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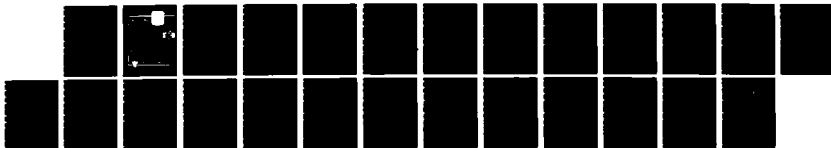
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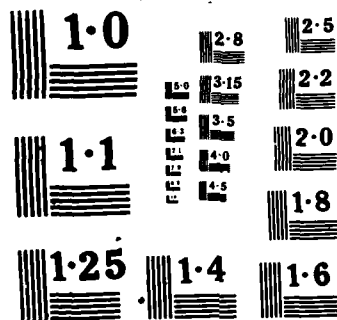
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THE MILITARY RETIREMENT SYSTEM:
IS IT OUT OF STEP WITH MODERN MILITARY MANPOWER NEEDS?

BY

LIEUTENANT COLONEL AUBREY D. CRAIG

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USAWC MILITARY STUDIES PROGRAM PAPER

THE MILITARY RETIREMENT SYSTEM: IS IT OUT OF STEP WITH MODERN MILITARY MANPOWER NEEDS?

AN INDIVIDUAL ESSAY

by

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13 May 1986

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ABSTRACT

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This essay examines the Military Retirement System, with a focus on the nondisability for active duty system and its contribution to meeting the manpower needs of the military now, and in the future. In the past 10 years, there have been numerous proposals for change, all which have recommended some change to the current system. The impetus behind these forces of change seem to be primarily centered on the generosity of the system and its high cost. The real issue is, will the current system produce a force structure required for a future military heavily dependent upon sophisticated weapons systems? The conclusion is that the system needs to be changed, not because of its generosity, but because it is not producing the type force needed in the 21st century.

THE MILITARY RETIREMENT SYSTEM:
IS IT OUT OF STEP WITH MODERN MILITARY MANPOWER NEEDS?

Introduction

The military retirement system is three separate but interrelated benefit systems: A nondisability system for retirements from active duty, a nondisability system for retirement from the Reserves, and a disability retirement system. This essay will review the nondisability for active duty system, with a focus on its contribution to meeting the manpower needs of the military now, and in the future.

In the past 10 years, there have been numerous proposals for change, DOD reviews, Congressional studies and independent research, most of which, have recommended some change to the current system. The impetus behind these forces of change seem to be primarily centered on the generosity of the system, when compared against other systems, and its high cost. The mounting Federal deficit coupled with the dramatic increase in outlays for military retirement have provided additional impetus to a growing coalition of critics. The system, however, has remained virtually intact since 1948. The current system has served the country very well during the past 38 years. Representative Majorie Holt (R-Maryland), a senior member of the House Armed Services Committee, after hearings on military retirement, said,

What I see coming out of the hearings that we've had is that this is the best system we could devise. Anything that anybody else suggests is going to be worse.¹

In other words, if it's not broken, don't fix it.



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The real issue however, is will the current system produce a force profile required for a future military heavily dependent upon sophisticated weapon systems.

Background

The evolution of the military retirement system has been guided by four principal motivations: (1) to provide for members who are old or disabled; (2) to help maintain a competitive employment position for the military; (3) to keep promotion opportunities open to young and able members; and (4) to avoid excessive cost.² Provisions for maintenance of disabled military members date to the colonial days. The first national pension law was passed August 26, 1776, which promised half pay for life to the disabled. Officers were promised, by Congress in 1780, half pay for life if they served to the end of the war. In 1818, an act was passed providing relief to Revolutionary War veterans in need. In 1832 it was changed to full pay for life, regardless of need. Widows were included in 1836.³ This pattern was followed for Service pensions for subsequent wars, with each war treated separately. The Navy received authorization in 1855, to involuntarily separate with partial pay, officers considered incapable but not disabled.

The Civil War brought more changes. In 1861, older officers no longer fit for field duty were allowed to voluntarily retire after 40 years of service. In 1861 and 1862, subsequent laws were passed providing for involuntary retirement for age or years of service.⁴ In 1870, Congress, in order to reduce the forces to a peacetime level, permitted voluntary retirement of officers after 30 years of service upon approval by the President. Two features of the current system were

established at this time; voluntary retirement after 30 years and 75 percent of base pay at the serving grade. This system was extended to the Navy in 1873.⁵

In 1885, the first nondisability retirement law for the Army and Marine Corps enlisted members, paralleling the officer system, was enacted. The law was extended to the Navy enlisted members in 1899.

The Navy established a third feature of today's system in 1938, as a result of experiencing promotion stagnation problems caused by the large influx of officers in the World War I years. To remedy this situation, Congress extended the selection board process to all grades above O-2, set limits on years of service for O-5's and O-6's, and provided for voluntary retirement at 20 years of service.⁶

The Army and Air Force Vitalization Act of 1948, standardized nondisability retirement laws for all Services. The act established 20 years as the minimum requirement for voluntary retirement, placing the Army and Air Force on par with the Navy. The Act also provided for removal of substandard officers with severance pay equal to one month's pay per year of service, not to exceed one year's pay.⁷

Since 1948, the only changes to the retirement system have been modification of the cost-of-living adjustment mechanism and the method for determining retired pay entitlements. The cost-of-living mechanism has been changed six times. The last time was by Public Law 98-270, enacted in April 1984. The law required that a once-a-year cost-of-living increase will be calculated from the third CY quarter and entitlements earned in a particular month are paid at the first of the subsequent month. Another significant change was in September 1980, by Public Law 96-342, which replaced use of terminal basis pay with an

average of the highest three years of basic pay for determining retired pay entitlements. This legislation was "grandfathered" for service members who entered service before September 8, 1980.

The changes since 1980 have been cost-cutting measures, with little regard to the impact on the dynamic of retention, which affect the Services ability to staff the force. The cost issue will be addressed later in this paper.

The only other change to the current system has been in the method of funding. Public Law 98-94, signed in September 1983, placed the military retirement system on an aggregate entry-age normal cost funding method, effective in the fiscal year 1985 budget. This method is called "Accrual Accounting", which records cost and sets aside funds in the current budget to pay the retirement annuities that eventually will be received by military personnel who are in current service.⁸

The current nondisability retirement system can best be described as an evolutionary system based on the Army's need to field a more effective military officer corps during the Civil War. The arguments for maintaining a youthful and vigorous force have been very persuasive when you consider our war experience during the past 100 years. Prior to the 1960's a young and vigorous enlisted force was maintained through an administrative policy of controlling promotion opportunities and reenlistments. However, during the past 20 years substantial retirement benefits have been a major factor in the retention of skilled noncommissioned officers.

The legislative history clearly indicates that the primary purpose of the nondisability retirement system is to support and complement the manpower force management requirements of the Services in order to meet

national security objectives.⁹ The last major legislative modification in this process was the Defense Officers Personnel Management Act (DOPMA). Public Law 96-513 (DOPMA) was signed by the President on December 15, 1980. Congress has not shown any interest in comparable legislation for enlisted members. The Services develop enlisted force management policies in order to meet enlisted manpower structure requirements.

The Current System

The current system allows voluntary retirement upon credit of at least 20 years of service at any age, subject to service Secretary approval. Personnel who leave with less than 20 years, receive nothing. The retiree receives an immediate annuity calculated at 2.5 percent of base pay for each year of creditable service, subject to maximum of 75 percent of base pay. Hence the retired pay after 20 years is 50 percent of terminal basic pay, with a maximum of 75 percent after 30 or more years of service. Basic pay is equal to terminal basic pay if the retiree became a member of the Armed Services before September 8, 1980. If however, the retiree became a member on or after September 8, 1980, base pay is equal to the average of the highest 36 months of basic pay. Retired pay is adjusted annually by the change in the Consumer Price Index (CPI) of the preceding year. In 1985, this adjustment was delayed and limited to a portion of the increase in the CPI for retirees under age 62.¹⁰ When the retiree becomes eligible for Social Security, there is no reduction of retired pay.

What is often overlooked, is that the current statutory service requirement for military retirement is 30 years of active duty. Service members do not have a right to retire after 20 years, but only to

request retirement and transfer to a reserve status. In practice, however, virtually all requests for early retirement are granted routinely.

The Services have found that approving early (20 years) retirement is particularly useful in managing the undesired shortage of members in the 10 to 20 years of service range within the overall enlisted force profile.¹¹ This requirement for highly skilled mid-career enlisted personnel is 20 percent of the total enlisted force. After 20 years of service, the steady-state force profile desired by the services reflect a need for less than 4 percent of the total enlisted force.¹² This profile is based on the Services desire to maintain a young and vigorous force, with an enhanced promotion opportunity for its junior members, thus using promotion opportunity as an incentive to remain in the service. The immediate benefits payable after 20 years of service and routine approval of all requests for early retirement have been the primary management tool Services use in achieving skilled mid-career manpower needs.

The retirement system supports and maintains a flow of retirees into a recallable pool as a means of providing an immediate manpower mobilization base. There are between 750,000 to 775,000 active force nondisabled retirees under the age of 60, of which approximately 425,000 will have been retired less than 10 years.¹³

The retirement system has little effect on the willingness of new recruits to join the military, because retirement benefits are distant and young persons "discount" those distant benefits heavily.¹⁴

Why Change

Ten major studies over the past 35 years have recommended changes to the retirement system. A common theme found in all studies has been that the current system was too expensive and recommended that benefits be reduced. Only the last major study (the Fifth Quadrennial Review of Military Compensation, January 1984), analyzed the impact of their proposed modifications on Services manpower requirements.

The dramatic increase in outlays for military retired pay have fueled the current criticism, especially in the face of growing federal deficits. In 1950, a relatively meager \$230 million was paid to retirees. This year retirement cost will exceed \$17 billion. As stunning as that growth appears, much of it can be attributed to the sharp increase in the number of retirees. In fact, per capita disposable personal income, which has increased eightfold since 1950, has outpaced average military retired pay, which has grown only sevenfold over the same period.¹⁵ Much of the increase in retired pay was the result of inflation and the retirement bulge caused by World War II.

Regardless of these facts, everyone, it appears, wants to cut retirement cost. Both the House and Senate are working on proposals to cut retirement. Department of Defense has submitted a proposal that would reduce retired pay to 44 percent of high-three basic pay for 20-year retirees. Former Budget Director David Stockman recently termed the military retirement plan a "scandal" and an "outrage." Rep. Les Aspin, D-Wis., House Armed Services Committee chairman, said "The current system has such generous benefits at the 20 year mark that it simply encourages people to get out at 20 years."

The Fifth QRMC comparative analysis of the military retirement plan and the best private-sector plans, revealed that the service members' lifetime retirement benefits for a 20 YOS Service retiree are about 30 percent higher than 90 percent of private sector retiree. The 30 YOS Service retiree benefits are only 15 percent higher.¹⁶

Proponents for change are focusing on the system's perceived generosity and high cost. This preoccupation with potential savings has diverted attention from the more important concern of efficiency of the system in support of our national security objectives. The current system must be evaluated on the manpower structure that would produce a force, capable of meeting the missions dictated by national policy. Any change to the current system should be based on achieving force profiles required to man, maintain readiness, and provide leadership for the use of high technology equipment.

Force Requirements

Military personnel requirements currently are approximately 2.1 million officers and enlisted members on active duty. Recent projections envision a modest growth to perhaps 2.25 million by 1988.¹⁷ The largest group (53.1 percent) consists of "first-term" personnel with fewer than four years of service. These comprise more than half of the enlisted personnel and over a quarter of the officer force. Career personnel with over 4 years and less than 11 years of service, comprise 24 percent of the force. Mid-career personnel (11-20 YOS) comprise 19 percent of the force. Less than 4 percent of the total force is desired by the Services to have over 20 years of service.¹⁸ The above force profile is the steady-state force desired by the

services, reflecting management response to legal and other current grade constraints on the aggregate force structure.

This force profile implies that the services want a young and vigorous force. DOD has stated that the purpose of the current system is to achieve a physically vigorous force by separating members at an early age, thereby ensuring that the military forces are staffed by young members.¹⁹ Since World War II, DOD's general concept has been that 20 year retirement coupled with career management policies maintains a young and vigorous force. However, what constitutes youth and vigor has not been fully explained by DOD.

A DOD Officer Personnel Management Study of May 1973 explained the importance of youth and vigor in the officer corps. It stated:

The military profession demands youth and vigor. Successful leadership of large numbers of young military men requires that their leaders personally demonstrate high standards of mental and physical ability, enthusiasm, and adaptability. Communications between seniors and juniors must be unhampered by large age differentials.²⁰

This emphasis on youth and use of the 20 year retirement option may have helped shaped a force lacking the experience, especially in the technical occupations, to meet the needs of the modern military into the year 2000.

In an earlier era when most military members were infantrymen or seamen, it made good sense to have a retirement system that treated all members the same. The Fifth QRMC review of the performance of the current system over the last 30 years, reveals that it has strongly supported its intended purpose.²¹ The Fifth QRMC states that the system should be structured to meet legitimate defense requirements in support of our national security objectives. Out of this principle

flows an appropriate policy premise that the retirement system is interrelated and inextricably linked with both the force management system and the compensation system.²² In this capacity, the retirement system must help support several vital needs:²³

1. Provide for a uniform flow through the personnel structure to maintain young, vigorous, and effective forces capable of operating both in times of peace and war;

2. Recognize the long-term voluntary acceptance of a highly restricted, disciplined and controlled career in a society where others enjoy greater individual freedoms (recognize the arduous nature of duty in the Uniformed Services);

3. Maintain a mobilization base of experienced personnel who can be rapidly recalled to active duty;

4. Provide for the financial security of career service members in their old age; and

5. Recognize that the personnel system is a closed-entry system and that mid- and senior-grade careerists who leave the system normally can only be replaced by new, entry level accessions.

Method of Funding

Prior to FY 85 the military retirement system was a pay-as-you-go method. The cost was expressed as a percentage of the basic pay payroll. As an example, FY 83 cost was about 53 percent or \$16 billion of the \$30 billion payroll.

Public Law No. 98-94 requires DOD to fund retirement costs using the advance funding concept and an accrual accounting technique starting in FY 85. Accrual accounting requires the treasury to establish an interest-bearing trust fund and amortize the system's pre-existing

unfunded liability (\$527 billion at the end of FY 82), following the example set by private-sector pension plans.

This fund was created inside the Unified Budget of the Federal government in order to house the money of the retirement system. The fund has three sources of income:²⁴

1. Normal cost payments made by the Department of Defense;
2. Unfunded Liability payments made by the Treasury; and
3. Interest earnings on investments in government securities made by the Treasury.

Payments to retirees and survivors of retirees and purchases of US Treasury securities are the two types of payouts. The purchase of a US security is also an intragovernmental transfer, while a payment to an annuitant is not.

The funding process requires no additional tax revenues. All of these intragovernmental transfers will generate both a credit and an associated equal debit within the Federal budget. Consequently, this funding method has no impact on the total Federal deficit. The issuance of US securities does not involve extra taxpayer revenues. However, these securities do impact the debt. As a result, the total privately held debt will not change. However, the total debt will increase and this might require an increase in the statutory borrowing authority.²⁵

The fund can pay retirees without collecting from taxpayers. Suppose the fund needed \$46 billion to pay retirees. The following transactions would take place:

1. Fund cashes in \$46 billion in securities (credit).
2. Treasury pays \$46 billion to fund (debit).
3. Net Federal surplus zero.

Since no surplus can be derived from using fund money, the government still has need for \$46 billion to pay retirees--the same need it would have under the pay-as-you-go system. A fund cannot transfer liabilities from one tax year to another and cannot offer any real security to the system under current policy.²⁶

Even though funding has no net affect on the taxpayer and the deficit, it has a very major impact on the DOD budget. Any manpower action which changes the normal cost percentage will appear immediately in the DOD budget. The increase or decrease of required annual payments to the Federal trust fund will reflect the impact of retirement on manpower decisions. This means that any action which affects new Service entrants is reflected in the DOD budget; any action which changes the benefit paid to current retirees or those already in the Service and who later retire, does not cause a change in DOD's budget. It does, however, affect the annual trust fund outlays which are actually drawn from general revenues and sales of securities each year.

Evaluation of Current System

Officers and enlisted members of each service were brought under the early retirement umbrella by separate pieces of legislation that spanned the time between 1915 and 1948. Twenty year retirement eligibility according to DOD is needed for a young and vigorous force. The concept of youth and vigor was derived from the legislative debate surrounding the need to eliminate older officers. Youth and vigor was never used as rationale for extending the early retirement to enlisted members. Youth and vigor are viewed now by DOD as a universal requirement for all members regardless of specialty or type of assignment. It is believed, within DOD, that without the prospect of 20 year retirement, service

members would not be as willing to accept a military career that could end in the midpoint of their productive life. The argument for a young and vigorous force is weak when one considers that only 16 percent of all enlisted personnel are assigned to direct combat duties. By emphasizing youth and overlooking the importance of occupational distinctions, the 20 year retirement system is helping create a force profile lacking experience in the technical fields. In today's high-tech military, technical skills and experience are essential in meeting the manpower needs now and in the future.

The 20 year retirement system does, however, provide a very strong retention function for mid-career personnel (11-20 years of service). The monetary incentive to complete just 20 years of service is very strong. For the typical enlisted man who has completed 15 years of service, the retirement benefits he earns by staying 5 more years are the equivalent of \$18,690 (1978 dollars) per year in pay. These benefits actually exceed the value of active-duty pay and allowances,, which average \$16,890 during the same 5 years. Thus, the pull to stay to 20 years is strong. But once 20 years is completed, the additional retirement benefits earned by staying another 5 years are the equivalent of only \$3,830 (1978 dollars) per year. This sharp drop causes a push to leave after 20 years of service.²⁷ "Working for half pay" is an expression used to describe the decision to stay past 20 years.

The retirement system has evolved to the point where the early retirement option is essential to meet mid-career personnel needs of the Department of Defense. But on the other hand, it discourages people from staying past the 20 year mark. The increasingly complex weapons systems we are now fielding demand a more experienced, technically

oriented, career force. The force profiles reflected in Fifth Quadrennial Review of Military Compensation, January 1984, indicate the Services desire to continue personnel an active duty until their usefulness or marginal utility to the active component begins to diminish is call the baseline steady-state force. This baseline force profile reflects that less than 4 percent of the total force is needed part 20 years of service.

When this is compared against the Current Objective force, only a very slight decrease of less than .1 percent is seen. The current objective is a force structure designed by the Services that reflects the current "best" structure they could obtain taking account of current force profiles and current compensation policy using historic retention patterns to determine the content of the force. In other words, the Services are happy with the retirement system as it is currently structured.

The current plan submitted to Congress by DOD, which would reduce retired pay to 44 percent of high three basic pay for a 20 year retiree, is clearly an attempt to minimize the impact on the current system by a Congressionally mandated change. House bill, HR 4420, was approved by the House Armed Services Committee on 20 March 1986. This bill would provide only 40 percent of basic pay to 20 year retirees. The Senate Armed Services Subcommittee on Manpower and Personnel is looking at even deeper cuts, 35 percent at 20 years.

The 20 year retirement option, as now administered by the Services, is clearly a doubled edge sword. On one hand, required for retention of mid-career members and to maintain young, vigorous, mission-ready combat forces. On the other hand, it encourages early retirement of members,

that by virtue of their skill, experience, and investment in their training should be retained. What we have is a retirement system that offers identical incentives to retain individuals regardless of their skills or contribution to the Services. When the retirement system is coupled with the overall compensation and promotion system,, it often tends to retain members whose usefulness has diminished and releases those we need to keep. The retention of personnel past 11 years of service should be based upon service manpower requirements by occupational skills and the ability of each individual to perform that duty effectively.

The youth and vigor issue must be reviewed in light of the increased need for technically skilled career personnel. Today, personnel in their 40's are far more vigorous than the same age group was in the 1940's.

By not vesting retirements benefits before 20 years of service, the system "locks in" skilled mid-career personnel with 12 - 20 years of service. This guarantees an adequate supply of trained mid-career personnel, but also ensures that few will stay beyond 20 years of service. Early retirement permits faster promotion of junior personnel, which is a major retention incentive for those personnel with less than 12 years of service. Sixty percent of all career personnel are made up of members with 4 to 12 years of service. Their retention is critical to the overall manpower needs of Services. Any change to the current system which would extend the mid-career force must consider other compensation elements, such as, special and incentive pay, bonuses, etc., in retaining these key personnel.

Other countries' military retirement systems differ from the United States' in many ways, including age at retirement, minimum length of service, integration with social insurance, and inflation protection. In general, however, the United States' system's benefits are more generous than most other countries' plans. For 20 year retirees it is considerably more generous than most, while for 30 year personnel it generally pays slightly higher benefits.²⁸

CONCLUSIONS

Any change to the current retirement system must consider the effect on the military force profile. The force profiles as currently defined by the service, may not be the optimum mix of career and noncareer personnel capable of meeting the missions dictated by national policy. The first step in any reform proposal of the military retirement system, must be the design of an optimum mix of skills, occupational grouping, years of service and career versus noncareer personnel. In an era when increasingly sophisticated weapons system put a premium on intelligence and experience, youth and vigor may actually diminish force effectiveness. However, certain occupational groupings of personnel do in fact require youth and vigor. What percentage of the total force this should be must be determined by the services. As an example, everyone would agree that a combat infantryman require youth and vigor and that a wholesale supply specialist would not.

It must also be recognized that service manpower force management is very difficult and unique. This is because each Service manpower and personnel system is essentially a "closed system" in which lateral entry of nonprior service personnel is rarely used. The aggregate forces comprises over 1,500 different skills, ratings, and codes. The

continuously changing skills mix required as a result of the introduction of new technology and weapon systems, add another level of complexity.

The retirement system is interrelated and linked with both the force management system and the compensation system. As such, any change without consideration of the impact on the force management system would be foolhardy. Only after the Services develop a manpower force structure reflecting the need to increase the experience level of the force, looking out to the 21st Century, can reform of the military retirement system be accomplished. This reform must be supportive of the force management requirements and integrated into the Compensation System. The Retirement System needs to be changed, not because of its generosity, but because it is not producing the type force needed for the future.

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