings of our policy simulations. First, we consider the effects on reserve participation. The age-55 and sliding-scale proposals would have a small effect on the percentage of active members who later join the reserves (1–3 percent for enlisted and 1–6 percent for officers), while the immediate annuity proposal would have a more substantial effect (5–20 percent for enlisted and 15–35 percent for officers). This is not surprising because the immediate annuity proposal is more generous than the other proposals and so would have larger effects. Similarly, the age-55 and sliding-scale proposals would only cause small changes in reserve retention while the immediate annuity proposal would cause large effects, especially in the experience mix of RC members. Under the immediate annuity proposal, mid-career reserve participation would increase, before the vesting point of 20 YOS, but subsequently decline after 20 YOS. This pattern reflects a behavioral response to the opportunity to receive reserve retirement benefits immediately rather than waiting until age 60. All three proposals would increase the percentage of RC members qualifying for RC retirement benefits, typically by 2–10 percent for the age-55 and sliding-scale proposals and by

40–80 percent for enlisted and 30–45 percent for officers for the immediate annuity proposal.

We also estimated the cost effects of the proposals. We find that the age-55 and sliding-scale proposals would increase cost per member by about 4 percent. The immediate annuity would generate a substantial increase in cost per member, nearly 25 percent. These increases would occur because retirement costs would increase as more RC members qualify for RC retirement benefits under these proposals and because all three proposals offer more-generous benefits than the current system.

On net, we find that the proposals are not cost-effective methods of sustaining the overall size of the RC prior-service force. Our finding that the cost per member increases under each proposal indicates that these proposals are more-expensive ways of maintaining the same RC force size.

Equity, Deployment, and Force-Management Flexibility

In addition to our quantitative assessment of the three specific proposals, we took a broader perspective on the issues surrounding reserve retirement reform and changing the age at which reservists can begin receiving benefits. Three of those issues are inequity of reserve pay and benefits with respect to active pay and benefits, recognition of more-frequent and longer deployments for reservists, and the role of the retirement system in facilitating the flexible management of personnel.

The main apparent inequity of the RC retirement system is that reserve retirement benefits begin at age 60 whereas active benefits begin immediately upon separation with 20 or more YOS. However, equity comparisons should extend beyond when retirement benefits start, because active and reserve service differs in important ways. AC personnel serve full time, are always on call for duty, and are likely to be deployed more frequently. They cannot hold a full-time civilian job and therefore cannot accumulate retirement benefits through a civilian employer. They are frequently relocated, uprooting them from their friends and community, and the moves diminish the employment and earning opportunities of the military spouse. In addition, the calculation of basic pay in determining retirement benefits favors reservists. Basic pay for a retired reservist is the value of basic pay in effect when the reservist turns 60, not the value of basic pay in effect when the reservist separated plus the cost of living adjustment to age 60.

Reserve deployments increased during the 1990s and rose further during the operations in Iraq and Afghanistan. However, increasing the generosity of reserve retirement benefits appears to be an inefficient, poorly targeted, and unfair way of compensating for the higher burden of deployment. It is inefficient because it is more costly in the current period for the government to provide a benefit in a future period than that benefit is worth to the reservist in the current period. Instead, it would be more efficient (and less costly) to offer cash pay today. Using retirement benefits to address the

stress from greater deployment is not well targeted, because more-generous retirement benefits potentially reward all reservists, including those with little or no deployment.

Flexibility in managing personnel allows the services to tailor military careers to obtain the best retention profile in each occupational area. But the reserve retirement benefit system, like the active system, has operated to create uniformity in careers, retention, and incentives for performance. In contrast, increasing current pay through special and incentive payments and revising the personnel management system can increase flexibility in managing personnel. A combination of special and incentive payments and retirement-system reform can be used to allow greater overall flexibility in force management.

Toward Broader Reform of Military Retirement

Our analysis of reserve retirement reform also considered the broader policy context—and specifically, reform proposals to change the active retirement system. Because both the active and reserve retirement systems have remained virtually unchanged since the 1940s despite frequent calls for change, we also sought to identify the obstacles to reform and the factors that might improve the prospects for successful changes to the active and reserve retirement systems.

Past commissions and study groups have been appointed to examine military compensation and AC retirement benefits. The issues they addressed are the cost of AC benefits, the inequity of paying benefits only to those who serve 20 years, the lack of management flexibility, and the similarity in career length produced by the 20-year cliff-vesting rule. These issues are increasingly relevant to the reserves. Achieving a compensation system that supports the seamless integration of reservists called to active duty will require that reserve retirement reform be coordinated with active reform, although the resulting systems will not necessarily be identical.

In addition to cost, another key obstacle to reform is a lack of consensus for change among the services, the U.S. Department of Defense (DoD), service members, and retirees. The AC and RC retirement systems have delivered a steady supply of experienced manpower. The services seem to have adapted their manning requirements to this retention. Perhaps tasks and jobs have been designed to accommodate the retention profile produced by the compensation system, promotion system, and cliff-vesting at 20 YOS. Past study groups have not demonstrated that there is an excess supply of senior personnel, nor provided evidence of the potential gains in defense capability and readiness from greater flexibility (which is not to deny the existence of such gains). Lacking compelling evidence of its benefits, the services have not been strong advocates of retirement reform. Veterans and retiree groups have also not advocated reform, possibly fearing that it would open the door to benefit cuts and broken trust with service members. A lack of consensus for reform might also come from differing views on the

objectives of the retirement systems. Advocates of change may emphasize the role of the retirement system as a policy instrument for force management, while advocates of the current system may emphasize its role as a reward for a long career of service, a benefit to help transition to the civilian economy, and a means of securing the retention of career personnel.

To garner insight into the factors affecting whether reform will be sought and into strategies to increase the chance of successful reform, we adapted an economic theory of compensation reform under political constraints to the issue of retirement reform. Based on the model, here are some key elements for developing a strategy to address the obstacles to reform:

- Identify the chief constituents involved in the retirement reform process, e.g., service members and DoD leadership. Define their different objectives of reform.
- Assess the gains and losses of reform to the constituents. For example, provide the services with information on how retirement reform would improve defense capability.
- Recognize that buy-offs and other factors that make reform more palatable are necessary to make the reform politically feasible. Buy-offs may be paid up to the point where they do not outweigh the improvement in defense capability or cost-effectiveness associated with the reform.
- A menu of reform choices can improve the feasibility of reform and reduce the cost of buy-offs.

Regarding the menu of choices, we discuss a case study of a government retirement system that was highly effective; namely, the transition of federal employees in the 1980s from the civil service retirement system (CSRS) to the federal employees retirement system (FERS). Based on the CSRS-FERS case study, we add the following lessons about effective reform:

- Provide a menu of choices that includes the existing retirement system as well as the new retirement system.
- Provide multiple enrollment opportunities to switch to the new retirement system, so the menu is an ongoing choice.
- Design the new retirement system to be more generous on average for new and junior employees but less generous for existing senior employees, thereby minimizing the amount of switching on average. Alternatively, “grandfather in” incumbent employees.
- Design the new system so that it is portable to other jobs.