

NAVAL POSTGRADUATE SCHOOL MONTEREY, CALIFORNIA



THESIS

**CONGRESS, MILITARY RETIREMENT BENEFITS,
AND DEFICIT REDUCTION: A COMPARISON OF
MILITARY RETIREMENT ADJUSTMENTS
BETWEEN THE 103RD AND 104TH CONGRESSES**

by

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June 1996

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ADJUSTMENTS BETWEEN THE 103RD AND 104TH CONGRESSES**

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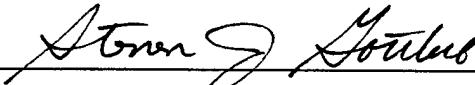
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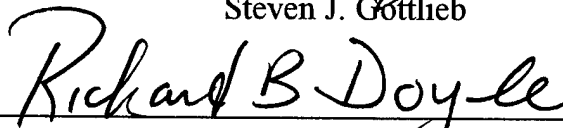
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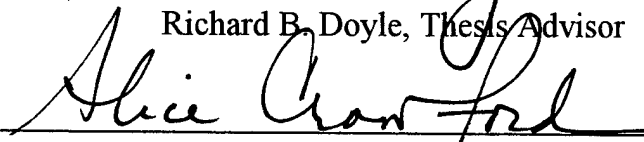


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ABSTRACT

Concern over large annual budget deficits and the contribution entitlement growth has played in this growth, has forced Congress to seek deficit reduction through entitlement reform. This thesis examines congressional policy toward military retirement reform as one part of this process. Through budget reconciliation, Congress enacted military retirement deficit reduction measures in 1993 which delayed retiree COLAs in fiscal 1994-99, but subsequent legislation partially rolled back these delays. Reconciliation instructions in 1995 led to a new deficit reduction initiative affecting military retirement called High-One. Political pressure prevented High-One from becoming law, with mineral sales substituted to achieve the necessary savings. The Balanced Budget Act of 1995, which incorporated the mineral sales, was vetoed. Study of this legislative activity provides important insight into Congress's view of military retirement in deficit sensitive times. It provides a comprehensive record of these events and concludes that future deficit reduction entitlement reform is certain to include military retirement. The form and value of future reform is likely to include further CPI based COLA reductions. While other structural military retirement reforms are feasible, their contributions must be more critically assessed relative to their impact on force structure objectives.

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I. INTRODUCTION

A. BACKGROUND

Congress, in executing its budget responsibilities, struggles to seek new and additional sources of deficit reduction. In doing so, Congress has come to view military retirement as one such contributor. This thesis explores the Congressional perspective on military retirement and how it has altered the system to capture deficit reduction savings. The primary focus is on the recent changes, or attempted changes, to the military retirement structure and enhancements. However, to more fully understand the recent activity, a broader view of military retirement is important.

During the 1980s, there were two significant changes to the military retirement system. These changes reduced the value of the military retirement benefit to those affected, and through other budgetary changes enabled savings from these retirement reforms to accrue immediately. In an effort to achieve additional spending reductions, Congress drafted legislation in 1993 that reduced the retirement benefit for those already retired by adjusting the effective dates of the Cost Of Living Allowance (COLA) between 1994 and 1998. While the COLA was not reduced, the dates on which they became effective were delayed by several months in each of those years. This was to yield a savings of approximately \$2.3 billion over five years. Due to political pressure and fiscal inequity between the military and civil service retirement adjustments, there has been some legislative retreat with respect to these COLA adjustments.

In 1995, Congress again attempted to alter the military retirement system. These changes involved adjusting the effective retirement pay computation basis from the base

pay during the month a service member retires to an average of the last 12 months base pay. This adjustment, referred to as the High-One, would have applied only to those service members who joined the service prior to September 1980. Unlike the 1993 changes, these proposals were met with a loud and immediate rebuttal. Yielding to the political fallout, the High-One legislation failed.

In considering both these cases, this thesis examines the components of success in the first case, failure in the second, and the forces and issues that influenced each outcome.

B. ORGANIZATION OF STUDY

The thesis begins by offering an overview of the three military retirement plans affecting service members. These include the Current System, which applies to service members who entered service before September 1980, High-Three for members entering between September 1980 and August 1986, and Redux, which governs all those who entered after August 1986. The Current System is the oldest and provides the basis from which the others were adapted. Examination of these programs and the legislative changes which brought them about, provides the first glimpse of the Congressional perspective on military retirement.

Following this treatment of the structure of military retirement, the thesis examines the Congressional budget process as it relates to military retirement. Specifically, it indicates how the budget process has been changed to more efficiently capture retirement change savings. The transition from the pre-1984 annual appropriations process to the establishment of the Military Retirement Fund and the

corresponding budget implications of these changes are described. Adoption of accrual accounting for military retirement budgeting and its enabling contribution in capturing retirement reform savings is explained. This aids in understanding the impact and benefit of changes to the military retirement structure within the context of deficit reduction. These changes provide an immediate savings impetus that has focused the Congressional budget process on military retirement changes.

Another element of military retirement benefits and the budget process, the COLA, is examined from both a historical perspective and in deficit reduction terms. COLAs, originally designed to protect military retiree purchasing power from the effects of inflation, have been viewed by Congress in several ways. Chapter IV tracks the original transition to a Consumer Price Index (CPI) based COLA as a cost savings measure, to the CPI+1 formula in the 1970s designed to protect retiree purchasing power in the face of minor implementation delays, to prolonged delays and reduced COLA initiatives as tools to achieve deficit reduction. Each phase represents a different Congressional perspective.

The thesis turns next to the 103rd and 104th Congresses. Both Congresses achieved deficit reduction through military retirement COLA adjustments. However, the final form was quite different than the original legislative intent. After originally legislating COLA delays, both Congresses retreated from these measures and sought suitable alternative savings. During this legislative turmoil, new military retirement related deficit reduction initiatives emerged. The process, participants and budget consequences of each of these measures is examined in detail. This study provides recent

insight into Congressional policy and perspective with respect to military retirement . It also examines the political consequences of this form of entitlement reform in the face of an effective constituent lobby. Additionally, it helps establish the context, primarily deficit reduction, and the measures Congress will pursue in trying to achieve its objectives.

C. SCOPE

The scope of this thesis primarily involves the Congressional budget process and military retirement. It is a budgetary look at military retirement from a Congressional perspective, addressing changes in military retirement and its ability to contribute to deficit reduction. It evaluates the feasibility of utilizing such changes as tools, considering the existing political realities that surround entitlement reform. While military retirement is described from its earliest periods, the general scope begins in 1958 and progresses from there. Specific attention is directed at the activities of the 103rd and 104th Congresses, covering 1993 to 1996.

The expected value of this thesis is to provide a detailed understanding of military retirement and the Congressional budget process. It provides a consolidated record of the events, proponents, opponents and key legislation related to the most recent military retirement adjustments and proposed changes. The result is a detailed understanding of the Congressional roles, missions, and authority in military retirement budgeting under conditions of extreme pressure to reduce the federal deficit by cutting all forms of spending. This study should be of value to Department of Defense (DoD) officials and Support Area Analysts responsible for studying military retirement issues.

It should provide the necessary insight required to more effectively address these issues as they develop in future budget debates.

D. METHODOLOGY

Numerous sources that address military retirement and the Congressional budget process were referenced in preparing this study. Pertinent data was drawn from Congressional hearing records, committee reports, conference agreements, reconciliation materials, and the respective defense authorization and appropriation bills that address the military retirement adjustments. Additional information was obtained by reviewing DoD documents, professional journals, periodicals, and news reports.

II. REVIEW OF MILITARY RETIREMENT BENEFITS

To more fully understand the relevant congressional policy regarding military retirement benefits, a reasonable description of the current system is appropriate. This chapter outlines the various annuity systems that currently constitute the pension programs available to service members. While these systems are similar, understanding their unique distinctions is important because Congress has approached them both unilaterally and individually through cost reduction legislation.

Currently within the military, there are three different retirement benefit programs. The three systems are usually referred to by their dominant characteristics with the first regarded as the Current System, the second, the High Three and the third is usually called Redux. The latter two are the result of legislative changes to the Current System that has been in place since 1947 [Ref. 1: p. 28]. The Current System is used as the basis of comparison since it serves almost all current retirees and all members who entered the service before September 8, 1980 [Ref. 2: p. 19]. The date when a member entered service determines which system he or she is governed by. The commonality and distinctions between each are outlined below.

A. THE ANNUITY AT 20 YEARS

Common to each of the military retirement benefit programs is the 20 year annuity feature. Service members become eligible to receive benefits upon achieving 20 years of service. There is no earlier eligibility or vesting in the retirement system for

service less than 20 years. Once eligible, a service member is entitled to receive retirement benefits for the remainder of his or her life. [Ref. 1: p. 6]

Since eligibility begins at 20 years of service, an understanding has developed that military retirement benefits amount to a 20 year retirement. The law stipulates that at 20 years, a service member becomes eligible to retire, while at 30, he or she is entitled to retire. Service members who wish to retire prior to serving the full 30 years, must request permission to retire early. Typically, permission is granted. But those who retire early (prior to 30 years) are immediately placed in reserve status and are subject to recall. [Ref. 3: p.105]

For service members retiring from active duty, there is no age eligibility requirement that must be satisfied prior to receiving benefits. However, service members retiring from the reserves do have an age eligibility requirement. Service personnel who retire from the reserve forces do not begin receiving pay benefits until they are sixty years of age. [Ref. 1: p. 6]

B. DEFINED BENEFIT PLANS

1. The Current System

Perhaps the most understood and most referenced of the three retirement benefit systems is the Current System. The beginning benefits associated with this plan amount to 50 percent of a service member's basic pay at 20 years of service. This is the oldest of the three systems and the one that covers almost all of the current population of retired service members. The 50 percent at 20 reference derives from the formula used in

determining the benefit a service member is eligible to receive when he or she first becomes vested. [Ref. 4: pp. 11-12]

Since 1855, gross percentages of military compensation have been utilized in determining retired compensation. The legislation that serves as the original basis for the Current System is the Naval Service Appropriation Act of 1917. This law established the 2.5 percent per years of service determination method. It also established the 75 percent of basic pay retirement compensation cap. This cap is achieved after 30 years of service. [Ref. 5: p. 453]

To determine the benefit amount, a service member multiplies the years of service by 2.5 percent to determine the annuity factor. Next, the annuity factor is multiplied by the basic pay received in the month of retirement. This determines the monthly annuity value. For a service member serving exactly 20 years, the point of initial vesting, the annuity factor to apply to the basic pay equals 50 percent. For example, if a service member's basic pay during the month of retirement is \$2261.40 and that member served exactly 20 years, the value of the monthly annuity would be calculated as follows:

$$20 \text{ years} \times .025 \times \$2261.40 = \$1130.70/\text{month}$$

For periods of service beyond 20 years, the annuity factor is increased by 2.5 percent per year to a maximum of 75 percent. This maximum is achieved after 30 years of service. For service beyond 30 years, the annuity factor remains constant at 75 percent. For part-year service, the annuity factor is adjusted for fractions of years (in months) times the 2.5 percent. For example, a service member who serves 23.5 years would have an annuity factor of 58.75 percent.

When determining the actual value of the monthly annuity, the annuity factor is multiplied by the basic pay in the month the service member retires. Only basic pay is included. It is important to point out that while this system is considered a 50 percent benefit program, it is based entirely on basic pay. No other compensation components are included in the annuity valuation. Therefore, in real or total compensation terms, the actual annuity benefit percentage is lower than 50 percent.

Determination of which system a service member is eligible for is based on when a service member joined the armed forces. The actual contractual date is called the Pay Entry Base Date (PEBD). To be eligible for the 50 percent at 20 program just described, a service member must have joined the armed forces and have a PEBD prior to September 8, 1980.

2. The High Three

The High Three system of military retirement benefits became law with the Department of Defense Authorization Act of 1981. The impetus for this change emerged from three congressional concerns. First, Congress sought to reduce the high and increasing costs associated with military retirement. Second, Congress wanted to raise the pay of active members and needed appropriate offsetting cost reductions elsewhere. And finally, in addition to reducing costs in the out years, adopting the High Three system made the defense system comparable to the Civil Service Retirement System (CSRS). The CSRS already employed the High Three concept. [Ref. 5: pp. 459-460]

The High Three system is very similar to the current program just described. The annuity factor determination is identical. The difference is that the basic pay in the

month of retirement is not used in determining the annuity value. Instead, an average of the high three years of basic pay, which a service member earned, is utilized to determine the annuity value. Usually this is the last three years of a service member's career.

Service member eligibility for this retirement benefit system is also governed by when he or she joined the armed forces. This system applies to those service members whose PEBD falls on or between September 8, 1980 and July 31, 1986. [Ref. 2: p.19]

3. Redux

The Redux, or Reduced Retirement Benefit system of military retirement benefits was enacted with the Military Retirement Reform Act of 1986. This act was passed on August 1, 1986 and applies to all service members who entered the military on or after that date. [Ref. 1: p.6] While the change associated with the High Three was an attempt to reduce costs, it did little to change the character and impact of military retirement compensation. Redux represents a significant attempt to both reduce the costs associated with military retirement expenditures and alter the early retirement bias of the previous systems. [Ref. 6: p. 8]

Like the other programs, Redux possesses the 20 year annuity eligibility. That is, a service member remains ineligible to receive benefits until he or she reaches 20 years of service. But unlike the others, the annuity factor determination is not a simple 2.5 percent times the years of service. The computation is slightly more complex. First, during the initial 20 years, the annuity factor increases by two percent per year. So a service member's annuity factor is only 40 percent at exactly 20 years. Thereafter, the annuity factor increases at a rate of 3.5 percent per year for years or fractions of years (in

months) between 20 and 30 years of service. This achieves the same 75 percent annuity factor cap at 30 years of service that the previous plans possess. Like the High Three plan, the annuity factor determined under the Redux plan is then applied to the averaged High Three years of basic pay. This reduced annuity factor remains in effect until the retiree reaches age 62. It then reverts to the same 2.5 percent per years of service computed under the Current and High Three plans. [Ref. 1: p. 6]

By creating an annuity factor growth differential between a careerist's initial service period (years 1 through 20) and the second (years 21 through 30), Congress attempted to alter the career length incentives offered under the previous systems. While the current and the High Three programs appeared to have an early retirement bias, Redux represents an inducement for longer service for the mid-careerist.

In addition to changing incentives, Congress also wanted to reduce retirement expenditures. Redux achieved this by reducing the required expenditures associated with those service members who retired early. Instead of paying 50 percent, the government will now only have to pay 40 percent of the High Three years of base pay to a service member who retires when first eligible. Additionally, while the annuity factor differential was designed to entice longer service, it also requires less expenditures per year, relative to the other programs, for any service member who retires before the 30 year statutory requirement.

Table 1 below provides a relative comparison of the actual annual annuity values for selected retirement grades and years of service (YOS). The table is based on 1996 basic pay tables.

Table 1

Annual Retired Pay Under the Three Current Military Retirement Systems, 1996

Grade/YOS	Current System	High-3	Redux
O-4/20	\$24,979	\$23,603	\$18,883
O-5/24	\$35,852	\$33,799	\$30,419
O-6/30	\$54,923	\$52,355	\$52,355
E-7/20	\$13,568	\$12,655	\$10,124
E-8/25	\$21,258	\$19,695	\$18,119
E-9/30	\$30,394	\$28,971	\$28,971

Source: Adapted from 1996 DoD Military Pay Chart.

C. COST OF LIVING ALLOWANCES

A chief complaint voiced during congressional consideration of the cost escalation of military retirement benefits has been the impact of compounding and the application of the Cost of Living Allowances (COLAs). In order to mitigate some of these effects, Congress also implemented changes to the COLA application rates.

Both the current and the High Three plans described above are fully indexed for inflation. Each year, the basic pay component of the annuity formula is increased at some rate to compensate for the degradation of buying power associated with inflation. For the current and High Three plans, the Consumer Price Index (CPI) is used to index the basic pay to correct for this inflation-related loss. [Ref. 2: p.19]

In order to achieve greater savings with the Redux plan, Congress changed the annual COLA increase application rate. Where previously the CPI was used, under Redux, this was changed to the prevailing CPI minus one percentage point. Therefore, from the time a service member retires, the High Three basic pay component of the annuity formula is increased by the CPI-1. This continues until the service member reaches 62 years of age. At this point, the High Three basic pay component undergoes a one-time correction to bring the basic pay factor up to the value associated with full CPI adjustments. That is, the basic pay component is increased to the value it would have been if it had increased at the full CPI during the period from retirement to age 62. From this point on, the COLA increase reverts back to the CPI minus one percentage point. It is not readjusted again. [Ref. 2: pp. 19-20]

III. BUDGETING FOR MILITARY RETIREMENT

The budget process with respect to military retirement underwent significant changes in 1984 with the establishment of the Department of Defense Military Retirement Fund. In order to fully appreciate the impact and benefits of these reforms, and the Congressional budget process changes that accompanied them, an understanding of the prior process is helpful. This chapter describes the previous process, that is, how Congress budgeted for military retirement pay prior to the 1984 changes. Then, the Military Retirement Fund (MRF) is described and finally, how the Congressional budget process controls the flow of funds through the Current System is explained.

A. "PAY-AS-YOU-GO" MILITARY RETIREMENT FUNDING

Prior to the establishment of the Military Retirement Fund in 1984, the budget process associated with military retired pay was essentially a pay as you go system. The Department of Defense, through the President and Congress, budgeted annually for the expected outlays associated with military retirees. With each annual defense budget submission, the Department of Defense would submit a budget request for the retired military personnel account as part of the annual defense budget. This request was based on actuarial estimates of the size of the retiree population, relevant economic assumptions about the economy and anticipated changes to military pay scales. [Ref. 5: pp. 711-714, Ref. 7: p. 15]

1. The Pre Reform Budget Process

Through the Planning, Programming and Budgeting System (PPBS), the Defense Department develops and requests an appropriate level of funding to support the national defense budget function. Once complete, the defense budget request is forwarded to the President. The President, through the Office of Management and Budget (OMB), then develops his overall budget request, which includes the annual defense budget request. [Ref. 8: p. iii]

The OMB utilizes 19 functions to structure the President's Budget. The budget function assigned to national defense is 050. Within this overall national defense budget request is the budget subfunction 051, which governs Department of Defense specific functions. This category includes all monies controlled by the Department of Defense (DoD) for DoD programs. Included in the annual DoD budget submitted to the President was a request for funds for the Retired Military Personnel account. The request for this account represented the amount the Secretary of Defense anticipated as necessary to pay the projected population of retirees for the fiscal year under consideration. [Ref. 7: p. 15, Ref. 8: p. 3]

After the President delivers his budget, Congress takes legislative action on it. The typical legislative budget process includes three key phases. Congress first agrees on a Concurrent Budget Resolution. This establishes a ceiling or top line for funding of defense programs in the form of budget function 050, the first budget function in the Resolution. Next, the Authorization committees draft authorizing legislation for consideration by the entire Congress and subsequent Presidential signature. This

establishes new programs and provides the authority to execute the functions of government. With respect to military retirement, defense authorization bills structure the eligibility requirements, valuation, computational procedures, and administrative statutes.

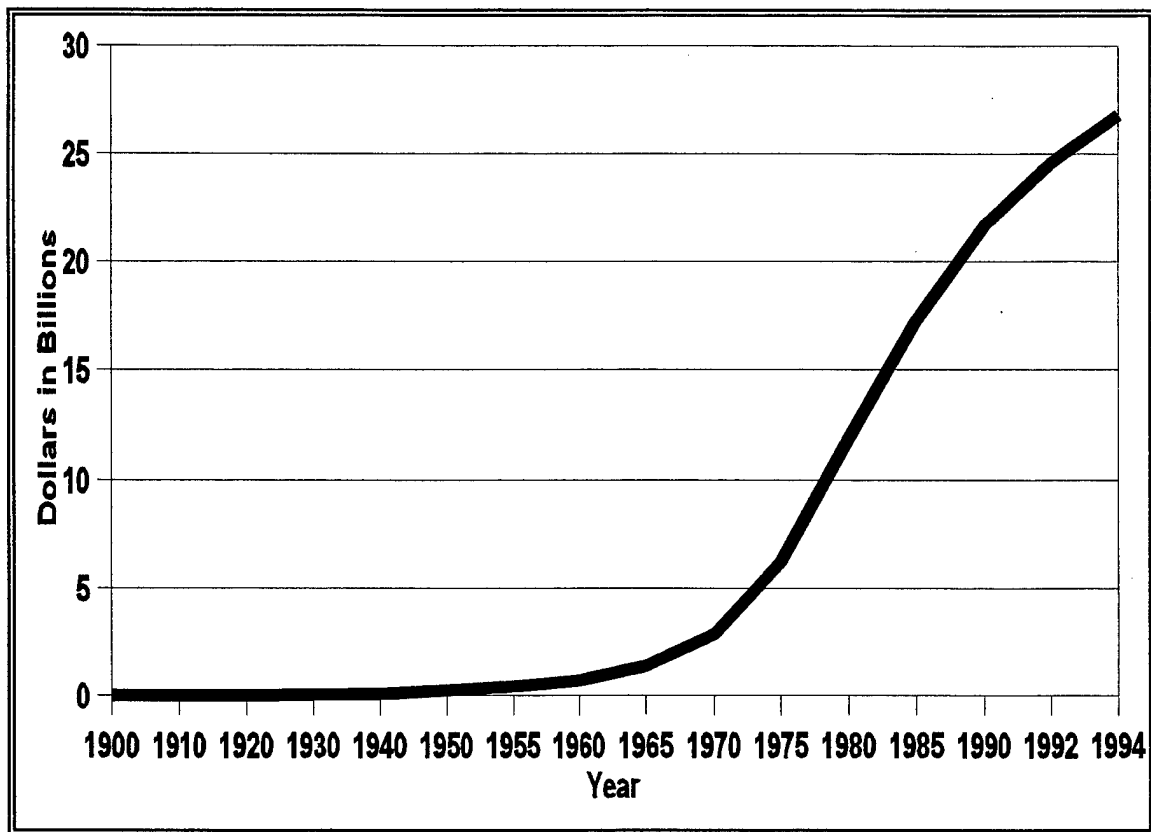
It is through the authorization process that programs such as the Military Retirement Fund are put in place. Finally, the appropriations process occurs. Appropriations bills provide the budget authority to fund the defense programs. Prior to 1985, all money required to fund military retirement was received through the annual defense appropriations acts. The annual defense appropriations act provided the DoD with the budget authority to pay retiree benefits. This annual appropriation funding for military retirement benefits continued until the establishment of the Military Retirement Fund.

[Ref. 8: pp. 24-36]

B. THE ROAD TO MILITARY RETIREMENT REFORM

During the seventies, the military retirement system came under increasing pressure for a variety of reasons. Chief among these reasons was cost growth. The chart below illustrates the dramatic growth trend associated with military retirement costs.

Figure 1: Military Retirement Expenditures 1900-1994



Source: DoD Statistical Report on the Military Retirement System, FY1994.

Other elements of concern included the perceived generosity of benefits relative to non-defense pension plans, the benefit system's early retirement bias, and its weakness as a force structure management tool. These concerns led to numerous studies aimed at changing the existing system. While many of the change recommendations led to the somewhat marginal benefit reforms described in Chapter II, two studies focused on the military retirement budgeting process. [Ref. 6: pp. 4-15, Ref. 10: pp. 35-46]

The chief complaint about the pay as you go system, in the face of rising costs, was that regardless of what Congress did to change the benefit structure of future retirees,

no cost savings would be achieved until those service members began retiring. [Ref. 11: pp. 1-6, Ref. 12: p. 19] Presumably, the earliest benefits of cost saving measures would be delayed for a minimum of 20 years.

Another complaint about the intergenerational, pay as you go system was that it distanced or removed the significant cost consequences of personnel and compensation decisions. That is, when considering force structure changes or basic pay increases, decision makers had only to consider the immediate budget impact, which was negligible, potentially ignoring larger, long-run costs associated with future retirement benefits. [Ref. 11: p. 5]

A third complaint about the annual funding for military retirement benefits was the growing and alarming size of the unfunded liability associated with retirement benefit obligations already incurred. The FY82 estimate of the preexisting liability was \$527 billion [Ref. 13: p. VII-20]. While the government carried such significant unfunded liabilities, it was only as recently as 1974 that Congress passed the Employee Retirement Income Security Act (ERISA). ERISA required private corporations that carried pension plans to begin prefunding those plans. Additionally, it required that these firms determine their unfunded liabilities and amortize that obligation in order to achieve full funding in the future. [Ref. 5: pp. 712-713, Ref. 7: pp. 19-20] The magnitude of the unfunded military retirement liability coupled with seeming hypocrisy implied by the government's intergenerational retirement funding while requiring private corporations to prefund their pension plans created the impetus for reform.

1. Department of Defense Military Retirement Fund

Due to the pressures outlined above and intent on achieving cost reductions, Congress directed the DoD to begin funding retirement costs in advance. The change required that accrual accounting concepts be utilized to prefund military retirement benefits. The change was actually mandated in Public Law 98-94, the FY84 DoD Authorization Act. Effective October 1, 1984, this act had three essential elements. First, it established the Department of Defense Military Retirement Fund. Second, it required the DoD to utilize accrual accounting procedures to prefund military retirement. And finally, it directed that the unfunded liability associated with existing military retirement benefit obligations be determined and an amortization schedule be developed to pay down this liability. [Ref. 14: pp. 530-535]

a. Establishing the Fund

The 1984 Defense Authorization Act amended Title 10, United States Code. Chapter 74 was added, which establishes the Military Retirement Fund and states both the purpose and procedures for its implementation.

There is established on the books of the Treasury a fund to be known as the Department of Defense Military Retirement Fund (hereinafter in this chapter referred to as the "Fund"), which shall be administered by the Secretary of the Treasury. The Fund shall be used for the accumulation of funds in order to finance on an actuarially sound basis liabilities of the Department of Defense under military retirement and survivor benefit programs.

10 U.S.C. § 1461

Through this legislation Congress sought to come to grips with the burgeoning unfunded liability of military retirement and provide greater cost visibility and responsibility. With respect to function, the Military Retirement Fund was separated from the DoD and placed under the jurisdiction of the Secretary of the Treasury. It was assigned to a budget subfunction under the income security function (600). [Ref. 7: p.26, Ref. 14: p. 46] While the Secretary of the Treasury manages the fund, a Defense Retirement Board of Actuaries was established to report to and advise the Secretary of Defense on the actuarial status of the fund. [Ref. 14: p. 531]

Fiscally, the Military Retirement Fund is funded through three sources. These funds are then used to pay retirees. First, the Secretary of Defense is required to recognize and pay the fund for current service member retirement liabilities. Next, the unfunded liability is to be amortized and paid. To do this, the Secretary of the Treasury is required to make one transfer payment per year from the general treasury into the fund. Finally, fund surpluses are to be invested in government debt securities. Interest earned via these investments accrues to the MRF. [Ref. 14: pp.534-535]

b. Accrual Accounting

Accrual accounting is a method of recording costs and allocating monies to pay these costs as they are incurred. In the case of military retirement, it means that money to satisfy the future liability associated with the earned retirement benefit of those currently in service should be budgeted for and set aside as that liability is incurred. [Ref. 11: p. 12] This is precisely what the MRF legislation in the FY85 Defense Authorization Bill stipulated.

The Secretary of Defense is tasked with paying the MRF as service members earn retirement benefits. Abandoning the previous pay as you go process, the legislation requires prefunding. The procedures set out in the bill require the Secretary of Defense to determine two basic pay factors. These factors, called single level percentages of basic pay or normal cost percentages (NCP), are to be used to determine the level of funds required to satisfy the costs of retirement that accrue as a result of current service. The factors are applied to the basic pay account each month to determine the amount to be transferred to the MRF. One factor is applied to the active duty pay accounts and the second to the ready (drilling) reserve pay accounts. These calculations, based on the previous month's payroll, are done monthly and the funds are so transferred. [Ref. 14: p. 534]

For budgeting purposes, the Secretary of Defense utilizes estimates of the individual NCPs, but in macro budget data they are often represented as a single weighted value. For future years' budgeting, the NCP factors are applied to the annual budget request for basic pay to determine the anticipated budget obligation for earned retirement benefits. This total is summed in the overall Military Personnel request submitted with the annual defense budget request.

For example, in 1985 the military basic payroll accounts totaled \$33.5 billion. The single level percentage of basic pay in 1985 was 0.501. The product of the single level percentage and the basic pay account yields an approximate budget request of \$16.9 billion to prefund the military retirement obligations earned in that year [Ref. 12: p.20]. Continuing this example and assuming the numbers above represent projections

for FY85, in his budget request for FY85, the Secretary of Defense would submit an aggregated Military Personnel payroll request of \$50.4 billion to satisfy the basic pay and retirement accruals. The actual Military Personnel request was greater at approximately \$67.324 billion [Ref. 7: p. 27]. This difference represents other components of compensation included in the Military Personnel budget requests. Gone from the budget process for military retirement is the Retired Military Personnel account used in the pay as you go process.

Table 2 below shows the actual basic pay account totals, the normal retirement costs associated with the basic pay level and the single percentage of basic pay factors used in determining the earned retirement benefits during the period from 1985 to 1994.

Table 2
Military Retirement Flow Relative to Basic Pay

In Billions of Dollars

Fiscal Year	Basic Pay	Retirement Costs	% Basic Pay Factor
1985	\$33.5	\$17.0	0.507
1986	35.4	17.4	0.492
1987	36.4	18.3	0.503
1988	37.3	18.4	0.493
1989	38.6	18.5	0.479
1990	39.8	16.3	0.410
1991	42.3	17.2	0.407
1992	41.1	16.3	0.397
1993	38.9	13.2	0.339
1994	38.3	12.8	0.335

Source: Valuation of the Military Retirement System 1994.

c. *The Unfunded Liability*

The third key element the MRF legislation sought to address was the enormous unfunded liability associated with the benefits of both active and retired service earned prior to the MRF's establishment. In 1982, when serious debate about this legislation began, the unfunded liability was estimated at \$527 billion [Ref. 13: p. VII-20]. When the legislation was passed, it gave the Defense Retirement Board of Actuaries six months to determine the present value of the unfunded liability. [Ref. 14: p. 532]. Their determination was that the unfunded liability was \$528.7 billion in 1984.

After determining the extent of the unfunded liability, the Board of Actuaries had to develop an amortization schedule to liquidate this obligation. The original repayment schedule they developed called for a 60-year amortization to repay this unfunded liability. [Ref. 12: pp. 14, 24] Once the original schedule was established, the Secretary of the Treasury was tasked with transferring one payment annually to fulfill the amortization requirement. These funds are transferred at the beginning of each fiscal year from the general treasury to the MRF. [Ref. 14: p. 534]

While the Secretary of the Treasury is responsible for making each annual amortization payment, the Secretary of Defense is responsible for maintaining an accurate valuation. Consequently, any changes to the retirement benefit structure or account valuation assumptions that require amortization changes must be accounted for. To accomplish this, the Secretary of Defense reviews the account valuation annually. Based on this review, he certifies, to the Secretary of the Treasury, the amount that must be transferred from the treasury to the MRF. [Ref. 14: pp. 531-535]

After ten years of payments, the accrued unfunded liability was \$491.4 billion as of September 30, 1994. The current amortization schedule is projected to completely liquidate the unfunded liability by FY 2044. [Ref. 12: pp. 13, 23, Ref. 15: p. 47]

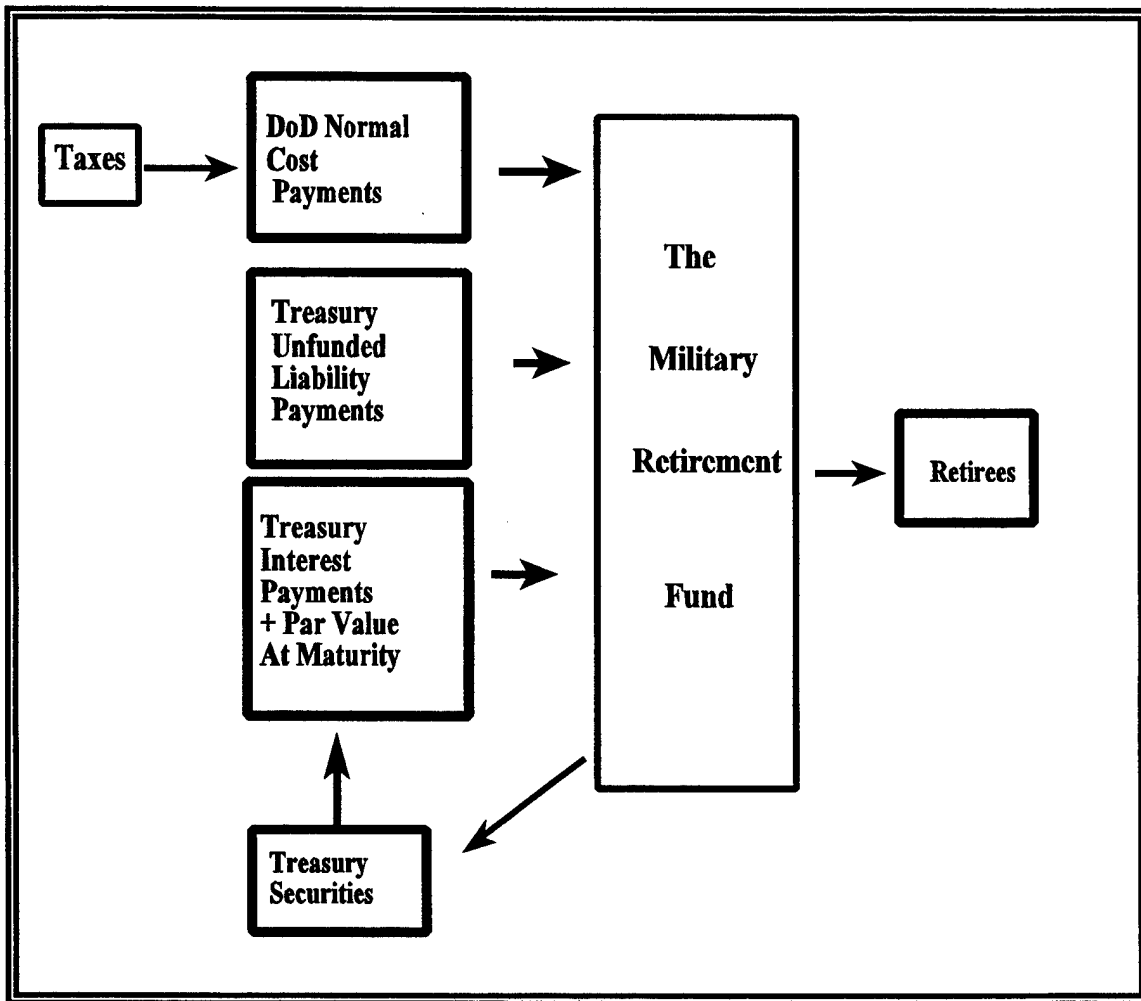
C. PROCESS CHANGES AND FLOW OF FUNDS

With the establishment of the MRF, certain budget process changes occurred. Under the old pay as you go funding, all appropriations for military retirement were annual appropriations. Now, the process for military retirement funding includes a mix of annual and permanent appropriations. With the establishment of the MRF, the Retired Military Personnel Account is no longer used. Instead, the DoD obligation for its accrual contribution to the MRF is included in the Military Personnel request within the DoD budget request. Technically it is included in budget subfunction 051 and budget function 050, national defense. Since the Military Personnel budget function includes the DoD contribution to the MRF, this is the portion of military retirement budgeting which remains an annual appropriation.

The treasury transfer into the MRF to satisfy the unfunded liability amortization payment and any accrued interest on MRF surpluses is directed by Chapter 74, Title 10 U.S.C. In this regard, this transfer represents a permanent appropriation in that an annual appropriation is not required to effect this transfer. [Ref. 7: p. 41]

Finally, since eligibility for retirement benefits is governed by statute, and Title 10 requires that the MRF assets be "made available for payments" to retirees, payments from the fund also behave like permanent appropriations. Figure 2 depicts the flow of funds into and out of the MRF.

Figure 2: The Military Retirement Flow of Funds



Source: Valuation of the Military Retirement System 1994.

1. Effects and Benefits of Accrual Accounting

The pursuit of actuarially sound principles and the switch to accrual accounting seem to have offered budgetary improvements over the pay as you go system. They have provided an added measure of cost visibility, particularly with respect to the unfunded liability and the impact of changes to retirement benefits. But more importantly, they

have provided Congress with a tool to achieve immediate cost reductions associated with changes to military retirement benefits. Under the pay as you go system, changes to retirement benefits (if grandfathered) would not result in reduced retirement outlays until those service members retired. With accrual accounting prefunding, savings associated with benefit reductions can be achieved within a month of enactment.

A simple comparison of the NCPs among the various retirement benefit systems currently in effect illustrates these effects. Table 3 lists the NCPs for FY95. These are the percentages to be applied to the basic pay account to determine the retirement accrual liability during FY95.

Table 3
Normal Cost Percentages FY 95

	Full Time	Reserve - Part Time
Current System	39.3	10.7
High - 3	35.0	10.0
Redux	29.7	9.1

Source: Valuation of the Military Retirement System 1994.

Under pay as you go, the retirement benefit reduction associated with the Redux system would not yield cost savings until FY 2006. With the MRF and accrual accounting, the savings were available in FY 1987. The Secretary of Defense, based on the percentages indicated above, has to transfer fewer funds each month to fulfill the prefunding obligation for service members covered by the Redux plan than those covered by the other plans. Accrual accounting, therefore, has yielded an immediate cost savings as the result of benefit change initiatives.

Certainly, the immediacy of savings impacts was not lost on Congress. Shortly after establishing the MRF, the first major change in military retirement benefits in nearly forty years was enacted with the Military Retirement Reform Act of 1986 (Redux). Since this period, military pension benefits have come under increasing scrutiny as a potential source of cost savings. One facet of this attention has been the retirement benefit COLA. The 103rd Congress, in an attempt to achieve deficit reduction, looked to both the military and federal civil service COLAs for savings. Chapter IV describes the contribution COLAs made toward deficit reduction and the legislative activity necessary to achieve these changes.

IV. RETIREMENT ADJUSTMENT BY THE 103RD CONGRESS

The climate surrounding the 103rd Congress in 1993 was one of heightened fiscal sensitivity about the enormous size and growth trends of both the budget deficits and the overall national debt. A number of measures, both revenue generating and deficit reducing, were introduced to gain control over the deficit. One legislative contribution to deficit reduction involved the COLAs paid to military and federal civil service retirees. The 103rd Congress, through the Omnibus Budget Reconciliation Act of 1993 (OBRA of 1993), sought to achieve a measure of deficit reduction by delaying the COLAs paid to retirees, both military and federal civil service, during each of the years from 1994 to 1998. The process involved many variations and compromises in the legislative language which eventually lead to the final legislation.

This chapter examines the various proposals that were made as the congressional process progressed. The focus is on the military retirement COLA. While a separate matter, occasional reference to the federal civil service retiree COLA is made. This COLA enjoyed shorter delays over fewer years than the military COLA, creating an equity issue that surfaces in later debates. To help frame the debate and congressional action associated with the OBRA of 1993 as it relates to military COLAs, a historical summary of COLAs and their application is helpful.

A. COLA BACKGROUND

1. Pre-COLA Retirement Pay Increases

Prior to the COLAs now in place, the principle of recomputation was utilized to index military retiree pay. Recomputation simply retains the active duty pay scale as the basis for retiree pay. As active duty pay increased, retiree pay increased. The retiree pay was based directly on the active pay scale. This process began with the Army and Navy Appropriation Acts of 1871. [Ref. 5: p.491]

The pay of all officers of the navy now on or hereafter placed on the retired list was to be based on the highest pay prescribed by this act for officers on the active list whose grade corresponds to the grade held by such retired officers.

The quote reflecting the link between retiree pay and active pay is slightly misleading. The active pay scale provided the basis for retiree pay. Retirees received a percentage of active pay based on years of service or degree of disability. But the important link between the two was established and remained in effect with minor adjustments until 1958. [Ref. 5: pp. 491-494]

During the period between 1871 and 1958, active duty military pay, and therefore retiree pay, was increased at irregular intervals. In the years immediately preceding the Armed Forces Pay Act of 1958, military pay was increased in 1952 and 1955. During congressional debate over the Armed Forces Pay Act of 1958, the practice of recomputation came into question. If recomputation was permitted based on the anticipated active pay raise in 1958, the cost was projected to be \$65 million. If instead, the retiree pay was increased by six percent and not recomputed based on the active pay raise, the projected cost was \$35 million. Congress elected to forgo recomputation and

increased the retiree pay by 6 percent. The active duty pay increase was 8.3 percent that year. [Ref. 5: p. 493, Ref. 12: pp. 5, 8] This is the first instance of separating the link between active and retired pay increases as well as establishing an increase differential between the two. What the act did not do is make the process permanent.

2. Consumer Price Index Adjustments to Retiree Pay

Continuing the irregular schedule of military pay raises, the next pay increase legislation occurred in 1963, and again, recomputation was questioned. This time, the link between retiree pay and active duty pay was severed permanently. The Uniformed Services Pay Act of 1963 eliminated the recomputation process and replaced it with a permanent system for adjusting retired pay. The new system called for increasing retiree pay to compensate for cost of living increases as reflected by the Consumer Price Index (CPI). [Ref. 12: p. B-5] This new, permanent system marks the beginning of the COLA based retiree pay increases currently practiced.

The rationale for change then, as it was in 1993, remained cost reduction.

The Committee on Armed Services recognizes the tradition that has attached itself in the past to the method of recomputing retired pay whenever the rates of basic pay for members on active duty are changed. It was not easy in 1958, and it is not easy now, to recommend this break with tradition. Nevertheless, the break with tradition was made in 1958 when recomputation of retired pay based on changes in active duty pay rates was not authorized.

The Committee on Armed Services fully realizes the obligation we have to those now retired who have served their Nation. But the committee also recognizes its obligation to those now serving on active duty and those who will enter on active duty in the future.

The committee cannot disregard the already heavy costs involved in military retirement or the substantial added costs which would result if

recomputation were to be retained as a part of the military retirement system. [Ref. 16: p. 19]

Interestingly, the active duty pay raise in 1963 was 14.2 percent while the COLA for retirees was only 5.0 percent. [Ref. 12: pp. B-7-B-8]

The CPI procedure as outlined in The Uniformed Services Pay Act of 1963 called for measuring the CPI in January of each year. This CPI was then compared to the annual average of the CPI for the preceding year. If the CPI increase was 3 percent or greater, retiree pay would be increased. The increase would be effective on April first of that year. [Ref. 5: p.494] While there was a COLA in 1963, it was paid on October 1, 1963 and was not awarded under this legislation. Before any COLAs were paid under this procedure, it was modified. The Armed Services Pay Act of 1965 (PL 89-132), passed on August 21, 1965, changed the indexing mechanism.

The new procedure called for comparing monthly CPI growth against the CPI base index used in the last COLA computation. When the monthly CPI rose 3 percent above the base index and remained at that level, or above, for 3 consecutive months, retired pay would be indexed. The amount of increase would be the highest increase experienced in that 3-consecutive-month series. The COLA increase would take effect on the first day of the third month following the 3-consecutive-month series of 3 or greater percent increases in the CPI. [Ref. 5: p. 494]

The following is an example to illustrate this process. Suppose the CPI base index after the October 1, 1963 COLA was \$100.00. Then, the first period of 3 consecutive monthly CPIs that were 3 percent or greater occurred in April, May and June of 1965, and the CPIs for those months were \$103.00, \$103.60 and \$104.40,

respectively. This example satisfies the requirement for consecutive CPIs exceeding the 3 percent threshold. Therefore, a COLA would be paid on September 1, 1965. The COLA percent will be the highest of the 3 consecutive monthly CPIs. In this case, 4.4 percent. The new CPI base index will become \$104.40. Conceivably, in periods of high inflation, this procedure could lead to multiple COLAs in any given year. Actually, multiple COLAs in one year were paid two times before this system was again changed. These occurred in 1974 and 1975 when two COLA increases were awarded in each of those years. [Ref. 12: p. B-7]

In 1969 the indexing procedure was modified once again. Surprisingly, this change increased the COLA benefit. PL 91-179 left the basic tenets described above intact. However, it added what has sometimes been called the 1-percent-kicker. The new procedure required that when the CPI increase thresholds were satisfied and a COLA was to be awarded, 1 percentage point was added to the COLA. The rationale for the increase was to compensate retirees for the delay between the CPI increase and the actual increase in pay. Continuing the illustrative example above, under the new law, the 4.4 percent COLA would be increased to 5.4 percent. The 1 percent addition was also included in the federal civil service retirement program via separate legislation. The legislation which included the civil service addition predated the military COLA increase by 2 months. [Ref. 5: p. 494]

The procedures established in 1965 and modified in 1969 continued until 1976 (FY 77). These new changes marked the beginning of what seems to be a period of continuous COLA attention by Congress. In 1976, with the DoD Appropriation

Authorization Act of 1977, the 1-percent-kicker was eliminated. Actually, the elimination of the addition was contingent upon a similar reversal of the civil service COLA addition. Both COLA programs lost the 1 percent addition. [Ref. 5: p.494]

After the 1 percent increase, originally designed to compensate for pay increase delays, was eliminated, Congress again changed the COLA system. Via separate legislation in 1977, the COLA adjustment procedures were changed yet again. The Legislative Branch Appropriation Act of 1977 (PL 94-440) stipulated that the COLA adjustment be made twice yearly. The semiannual adjustments were to be made on March 1st and September 1st of each year. The increase was based on the CPI rise between June and December for the March 1st increase, and January to June for the September 1st increase. [Ref. 12: p. B-5, Ref. 5: p. 494]

Considering the high and prolonged inflationary character of the late 1970s and early 1980s, one aspect of the COLA adjustment mechanism change that received little attention was the elimination of the 3 percent CPI increase threshold. The Legislative Branch Appropriation Act of 1977 (PL 94-440) did not continue this requirement as evidenced by the March 1, 1978 COLA increase of only 2.4 percent. [Ref. 12: pp. B-5-7]

The next change to the COLA mechanics occurred in 1980. The DoD Authorization Act of 1981 (PL 96-342) switched the semi-annual adjustment to an annual one. The September adjustment was eliminated and the basis for the increase became the December to December rise in the CPI. The COLA effective date became March 1st. This increase was both identical and coincident with the civil service retirement COLA. [Ref. 12: p. B-5, Ref. 5: p. 494]

Eliminating the 1 percentage point addition to the military retiree COLA saved approximately \$140 million during the first year and almost \$2.5 billion through 1983. Additionally, by switching to the annual, vice semi-annual adjustments, the compounding effect of multiple annual increases was eliminated. This generated additional savings. The 1984 estimate of these savings was \$170 million. [Ref. 17: p. 38]

Between 1982 and 1984 several measures were introduced that reduced the COLA benefits. During fiscal years 1983-1985, based on projections of inflation at greater than 6.6 percent, a partial or half-COLA limitation was instituted for non-disability retirees under 62 years of age. The half-COLA mechanism required that if inflation was high during the period from 1983-85, the COLA would be one half of the CPI increase, but not lower than 3.3 percent. Next, the OBRA of 1982 delayed the effective dates on which each of the COLAs were to be paid from March in each year to April 1983, May 1984 and June 1985. Actual inflation during this period was moderate, so the half-COLA triggers were not particularly painful for retirees. The CPI increase in 1983 was 3.9 percent. The 1983 COLA was 3.9 percent for retirees over 62, disabled retirees and survivors while the non-disabled retirees under age 62 received 3.3 percent. [Ref. 17: p. 39, Ref. 18: p. 1] The half-COLA procedure for non-disabled retirees under age 62 was quickly repealed by the Second Supplemental Appropriation Act for FY 1984 (PL 98-396). This restored comparable COLA calculation procedures to all retirees. [Ref. 18: p. 3]

The next legislative COLA attention occurred in 1984. The President's budget submission included several provisions related to the military COLA. The

recommendations included repealing the OBRA 1982 measures requiring COLA delays from March to May 1984 and June 1985, and also repealing the half-COLA calculation for non-disabled retirees under age 62. Instead, the administration recommended permanently changing the effective COLA date to January 1st of each year beginning with January 1, 1985. Additionally, the administration recommended changing the COLA computation procedure. Instead of the December to December rise in CPI, the new method determined the COLA by measuring the change in the average CPI between third quarters in successive years. That is, the CPI during each of the months from June to September in one year would be averaged and then compared to the average CPI for the same months in the following year. The change between these averages would determine the COLA. [Ref. 18: pp. 2-3]

The Omnibus Reconciliation Act of 1983 (PL 98-270), passed on April 18, 1984, included these recommendations and made them law. This essentially reversed the OBRA of 1982, and in so doing eliminated the COLA in 1984. The next COLA of 3.5 percent was paid on January 1, 1985. The previous COLA had been on April 1, 1983. [Ref. 12: p. B-7, Ref. 18: p. 3]

The next scheduled COLA was to be paid on January 1, 1986. The President's budget submission in 1985 (FY 86) recommended eliminating this adjustment altogether and resuming COLAs with the January 1987 increase. Both the Senate and the House, via the final Concurrent Resolution on the Budget, rejected the President's proposal and voted to maintain the scheduled COLA. Also in 1985, the Balanced Budget and Emergency Deficit Control Act of 1985 (Gramm-Rudman-Hollings or GRH) was passed.

Provisions in this law temporarily, and later permanently, suspended the FY 1986 COLA.

[Ref. 18: p. 3]

In 1986, President Reagan, in his FY 1987 DoD Budget request, again recommended eliminating the annual COLA. Again, the House and Senate rejected these proposals. This time however, the Congress went further. The OBRA of 1986 included the requirement for full COLA payments between 1987 and 1991 even if Gramm-Rudman-Hollings sequestrations were stipulated. Later Gramm-Rudman-Hollings amendments (PL 100-119, September 29, 1987) excluded military retirement COLAs from the sequestration process. [Ref. 18: p. 5] For the remainder of the Reagan administration, the military retiree COLA remained unchanged.

The incoming Bush administration resumed the COLA assault reminiscent of the early Reagan administration. In his budget submissions for both FY 1990 and FY 1991, President Bush first proposed eliminating the January COLAs in both 1990 and 1991. Next he recommended adopting the CPI minus 1 percentage point COLA calculation for all military retirees. (CPI-1 is the COLA calculation procedure already applicable to certain military members under the Redux military retirement system described in Chapter II) These recommendations were later dropped after Congress and the President reached a budget agreement. [Ref. 18: p. 5] COLAs of 4.7 percent and 5.4 percent, respectively, were paid on both January 1, 1990 and January 1, 1991. The procedure utilized compared the average CPI increases between the third quarters in each of the years preceding the COLA. [Ref. 12: p. B-7]

The previous discussion illustrates the role COLAs have played in budget debates

since their institution and the repeal of the recomputation procedure. This debate continued with the 103rd. Congress. The table below captures the history of COLAs since the tie between active duty and retired pay was broken.

Table 4
Military Retired COLAs, 1958-1995

Date	COLA (%)	Date	COLA (%)
6/1/58	6.0	9/1/78	4.9
10/1/63	5.0	3/1/79	3.9
9/1/65	4.4	9/1/79	6.9
12/1/66	3.7	3/1/80	6.0
4/1/68	3.9	9/1/80	7.7
2/1/69	4.0	3/1/81	4.4
11/1/69	5.3	3/1/82	8.7
8/1/70	5.6	4/1/83	3.9/3.3
6/1/71	4.5	1/1/85	3.5
7/1/72	4.8	1/1/86	0.0
7/1/73	6.1	1/1/87	1.3
1/1/74	5.5	1/1/88	4.2
7/1/74	6.3	1/1/89	4.0
1/1/75	7.3	1/1/90	4.7
8/1/75	5.1	1/1/91	5.4
3/1/76	5.4	1/1/92	3.7
3/1/77	4.8	1/1/93	3.0
9/1/77	4.3	4/1/94	2.6
3/1/78	2.4	4/1/95	2.8

Source: Valuation of the Military Retirement 1994.

B. MILITARY COLAS AND THE 103RD CONGRESS

In 1993, during the FY 1994 budget debate, both the military and federal civil service COLAs came under scrutiny again. The end result was the Omnibus Budget Reconciliation Act of 1993. The OBRA of 1993 made no substantive changes to the COLA calculation procedures or eligibility requirements. Rather, it shifted the effective dates on which each of the COLAs, military and civil service, would be paid. The shift was from January first to various dates through the years 1994 to 1999. This was the first such split since 1969. An important distinction is that OBRA 1993 delayed the dates differently for military and civil service COLAs during those years, creating what many saw as an unacceptable inequity. How Congress arrived at this legislation is important in explaining how the disparity in COLAs occurred.

1. The Budget Resolution

The President's Budget submission in 1993 for FY 1994 contained no provisions or restrictions associated with the military retiree COLA. The House, however, in developing the budget resolution, included COLA adjustments as part of its package of deficit reduction. The House of Representatives Concurrent Resolution on the Budget called for changes in legislation from the Committee on the Armed Services to achieve savings of \$186 million in FY 1994 and total savings during FYs 1994-1998 of \$3.940 billion. [Ref. 19: p. 261] The Budget Committee certainly recognized that the committee with jurisdiction was free to achieve these targets in a manner they felt appropriate, but based these targets on certain legislative assumptions.

The Budget Committee's assumptions about the COLA adjustments included the following provisions. All military retiree COLA increases would be capped at \$400 for FY 1994 and the COLA would be paid on January 1, 1994. For retirees under age 62, the COLA calculation would be 50 percent of the CPI increase. Upon reaching 62 years old, there would be a one time increase or catch-up in retired pay to restore the purchasing power lost to the half-COLA. This change would be permanent. Finally, for current retirees over age 62, the COLA would be computed based on the CPI change minus 1 percent. This was not to be a permanent change and would apply only in FYs 1995-1997. [Ref. 20: p.51, Ref. 18: p. 8]

The Senate Concurrent Resolution on the Budget directed the Senate Committee on the Armed Services to report changes in authorization legislation which resulted in no reductions in outlays in either FY1994 or the period FY 1994-1998. [Ref. 21: p. 47]

At the Budget Resolution Conference, the deficit reduction targets were reduced somewhat. The Budget Conference Report required the House and Senate Armed Services Committees to report legislative changes that achieved savings of \$128 million in FY 1994 with total deficit reduction savings of \$2.361 billion for FYs 1994-1998. [Ref. 21: pp.1, 17-18]

The underlying policy assumptions in the Conference on the Budget Resolution about how these targets were to be met were directed primarily at retirees under age 62. The \$400 cap would only apply to retirees under age 62 and only in FY 1994. The COLA would be paid on January 1, 1994 and the 50 percent of CPI calculation for retirees under 62 would become permanent. The one time COLA increase at age 62 was

included as well. This half-COLA with the catch-up at age 62 is exactly the same as the House budget proposal. [Ref. 18: pp. 9-10]

The changes in these assumptions were the result of conference compromises. The conferees agreed to narrow the scope of the COLA adjustments to those under age 62 only, while reducing the savings target from the House's original \$3.940 billion to \$2.361 billion during FYs 1994-1998. [Ref. 19: p. 261, Ref. 20: pp. 17-18, Ref. 21: p. 106]

2. Armed Services Committee Action

Both the Senate and the House Armed Services Committees, under the new instructions from the Budget Resolution Conference, began deliberation to achieve the directed deficit reduction targets. In both the Senate and the House, the underlying assumptions to reduce COLAs for those under age 62 were rejected. Instead, each committee reported legislation that delayed COLAs vice reducing them.

The Senate Armed Service Committee reluctantly proposed the following COLA delays. The January 1st COLAs in FYs 1994 through 1997 would be delayed for 9 months and would be paid on October 1st. In FY 1998, the COLA would be delayed 8 months and would be paid on September 1st. Thereafter, the COLA would return to the January 1st payment schedule. In each case, the COLA would be a full COLA. There would be no reduction in the COLA computation procedure. Finally, the COLA that applies to disabled retirees and survivors would not be delayed. These recipients would receive their COLA increases on January 1st of each FY. [Ref. 23: pp. 52-54]

In delivering their report, the Senate Armed Services Committee leadership expressed their concern about both the seemingly disproportionate contribution to deficit reduction the DoD has had to bear, and the equity issue associated with delaying military retiree COLAs longer than those of other federal retirees.

The Committee makes these recommendations reluctantly. In recent years, the defense budget has made a greater contribution to deficit reduction than any other part of the budget. Indeed, defense savings represent virtually the only deficit reduction in the Budget Enforcement Act of 1990 that have actually been delivered.

In this case, the Committee had no alternative to reducing military retirement benefits in achieving its required savings, since military retirement constitutes 99 percent of the Armed Services Committee's direct spending allocation under the Budget resolution.

The members of the Armed Services Committee are concerned that the required reductions in military retirement spending will result in greater COLA delays for military retirees than for other federal retirees. COLA equity should be a basic principle and we urge the full Senate and the conferees on the Reconciliation Bill to take this into consideration.

[Ref. 23: p. 54]

The House Armed Services Committee similarly rejected the COLA reductions for retirees under age 62. The Committee felt the age distinction was inequitable. Instead, they too elected to delay the COLA application dates. The Committee recommendation called for a variable delay in the COLA application dates. This has also been referred to as a "rolling COLA." The provisions called for paying a full COLA in each year from FY 1994 to FY 1999. But the COLA effective date would be delayed 4 months in FY 1994 and three additional months in each succeeding FY. Specifically, the COLA delays would be:

1. Delay FY 1994 COLA from January 1, 1994, until May 1, 1994.
2. Delay FY 1995 COLA from May 1, 1995, until August 1, 1995.

3. Delay FY 1996 COLA from August 1, 1996, until November 1, 1996.
4. Delay FY 1997 COLA from November 1, 1997, until February 1, 1998.
5. Delay FY 1998 COLA from February 1, 1999, to May 1, 1999.

Similar to the Senate version, disabled retirees and survivors would continue to receive their COLAs on January 1st of each year. [Ref. 24: pp. 72-73] Congressional Budget Office estimates projected savings associated with these rolling delays to be \$214 million in FY 1994 and \$2.339 billion between FY 1994 and FY 1998. [Ref. 24: p.75]

3. The Omnibus Reconciliation Act of 1993

Approaching the conference on the OBRA of 1993, the House and Senate had similar proposals in that they both sought to achieve the deficit reduction targets via COLA delays. Votes in both the House and the Senate on their respective Reconciliation Bills retained the proposals of their Armed Services Committees. [Ref. 7: 51-52] There seemed to be agreement between both Armed Services Committees and various interest groups that if military retiree pay had to provide some deficit reduction, delaying the COLA was the least objectionable means of doing so. Between the alternatives, the rolling COLA proposal from the House was less desirable. The Senate version, a 9 month delay in each of the following five years seemed simpler and was favored by the various parties who testified during committee hearings. [Ref. 25: pp. 4-5]

The Budget Reconciliation conference convened between July 15 and August 2, 1993. Once the bill came out of conference, the House and Senate considered the conference report. The House passed the bill on August 5th, on a vote of 218-216. The Senate considered the measure on August 6th. The Reconciliation bill passed 51-50 with the Vice President casting the tie-breaking vote. President Clinton signed the

reconciliation bill into law (PL 103-66) on August 10, 1993. [Ref. 22: p. 108, Ref. 26: p. 1] The OBRA of 1993 was to reduce the federal deficit by \$504.8 billion in fiscal 1994-1998, with \$250.1 billion accruing from tax increases and \$254.7 from spending cuts. A fraction of those cuts--\$2.4 billion, or less than 1 percent--came from delayed military retiree COLAs. [Ref. 22: p. 124]

The COLA changes in the Reconciliation Bill were a compromise between the House and Senate versions. The final legislation delayed non-disabled military retiree COLAs in each FY from 1994 through 1998. The FY 1994 COLA would be delayed 4 months and would be paid on April 1, 1994. Thereafter, the COLAs would be delayed 9 months and would be paid on October 1st in FYs 1995-1998. [Ref. 22: p. 129] COLAs for disabled retirees and survivors were exempt from the scheduled delays and would continue to be paid on January 1st of each FY.

The deficit reduction contribution from these delays was estimated to be \$180 million in FY 1994 and \$2.358 billion in fiscal 1994-1998. [Ref. 18: p. 16] Interestingly, the OBRA of 1993 also changed the effective dates of the federal civil service retiree COLAs to achieve a contribution to deficit reduction. However, the dates were changed differently than those of military retirees. The civil service retiree COLA was delayed from January 1st to March 1st in FY 1994, 1995 and 1996 only. This was a 3 month delay for only 3 years. This created the perception of inequity which the Senate Armed Services Committee cautioned against. This issue surfaces again in the COLA debates that follow the OBRA of 1993.

COLAs, as evidenced by their history since incorporation in 1958, have been used regularly as a means of cost savings. Typically however, the adjustments have been made uniformly through both the federal civil service and military retirement plans. The principle of COLA equity between the retirement benefit plans has been both a basis and condition for many changes. With the OBRA of 1993, this equity principle was breached. This becomes an important consideration in military retiree compensation and budgeting in the following years. The next chapter explores some of the ramifications and changes that result from the dissimilar COLA delays.

V. RAMIFICATIONS OF THE 103RD CONGRESSIONAL ADJUSTMENTS

In 1995 and 1996, under pressure associated with the inequity between the federal civil service and military COLA delays resulting from OBRA of 1993, Congress moved to reverse the disparity. Since both the military and federal retirees received their COLAs on the same date in 1994, the inequity issue gained importance in the FY 1995 budget debate and continued through FY 1996. Legislation in each year moved the military COLA application date to coincide with the federal civil service COLA date. Like the budget process in 1993, the legislative adjustments to reverse the OBRA of 1993 are important in understanding the current military retirement circumstance and the role military retirement has played in recent deficit reduction activity.

A. THE COLA EQUITY PRINCIPLE

Congress treated federal civil service retirement and military retirement programs equally with respect to COLAs since 1963. By that time, both retirement programs had automatic periodic inflation adjustments based on CPI increases. When one program was changed, the other was typically changed in the same manner. [Ref. 26: p. 3] One example of this parity was the addition of the 1-percent-kicker to the COLAs of both programs in 1969. [Ref. 5: p. 494] In 1973, automatic inflation adjustments were extended to Social Security benefits as well (PL 93-66, PL 93-233). The military and civil service COLAS were identical through most years since their inception and specifically identical since 1969. Social Security COLA increases were also comparable once automatic increases took effect. Therefore, by 1973 there was an expectation that

equity among all three programs would be observed. By 1984, the mechanism and timing of COLA increases became the same for all three programs. [Ref. 26: p. 4]

With the OBRA of 1983, military retirees, civil service retirees and Social Security recipients were to receive the same COLAs at the same time. In 1985, due to GRH sequestration requirements, both the military and civil service retirement programs had that year's COLA canceled. However, Social Security recipients were exempt from the sequestration and received a COLA of 3.1 percent. This is the first breach between Social Security and the others but it's important to note that military and civil service retirees were treated the same, reinforcing the equity principle. The military and civil service retirement COLAs remained consistent until the OBRA of 1993. This was the second breach. [Ref. 27: p. 4] Consequently, there has been a principle, whether practical or legislative, of equity between the federal civil service retirement and military retirement with respect to COLAs. To a lesser extent, Social Security has also been aligned on an equity basis as well.

Numerous groups expressed their concern regarding the break with the equity principle during the legislative debate in 1994. Senator Sarbanes captured the issue well during the FY 1995 Defense Authorization Bill floor debate.

What happened in last year's budget process is that we severed a linkage between civilian and military COLA's which has existed for the past 25 years. Since 1969, military and Federal civilian retirees have received an identical COLA on the same date. With military recruitment in decline, career stability affected by force drawdown, and even more intense operational requirements on the remaining forces, I think it is very important that we not send the message that military retirees will receive disparate and unequal treatment....it really comes down to honoring commitments that have already been made.

[Ref. 28: p. S. 8076]

Senator Sarbanes reiterated a key element of the military retiree outcry about the COLA delay. Simply, the military retirees did not resent the sacrifice related to the delayed COLAs. What they thought unfair was the unequal treatment relative to the federal civilian retirees. [Ref. 28: p. S. 8076]

This became the context of the legislative debate as Congress began to redress this issue.

B. POST OBRA 1993 COLA LEGISLATION

1. Fiscal Year 1995

The COLA disparity was not addressed in the President's budget submission for FY 1995 nor were any COLA provisions included in the Congressional Budget Resolution. [Ref. 18: pp. 12-13] The debate began in the House and Senate Armed Services Committees.

First, the House Armed Services Committee approved its version of the FY 1995 Defense Authorization Bill on May 5, 1994. This version of the bill moved the date of the military COLA to coincide with the civil service COLA of April 1, 1995. This was a one year shift only. It did not move the COLA application dates in the later years addressed by the OBRA of 1993. It authorized \$376 million to fund the COLA date shift. A corresponding appropriation was still required to actually make the earlier payment possible. Finally, the committee included legislative language indicating that they would work to find a solution to the remaining COLA delays in the out years. The full House considered and passed the bill on June 9th. [Ref. 29: p. 422, Ref. 18: p. 13]

The Senate also considered the COLA disparity. The Senate Armed Services Committee reached a similar conclusion to that of the House. They agreed that the inequity should be reversed, but their approach was slightly different. In developing their Defense Authorization report to the Senate, the Senate Armed Services committee considered three alternatives. [Ref. 30: pp. 197-199]

First, they considered the House alternative of simply moving the military COLA to April 1st and authorizing the funds to pay for this move. This alternative was unpopular for several reasons. The \$376 million to pay for this shift would have to be appropriated out of the discretionary defense budget for FY 1995. This created a dangerous and, as some Senators viewed it, unacceptable precedent of diverting discretionary funds to pay for an entitlement. The second objection raised was related to rules prohibiting such a funds shift. It was noted that by increasing the COLA (the date shift results in an increase) without paying for it by a corresponding reduction in another entitlement the PAYGO (pay-as-you-go) provision of the Budget Enforcement act was violated. PAYGO requires that increases in one entitlement are paid for via offsetting reductions in another entitlement so that the net effect is deficit neutral. [Ref. 30: pp. 197-199]

The second alternative the committee considered involved delaying the civil service COLA further in order to advance the military retirement COLA. Both dates would be shifted to the same date. This approach achieved payment date equity not only in 1995 but could also be continued in the out years. The proposal delayed the civil service date and advanced the military date 3 months to July in both 1995 and 1996 and

various other dates through 1998. This alternative offered advantages the earlier one did not. It maintained the PAYGO principle, it was deficit neutral, and it did not burden the already beleaguered defense budget. The difficulty was that delaying the civil service COLA date was outside the Armed Services Committee's jurisdiction and would require Senate action to implement. A second concern was that this dual shift in COLA dates would create a rivalrous environment between benefit recipients. [Ref. 29: pp.198-199, Ref. 30: S. 8075-8081]

The third alternative considered by the Armed Services Committee was to simply advance the military COLA date to coincide with the civil service COLA date and add the cost to the deficit. This too seemed to violate the PAYGO requirements stipulated in the Budget Enforcement Act of 1990. [Ref. 30. pp. 198-199]

The Senate Armed Services Committee considered and passed their Authorization bill on June 9th by a vote of 19-3. The committee chose the second alternative and elected to delay the civil service COLA and advance the military COLA to the same date. Since the Senate Governmental Affairs Committee has jurisdiction over the civil service retirement, the Senate Armed Services Committee did not include statutory language to change the civil service retirement COLA. Instead, the Committee proposed to offer an amendment to the National Defense Authorization Bill during full Senate consideration of that bill. Before that occurred, Senator Warner of Virginia offered a different amendment (No. 2143 to the National Defense Authorization Act for FY 1995) to redress the COLA inequity. Serious debate ensued. [Ref. 18: p. 13, Ref. 29: p. S. 8075]

Senators Warner and Sarbanes coauthored the Warner Amendment, which sought to reverse the Senate Armed Services Committee proposal. The Warner Amendment was essentially identical to the House Authorization bill. The Warner Amendment called for advancing the military COLA to April 1, 1995 and authorizing the \$376 million for pay for this increase. Like the House version, the money would still have to be appropriated to make this legislation effective and the COLA increase would have to come from reductions in other defense programs. [Ref. 31: p. 1813, Ref. 28: p. S. 8075]

The Senate debate surrounding the Warner Amendment captures many of the key arguments, both pro and con, surrounding the COLA shift and COLA equity issues.

The proponents of the Warner Amendment, such as Senators Warner, Sarbanes, Glen, Roth and numerous interest groups, argued that equity for military retirees and the importance of the credibility signal it sends to current and future service members was more important than the fiscal consequences of shifting the date. The \$376 million out of an approximate \$270 billion in projected defense outlays for FY 1995 did not seem unreasonable. The COLAs for both groups had already been delayed and so the argument was only about reducing the extent of the delay for the military. Senator Sarbanes argued that this was already a compounded assault on retiree purchasing power since COLAs are retrospective, that is, the inflation has already occurred for up to 15 months before the COLA is applied. Therefore retirees continually lose purchasing power to inflation, despite the COLA.

The final argument in favor of the Warner amendment was presented in rejecting the Senate Armed Services Committee proposal to delay civil service COLAs in order to

advance the military COLA. The senators felt this would set a divisive precedent pitting one benefit recipient group against another. Both the military and civil service support organizations opposed this proposal as did the Senate Committee on Governmental Affairs (the committee with jurisdiction over civil service compensation). [Ref. 28: pp. S. 8075-8087]

The key opponents of the Warner Amendment included the Administration, Senators Nunn, Inouye and Byrd. They eloquently argued against the Warner Amendment for several reasons. First, they felt the bill set a dangerous precedent of funding an entitlement by "robbing" a discretionary account. This, they continued, would significantly undermine the PAYGO principle and in this case, further reduce the defense discretionary accounts. Senator Nunn argued that, depending on which defense accounts were reduced, the consequences could be much larger than \$376 million. Because of the long spend-out rates in various accounts, to achieve \$376 million in savings might ultimately cost significantly more. Senator Nunn suggested that to achieve \$376 million in savings would require a \$500 million reduction in Operations and Maintenance (O&M), an \$800 million reduction in Research and Development (R&D), or depending on which procurement account might be used as an offset, the cost could be billions. Finally, the opponents of the Warner Amendment argued that the ultimate result would be a shift of all the military COLA related deficit reduction of the OBRA of 1993 to the discretionary defense account. [Ref. 28: pp. S. 8077-8086]

In the end, the arguments juxtaposed equity and the fiscal need to protect discretionary defense spending. The Senate voted 88-12 on July 1, 1994 in favor of the

Warner Amendment. The Defense authorization bill moved to the Conference Committee.

The Conference Committee considered and reported the Defense Authorization legislation on August 12th. The committee adopted the House and Senate language that shifted the military COLA date to the civil service date and authorized the requisite funds. Their language included an admonishment against the use of discretionary funds to pay for an entitlement and a recommendation that an alternative be found to fund COLA disparity corrections in 1996-1998. Finally, the conference report included a Sense of the Congress statement that the effective dates of military and civil service COLAs should be the same. [Ref. 18: p. 14, Ref. 32: pp. 127-128] The House approved the conference report (H. R. 103-701) on August 17th by a 280-137 vote. The Senate passed it on September 13th by an 80-18 vote. The President signed the Defense Authorization Bill on October 5th, which then became PL 103-337. [Ref. 29: pp. 421, 425-428]

With PL 103-337, advancing the military COLA effective date successfully passed the authorization process. However, without the requisite funding, the actual payment could not be effected. Funding the shift is within the jurisdiction of the House and Senate Appropriations Committees.

The House Defense Appropriations Subcommittee agreed to the intent and principle of advancing the COLA date for military retirees but did not specifically appropriate the required \$376 million. Instead they argued that the Defense Military Retirement Fund had adequate resources to absorb the added cost. They stipulated

further that they did not believe that discretionary funds should be used to fund entitlement programs. [Ref. 33: p. 65, Ref. 29: pp. 490-491] The full House then quickly passed the Defense Appropriations bill on June 29th by a 330-91 vote. [Ref. 29: p. 488]

The Senate Defense Appropriations Subcommittee, despite previous opposition by the committee's chairman, Senator Inouye, during the Warner Amendment debate, supported the military COLA advance. They included the \$376 million appropriation required to advance the military COLA. The full Senate Appropriations Committee also included the appropriation required to advance the military COLA and passed the bill on July 29th by a vote of 30-0. [Ref. 29: p. 493, Ref. 34: p. 375] This also occurred despite the earlier opposition of Senator Byrd, Chairman of the Senate Appropriations Committee, to the Warner Amendment. [Ref. 18: p. 14] The full Senate adopted the measure on August 11th. With passage of both the House and Senate Appropriations bills, the matter was next considered in the Defense Appropriations Conference.

The conference agreement of September 26, 1994 included the appropriation to fund the shift. In so stating, the conferees made a strong statement against reductions in discretionary spending to fund entitlements. [Ref. 35: p. 164]

Under the rules of the Congressional Budget Act, correction of this disparity should be authorized in a manner that causes the increased cost to be borne through offsetting savings in other mandatory or entitlement programs. Instead, the 1995 Defense Authorization Act required the 1995 payment for military retirees to be accelerated only if paid for in the 1995 Defense Appropriations Act via reductions in other Department of Defense discretionary programs. This financing mechanism is unfortunate and unwise. It subverts the pay-as-you-go principle for mandatory and entitlement programs while hurting important defense readiness and modernization efforts.

The conferees have reluctantly agreed to fund the acceleration of the 1995 military COLA payment because the disparity between military and civilian retirees is fundamentally unfair, and other committees have refused to pay for it under the proper procedure.

The legislation also stipulated that future civilian and military COLAs be effective simultaneously providing the President, in his 1996 budget submission, proposes legislative changes that honor PAYGO principles and authorization legislation also includes appropriate PAYGO legislative changes. [Ref. 35: pp. 164-165]

The House and Senate considered and passed the conference version on September 29th and the President signed the bill on September 30th. The Defense Appropriation Bill for FY 1995 became PL 103-335. [Ref. 29: p. 488] With this new law, which synchronized the military and civil service COLA dates in FY 1995, Congress and the President reversed the first of 4 years of COLA disparity. Additionally, the law provided preliminary guidance to fix the problem again in 1995 (FY 1996) and then directed that the out year COLAs be paid simultaneously. This represented progress toward COLA equity restoration but still left the problem unresolved for FY 1996.

2. Fiscal Year 1996

The legislative activity surrounding the COLA equity issue in 1994 (FY 1995) represents to some extent, a pinnacle in military COLA activity. With the elections in 1994, the Republican Party achieved a majority in both the House and Senate of the 104th Congress. With the change in party leadership, the context of the budget debate shifted dramatically toward deficit reduction. As Senator Sarbanes indicated in the Warner Amendment debate, to achieve serious deficit reduction by engaging entitlements, health care and Social Security costs must be addressed. [Ref. 28: p. S.

8083] And so the larger debate in 1995, curtailing high end entitlement programs and achieving a balanced budget, dominated the legislative agenda. The bigger budget issues largely overshadowed smaller ones, like military COLA equity. The groundwork for the military COLA date advance had been accomplished in 1994. Congress agreed in principle and legislation that the different dates were unfair and indicated that the issue should be rectified in FY 1996 and beyond.

The Appropriations bill in 1994 (FY 1995) required that in order for the military COLA to coincide with its civil service counterpart, two things had to happen. The President had to propose legislative changes to support the COLA shift that honored PAYGO, and the authorizing committees had to do the same. [Ref. 35: p. 488]

The President's FY 1996 budget was submitted to Congress on February 6, 1995. It included a legislative proposal to shift the FY 1996 military COLA effective date to the civil service date. The budget submission also proposed that funding for the added cost come from the Military Retirement Fund. This is the same suggestion offered by the House Appropriations Committee a year earlier. [Ref. 36: pp. 377-378, Ref. 37: p. 408]

The House and Senate Budget Committees then considered their budget objective guidelines for their respective committees. The House Budget Committee did not provide specific discussion or policy assumptions regarding military COLAs. The Senate Budget Committee proposed conformance of the military and civilian retiree COLA effective dates. The budget conferees included the Senate assumptions of coincident dates in the Final Concurrent Resolution on the Budget for FY 1996. [Ref. 38: pp.14-18, 100-109, Ref. 39: p. 79]

The Concurrent Resolution on the Budget was passed on June 29th in the House by a vote of 239-194, and in the Senate by a vote of 54-46. [Ref. 40: p. 1901] Next, the respective committees considered legislative proposals to achieve the requisite deficit reduction targets specified in the budget resolution.

The House Committee on National Security, in their version of the National Defense Authorization Act, included a date shift of the military retiree COLA from October 1st to April 1st of 1996. They specifically authorized \$403 million for the Military Personnel Account to fund the date advance. However, again they found themselves committed to proposing payment for an entitlement program from discretionary funds. As in 1994, they again made a strong statement discouraging the practice. [Ref. 41: pp. 232-233]

The committee is disappointed that the President's initiative within the budget request to resolve the disparity between the two groups of retirees was proposed in such a manner as to compel the committee to once again use scarce discretionary funds to address a mandatory spending initiative. Because the committee has no ability to provide a mandatory offset for the Administration's COLA equity initiative within the 050 budget function and therefore avoid a "PAYGO" problem, under the Budget Enforcement Act, the committee has authorized \$403 million in the personnel account to restore equity in COLA payment dates. This decision once again demonstrates the committee's resolve to protect the purchasing power of military retired pay. However, the committee remains committed to seeking through the budget process a solution that does not require funding from discretionary accounts.

The full House considered and passed the National Defense Authorization Act on June 15, 1995 by a 300-126 vote. [Ref. 42: p. 1942]

The Senate Armed Services Committee also considered and incorporated a provision to shift the COLA dates. The committee recommended that the military retired

pay COLA for 1996 occur on April 1, 1996. They also indicated that future COLAs should be paid thereafter on January 1st of each year (January 1st is the permanent law normal COLA payment date). [Ref. 43: p. 257] The committee proposal was considered by the Senate and passed on September 6th. [Ref. 44: p. 3092]

The House and Senate Conference convened to consider the Defense Authorization legislation. Significant political issues, including a ban on military subsidized abortions and deployment of an anti-missile defense system, which were included in defense authorization, prolonged the conference. [Ref. 45: p. 3469] Compromise was finally reached on these matters and the committee reported legislation that addressed the COLA issue. During FY 1996, the COLA for military retirees would be paid on April 1st. If a military COLA was warranted in FY 1998, that COLA would be paid on October 1, 1998. However, if in FY 1998, civil service retirees were to receive a COLA on any date earlier than the military date, the military COLA would advance to the earlier date and would be paid at the same time.

The structure of the FY 1998 authorization language reflected uncertainty about the civil service COLA. [Ref. 46: pp. 186-187] Through separate legislation under consideration, the date of the civil service COLA might have been delayed to April 1st in FY 1998. This would have been an extension of the OBRA 1993 civilian COLA delay. The Balanced Budget Act provision for civil service COLAs proposed delaying the civilian COLAs to April 1st in each year during 1996-2002. [Ref. 47: p. 179] The House considered and passed the conference agreement on December 15th by a 267-149 vote. The Senate adopted the conference report on December 19th 51-43.

However, when the bill went to the President, he vetoed it on December 28th. His chief objections involved the anti-missile defense system included in the Authorization bill. The President felt the policy implications of an anti-missile defense system as outlined in the Authorization bill, violated the 1972 ABM (Anti-Ballistic Missile defense) Treaty. Additionally, he objected to other politically sensitive issues including a ban on military sponsored abortions and a provision requiring that AIDS-positive service members be discharged within 6 months of discovery. [Ref. 48: pp. 3897-3898]

Interestingly, although the military COLA date shift in the Authorization bill was budgetarily insignificant, it played a role in the larger debate relating to the Authorization Bill's veto. The COLA shift and the active duty pay raise were offered by the bill's proponents as an indicator of Presidential hypocrisy in the post-veto public debate. The argument was that the President, while aggressively pursuing a troop deployment to Bosnia, was willing to prolong service members' hardships by vetoing their pay raise and the retiree cola advance. [Ref. 48: p. 3897]

After the veto, the House vote to override the veto failed 240-156. [Ref. 49: p. 61] The House and Senate conferees reconvened. By January 19th, the conferees had reached an agreement they felt satisfied the President's objections. The House and Senate both passed the revised conference agreement on January 24th and 26th, respectively [Ref. 50: p. 154, Ref. 51: p. 225] The President signed the Defense Authorization Bill on February 10, 1996 [Ref. 52: p. 507].

With the Defense Authorization Bill signed on February 10, 1996, the military

COLA date shift was final. The appropriations bill required to fund the shift had already become law, without the President's signature, in December. [Ref. 53: p. 3773] But review of the FY 1996 Appropriations process aids in fuller understanding of the budget process in 1995.

The House Appropriations Committee considered the matter first. They expressed their support for the military COLA date advance. [Ref. 54: p. 20] The full House then began debate on July 31. While the House version expressed support, no specific appropriations assumptions about the military COLA date advance were included. However, politically charged funding issues, such as the purchase of additional B-2 Stealth Bombers and military-subsidized abortions, dominated the debate and delayed the vote [Ref. 55: p. 2384]. The House passed its version of the Defense Appropriations Bill on September 7, 1995. [Ref. 55: p. 2384, Ref. 56: p. 3773]

The Senate Appropriations Committee did not expressly address the COLA date shift in its DoD Appropriations Bill. However, there was language in the bill expressing the committee's intent to enhance programs that support military members and their family needs. The Senate version of the Defense Appropriations bill passed on September 8th and the bill went to conference. [Ref. 56: p. 3773]

There were two defense appropriations conferences in 1995. The military COLA advance was not specifically included in either conference report, but the final bill did appropriate funds from the military personnel account to pay retirees subject to permanent law. With an FY 1996 Authorization bill in law, this would clear the way for an April 1st payment. [Ref. 62: p. 30] The first defense appropriations conference report

failed to pass a House vote 151-267 on September 29th. Again, the major objections involved B-2 procurement and military sponsored abortion funding. [Ref. 57: p. 3013]

The conferees reconvened. The second conference reported on November 15th. The new report kept provisions to purchase more stealth bombers but softened the anti-abortion language. The revised conference report passed both the House and Senate on November 16th. The bill, which he was expected to veto, next went to the President. [Ref. 58: p. 3550]

Many Democrats expected the President to veto the Defense Appropriations Bill. However, while the President objected to both the added defense spending associated with increases for procurement and the abortion ban issue, he was also committed to provide U. S. forces to Bosnia as part of a Balkan peace agreement. Funding the peace enforcement mission required passing the Appropriations Bill. In an expression of objection, the President did not sign or veto the bill, instead allowing it to become law without his signature. This occurred on December 1, 1995. [Ref. 59: p. 3672]

Between the Appropriations and the Authorization Process, the military COLA for FY 1996 was advanced from October 1, 1996 to April 1, 1996. The COLA was 2.6 percent and was paid simultaneously to both the military and federal civil service retirees. [Ref. 60: p. 28]

Throughout the Authorization and Appropriations process, the respective committees indicated that advancing the military COLA to coincide with the federal civil service COLA would have to be paid for by reducing discretionary defense spending. However, without specific detailed committee notes, it is difficult to determine which

accounts were identified to provide the necessary funds. General statements in 1994 (FY 1995) indicated that Operations and Maintenance (O&M) provided the bulk of the funding as well as contributions from personnel account savings. [Ref. 29: p.495] This is consistent with the final spending analysis in that O&M was reduced in the final appropriation by over \$1 billion from the budget request, while the Military Personnel account remained relatively constant despite a force reduction of 85,000 service members from the 1994 level. The O&M reduction occurred while the other major spending accounts were increased. [Ref. 29: p. 489, 495]

A similar problem exists with specifically discerning where the funds came from to pay for the COLA date shift for 1995 (FY 1996). The final Appropriations language authorized spending from the Military Personnel account to fund the COLA increase. What funds, if any, were used to replenish the Military Personnel account remains difficult to track. During the COLA advance debate, two sources were referenced. First, O&M reductions provided one potential source and the proceeds from the sale of strategic reserve assets provided another. Contributions from both of these sources were enacted in the 1995 Authorization and Appropriations legislation. Specifically tracking these funds to the Military Personnel account is infeasible.

However, reductions in O&M provided over \$832 million in general savings, while sales of strategic mineral reserves was estimated to yield \$649 million in added revenue over seven years.[Ref. 62: p. 45, Ref. 63: p. 2929] Significant additional savings were anticipated from the sale of petroleum from the Naval Petroleum reserves at Elk Hills. Congressional Budget Office (CBO) estimates valued these sales at \$2.2 billion

over seven years. [Ref. 62: p.2929] These savings and additions net an adequate sum to pay for the military COLA advance, estimated to cost \$356 million for FY 1996 [Ref. 61: p. 2].

The COLA legislation following the cuts required by the OBRA of 1993 served to eliminate the disparity between the military and federal civil service retirement COLA effective dates. In the end, both programs had their effective dates shifted from January 1st, the permanent law effective date, to April 1st in both 1995 and 1996. Additionally, the 1995 and 1996 Defense Authorization bills tied the two programs together in fiscal 1998 and beyond. The current legislative effective date for both the military and civil service COLAs in FY 1997 and beyond is January 1st. [Ref. 64: p. 21] Considering the ongoing deficit reduction imperative, this issue is likely to be revisited.

The COLA debate was not the only military retirement concern facing the 104th Congress in 1995. Like the OBRA of 1993 budget process, the Concurrent Resolution on the Budget in 1995 (FY1996) provided the House Committee for National Security and the Senate Armed Service Committee new deficit reduction targets. Once again, military retirement was targeted for cuts. The next chapter addresses another military retirement initiative, "High-One," considered by Congress.

VI. PROPOSED RETIREMENT ADJUSTMENTS BY THE 104TH CONGRESS

While the 104th Congress grappled with permanently reversing the OBRA of 1993 COLA delays and finding substitute funding to pay for the date disparity reversal, another retirement-related proposal to achieve additional deficit reduction surfaced.

“High-One” as it has been termed, was a proposal that sought to change the retirement benefit formula for service members who entered service prior to September 8, 1980.

[Ref. 65: p. 18] The proposal began in May 1995 with the Senate Budget Committee and their version of the Concurrent Resolution on the Budget for FY 1996. It was defeated in September. Like the COLA debates, the High-One proposal and the ensuing debate provide an important perspective on how Congress views military retirement while pursuing its deficit reduction objectives. It also illustrates the impact an effective constituent campaign can have. This chapter describes High-One’s short but interesting legislative life.

A. HIGH-ONE

The High-One proposal sought to alter the military retirement benefit computation formula for service members who entered service prior to September 8, 1980 and retired after September 30, 1995. This population of potential retirees is governed by the Current System described in Chapter II. The procedural change proposal involved altering the retirement basis from the basic pay in the last month of service to an average of the last 12 months of basic pay. The averaged monthly basic

pay would then be included in the same computation formula for the Current System described in Chapter II.

Using an average vice the monthly basic pay in the month of retirement potentially reduces retirement expenditures by diluting the effects of various raises service members receive. There are three types of basic pay raises. These include annual CPI inflation-based raises, longevity raises and promotion raises. Under the Current System, if a service member were to receive either a longevity or an annual CPI based raise in a given month and then retire in the following month, that entire raise would be reflected in his retirement basis. Under High-One, the effect of that raise would be averaged with the previous 11 month's pay to determine the retirement basis, thereby reducing the service member's benefit and retirement expenditures. Promotion raises increase the retirement computation basis, but would be minimally influenced by High-One because most minimum time in grade requirements for promotion exceed 12 months.

The following is an example of High-One's impact on an annual raise. An E-7 who retired in February 1996 with 20 years of service would have a monthly basic pay of \$2,261. This pay includes the FY 1996 pay raise of 2.4 percent. Under the Current Plan, this would be the monthly basis for his retirement benefit. At exactly 20 years, this service member would receive 50 percent of that basis or \$1,131 per month. If this same E-7 were to retire under High-One, his computational basis would be the average of the last 12 months of basic pay. In this case, 11 months at \$2,208 and 1 month at \$2,261. The High-One computed basis would be \$2,212 and his monthly retired pay would be \$1,106. If that E-7 had received a longevity increase in January 1996, as well as the pay

raise, under High-One the computational basis would be \$2,187 with monthly retired pay or \$1,093. [Ref. 66: p. 4]

B. THE BUDGET PROCESS

1. Budget Resolution

The High-One based deficit reduction objectives were first included in the Senate version of the Concurrent Resolution on the Budget for FY 1996. The specific deficit reduction targets were \$338 million between fiscal 1996-2000, and a 7 year objective that totaled \$649 million by FY 2002. The FY 1996 High-One contribution was only \$21 million. [Ref. 67: p. 127] The House Concurrent Resolution on the Budget did not include High-One or any other military retirement adjustment assumptions as part of its deficit reduction plan. Instead, the House version called for \$2 billion in deficit reduction from the sale of Naval Petroleum Reserve assets. [Ref. 68: p. 132]

The conferees included both the House and Senate deficit reduction objectives in the Final Concurrent Resolution on the budget. The conference report retained the Senate's High-One assumptions and its specific deficit reduction targets as reported in the Senate Budget Resolution. Specifically, the \$649 million in savings through FY 2002 remained intact. The House revenue objectives from the sale of petroleum reserves was reduced in the conference report from \$2 billion to \$1,550 million. [Ref. 69, p. 50]

The conferees reported out on June 26th. Both the House and Senate approved the Conference Report on June 29th. The House and Senate Authorization Committees then had until September 22nd to report legislation that achieved the specified targets.

[Ref. 40: p. 1901] The committees responsible for High-One were the House National Security Committee and the Senate Armed Services Committee.

2. Authorization

The High-One debate began in the House National Security Committee. With an aggressive deficit reduction agenda, the Republicans reluctantly supported High-One legislation. Although they were not happy with the prospect of cutting military pensions, they felt compelled to do so because of the Budget Resolution. Rep. Fowler (R-Fla) explained “we’re caught between a rock and a hard place” when discussing High-One.

[Ref. 71: p. 2385]

Democrats on the House National Security Committee argued that High-One amounted to renegeing on a retirement contract with the more senior service members. They added that High-One was particularly troubling in that it could affect service members already committed to retire in 90 or more days, implying a more unsettling contractual breach since these service members could not extend their service to mitigate the impacts of High-One. Rep. Peterson (D-Fla), a veteran with 6 years as a Prisoner of War in Vietnam, suggested that the bill be called the “Vietnam Veterans Retirement Reduction Act” since it affected all remaining active service members from Vietnam.

[Ref. 70: p. 2385] A Democratic representative from Texas, Chet Edwards, offered an amendment to eliminate pension language from the legislation. On a party-line House National Security Committee vote of 22-29, this amendment was defeated. [Ref. 70: p. 2385]

Also included in the House National Security Committee bill was the provision to sell Naval Petroleum Reserves. This portion of the bill created little controversy.

The committee deadline to report reconciliation legislation was 6 weeks away. However, the House National Security Committee, eager to pass its reconciliation legislation before the August recess, voted on August 1st. The bill authorizing High-One retirement changes and the petroleum sales passed the House National Security Committee by a 31-21 vote. The House began its summer recess on August 4th to reconvene on September 6th. [Ref. 70: p. 2385, Ref. 71: p. 2327] During this recess, High-One political fallout began.

3. High-One Political Ramifications

During the congressional recess, an extensive campaign against High-One developed. First, the senior military leadership responded. On August 2nd, one day after the House National Security Committee vote, the Chairman of the Joint Chiefs of Staff (CJCS), General Shalikashvili, along with the Vice Chairman and the Joint Chiefs, delivered a letter to House National Security Committee Chairman, Rep. Floyd Spence and the ranking minority member, Rep. Dellums. [Ref. 72: pp. 1-2] Their letter attacked High-One on several issues. The first argument was that High-One represented an unacceptable breach of faith with people who have faithfully served their country. They insisted that "commitments must be kept." [Ref. 72: pp. 1-2]

Further, they attacked the economic assumptions of High-One's potential savings as flawed. While High-one might serve to reduce the retirement benefit, if service members elect to delay retirement and remain on active duty longer to recoup the High-

One loss, the plan might actually increase expenditures. Their example demonstrates this.

In 1995, if an E-8 with 26 years of service retired, he would receive \$1,914 per month. Under High-One, the monthly pay would be \$1,753, which represents an 8.4 percent reduction. If this E-8 delayed retirement 12 months to get the full benefit of the last raise, his monthly retired pay would grow to \$1,988 per month because of the increase for one additional year of service. This results in an added lifetime cost of \$84,000 for this service member's retirement. If the additional year of salary for this E-8 is considered, delaying retirement would add another \$49,000 in that year alone. They also argued that High-One was somewhat capricious in that it would reduce retirement pay in a variable manner from 3-8 percent depending on individual rank and time in service variance. [Ref. 72: pp. 1-2]

General Shalikashvili argued further that with the military draw down not yet finished, an incentive to delay retirement, like High-One, would be counter-productive. The alternative in the face of High-One and its incentive to delay retirement would be involuntary retirements, a prospect the CJCS considered "abhorrent." [Ref. 72: pp. 1-2]

The CJCS letter was followed immediately by an August 4th letter from Secretary of Defense Perry to House Budget Committee Chairman, Rep. Kasich. Secretary Perry also decried High-One for its impact on morale and its unprecedented abandonment of grand fathering, where retirement benefits were changed for future members but not for current members. [Ref. 73: pp. 1-2]

Both of these letters preceded a major mail and media campaign waged by active service members, various military interest groups and military retiree organizations.

[Ref. 74: p. 1] Military associations (26), veterans groups and military retiree associations composed a coalition structure called The Military Coalition to organize campaigns like the one against High-One. [Ref. 75: p. 3] In this case, they were very vocal. Their objections stressed that High-One was a breach of faith and would hurt recruiting, retention and morale. [Ref. 74: p.1, Ref. 65: p.18]

Not all the opposition was from service members and Democrats. On September 13th, in a letter to the House Republican Leadership, 71 Republicans threatened to oppose the Balanced Budget Plan if High-One was retained. Rep. Henry Bonilla (R-Tex) drafted the letter. In it he indicated that balancing the budget must be weighed against the requirement to uphold obligations. [Ref. 76: p. 3]

By the time Congress returned, the political repercussions with respect to High-One were significant. Democrats seized the issue to highlight ideological differences between the parties. President Clinton, speaking on September 2nd during a 50th anniversary ceremony marking the end of World War II, vowed not to break commitments made to our service members. [Ref. 75: p. 3]

Amazingly, there are those today who believe that in order to balance the budget it's alright to break our commitment...for men and women who have served at least 15 years. As long as I am President we are not going to break our word to members of the Armed Forces.

The Senate Majority Leader, Senator Dole came out against High-One on September 1st. In his rejection of High-One, he offered to find an acceptable alternative to achieve the requisite deficit reduction so High-One did not have to be implemented. In

a letter to Secretary of Defense Perry, Dole suggested the sale of defense related surplus military equipment. [Ref. 75: p. 3]

By early September, the Senate Armed Services Committee had not yet drafted its reconciliation legislation. Instead, the Senate Armed Services Committee decided to wait and see whether any alternative to High-One could be achieved. They delayed writing their portion of the reconciliation legislation until late September. In the meantime, the House National Security Committee began to explore alternatives to High-One.

One alternative considered that might achieve the same level of deficit reduction, thereby allowing High-One to be abandoned, was to increase commissary surcharges. Commissaries are defense subsidized grocery stores utilized by service members and retirees. The DoD surcharge expenditure, considered a mandatory entitlement expenditure, serves to reduce commodity prices charged to customers. If the defense surcharge contribution was reduced and the commissary customer surcharge portion increased, the necessary savings could be achieved. The DoD argued against this alternative, indicating it would merely shift one retirement cut to another since many retirees utilize commissaries. [Ref. 64: p. 4]

A second alternative considered was a reduction in unemployment benefits provided to separating service members. Under current law, service members who leave military service are eligible to receive unemployment benefits within 1 week of separation and the benefits last up to 26 weeks. The savings proposal recommended delaying the entitlement period from 1 to 4 weeks and shortening the eligibility period to

13 weeks, vice 26 weeks. Younger service members and their representative organizations opposed this alternative. It, too, was not adopted. [Ref. 64: p. 4]

A third alternative considered by both the House National Security Committee and the Senate Armed Services Committee involved the sale of stockpiled surplus assets. First suggested by Senator Dole, this option appeared most advantageous of the three. It permitted abandoning High-One without hurting any competing personnel programs. Further, it seemed consistent with perceptions that with the Cold War over, the requirement to maintain large stockpiles of strategic assets and minerals had been reduced. [Ref. 64: p. 4]

By September 13th, House National Security Committee Chairman Spence and Senate Armed Services Committee Chairman Thurmond had reached an acceptable alternative in order to abandon High-One and still achieve the required deficit reduction. The plan called for the sale of surplus military equipment as well as excess quantities of minerals held in strategic reserve. During a September 14th announcement, Rep. Spence said: [Ref. 77: p. 2827, Ref. 76: p. 3]

High-One will never see the light of day....My proposal will keep faith both with our men and women in uniform and with this Congress's commitment to balance the budget in seven years.

After the announcement, details still had to be resolved. The final agreement called for sales of strategic minerals such as aluminum, platinum, rubber, etc. These sales were in addition to the already agreed upon petroleum sales. Once the mineral sales were agreed upon, CBO was required to provide an estimate to ensure that the projected

revenues would achieve the necessary revenue target. The CBO estimate supported the asset sale, indicating it would achieve the required \$649 million. [Ref. 78: p. 3127]

An interesting political sidebar emerged in the announcement of the High-One alternative. Rep. Spence congratulated House National Security Committee Republicans for finding a solution. The House National Security Committee ranking minority member, Rep. Dellums, challenged Spence's announcement, indicating Republicans had only "succeeded in undoing their own work." [Ref. 63: p. 2929] Rep. Edwards, who had previously sponsored an amendment to abandon High-One, later said, "For the Republicans to take sole credit is like a physician shooting someone and then saving his life," about the Republican High-One claims. [Ref. 63: p. 2929] Spence apologized to House Democrats, next attempting to divert blame to the administration by charging that DoD had been "conspicuously unresponsive" in seeking a solution to High-One. Separately however, defense officials had worked closely with Senate Armed Services Committee members in pursuit of High-One alternatives, challenging the legitimacy of Rep. Spence's unresponsiveness claims. [Ref. 76: p. 3, Ref. 77: p. 2827]

The final legislative defeat of High-One occurred on September 20th when the House National Security Committee voted 50-0 to adopt the asset sale changes and eliminate High-One from their reconciliation legislation. With their input submitted, the final House version of the reconciliation bill, the Seven Year Balanced Budget Reconciliation Act of 1995 passed a full House vote on October 26, 1995 by a 227-203 vote. [Ref. 80: p. 3914, Ref. 81: p. 3287]

The Senate Armed Services Committee reconciliation legislation never included High-One retirement change language. Instead it included the original petroleum reserve sales and added the strategic mineral sales. The Senate Armed Services Committee voted 15-1 on September 18th. [Ref. 63: p. 2929, Ref. 79: p. 8] Their legislation was included in the final Senate version of the Balanced Budget Act of 1995. This legislation passed a Senate vote 52-47 on October 28th. [Ref. 80: p. 3914, Ref. 82: 3290]

House and Senate conferees drafted the final version of the Balanced Budget Act of 1995 and returned it to the House and Senate for final passage. Both the House and Senate passed the bill on November 17th, the House by a 237-189 vote and the Senate by a 52-47 vote. [Ref. 80: p. 3914, Ref. 84: p. 3512] However, when the bill went to President Clinton, it was vetoed on December 6, 1995. With no chance of an override, the legislation died.

One interesting side note with respect to High-One's legislative defeat occurred even prior to the House National Security Committee's September 20th vote to abandon High-One. On September 7th, the House of Representatives answered the public's outcry against High-One by including an amendment in their FY 1996 DoD Appropriations Bill. The amendment prohibited the use of funds to administer any High-One changes related to retirement. This amendment, which was included in the final Appropriations Conference Report and ultimately became law, made it fiscally impossible to implement High-One in FY 1996. [Ref. 64: p. 3, Ref. 62: p. 45]

Even before the President's veto of the Balanced Budget Act, High-One had been defeated by a concerted opposition campaign. Considering the meager deficit reduction

contribution--\$338 million in the first 5 years and only \$21 million in FY 1996-- compared to the political outcry and legislative attention required, High-One seems in retrospect to have been an impractical initiative. Additionally, the sale of military assets appears to be a limited means to achieve deficit reduction. But while they both appear to be an inefficient pursuit of deficit reduction, they clearly indicate the diligence and specificity Congress employs in performing its budget responsibilities. As pressure to achieve deficit reduction and balanced budgets continues, Congress will continue to seek new ways to accomplish its mission. As High-One demonstrates, no contribution is too small or insignificant to escape attention.

VII. CONCLUSIONS AND RECOMMENDATIONS FOR FURTHER RESEARCH

This thesis addresses military retirement reform and its contribution to deficit reduction. Specific attention focuses on legislative initiatives in both the 103rd and 104th Congresses. In 1993, the 103rd Congress achieved military-related deficit reduction through delays in implementation of COLAs for military retirees. However, the source and amount of deficit reduction turned out to be different than originally intended. Subsequent legislation achieved the same amount of deficit reduction but did so with a reduced amount accruing from the original COLA delay. Later changes shortened the entitlement delays and shifted defense entitlement deficit reduction to other accounts. So while the deficit reduction objectives were met, the impact on military retirement changed.

A second interesting situation arises when the process is viewed sequentially. The 103rd Congress sought deficit reduction by delaying COLAs. Subsequent legislative initiatives sought to retreat from these original measures while preserving the savings associated with COLA delay. The 104th Congress continued the retreat from the 9-month-military COLA delay, reducing it again to only 3 months. However, while retreating from the COLA delays and responding to new reconciliation instructions, the 104th Congress embarked on a new military-retirement-related deficit reduction initiative. So while Congress was trying to undo one military retirement benefit reduction, it embarked on yet another attempt to achieve deficit reduction by reducing military retirement. Understanding the sequence and the process helps explain this

seemingly contradictory behavior. It also provides the necessary understanding from which reasonable inferences about future military retirement legislative policy might be drawn.

A. 103RD CONGRESS

In the OBRA of 1993, Congress included both military and federal civil service COLA delays. These delays were two of the many mechanisms through which Congress sought to achieve deficit reduction in FY 1994 and beyond. Desired savings from military COLA delays totaled \$2.4 billion during fiscal 1994-1998 and \$788 million from the civil service COLA delays. [Ref. 18: p. 16] The civil service COLA delays were for only 3 months during fiscal 1994-1996. Clearly, the civil service COLA delays were of shorter duration and achieved less savings than the military COLA delay. By delaying the COLAs differently, Congress created a perceived inequity between retirement systems that had enjoyed practical and legislative parity since 1969.

This inequity became the seed of at least a partial rollback of the 1993 military retirement adjustments. The disparity between COLA dates fueled a constituent opposition campaign. Subsequently, the FY 1995 military COLA was advanced to coincide with the civil service COLA. This was a shift in the effective date of the COLA from October 1995 back to April 1995. The net result was to restore parity between the two government retirement systems. To achieve this result some of the required deficit reduction was shifted from military entitlements to discretionary defense spending, i.e., O&M and Personnel accounts.

B. 104TH CONGRESS

The 104th Congress continued the reversal of the OBRA of 1993 in 1995 (FY 1996). The military retirement COLA was again advanced, this time from October 1996 to April 1996, to coincide with the federal civil service COLA. Additionally, the later year delays from the OBRA of 1993 were also undone, replacing COLA delay reductions with other expenditure reductions and revenue measures. Since the military COLA delays were ultimately reduced from 9 months to 3 months during 3 years vice 5, their contribution to deficit reduction was reduced. The OBRA of 1993 originally anticipated \$1.22 billion in savings from delayed military COLAs through FY 1996. With the post-OBRA reversals, this total was reduced to approximately \$524 million, with the remaining deficit reduction shifted to other accounts. These offsets included O&M and Personnel reductions and revenue increases from the sale of petroleum reserves. [Ref. 18: p. 16]

While the 104th Congress was reversing the military COLA delay, a second military-retirement-related deficit reduction initiative was emerged. High-One, a proposed change to reduce retirement benefits for certain service members, was introduced with the Senate Budget Resolution of 1995. Just as the 103rd Congress had been given a deficit reduction objective in 1993, which led to the OBRA of 1993, the 104th Congress now had another deficit reduction target. The desired savings totaled \$649 million during fiscal 1996-2002. [Ref. 67: p. 127] As with the post-OBRA debates, High-One became the subject of political opposition. Unlike the COLA delays, High-One was ultimately defeated and replaced before becoming law. Sales of strategic

minerals provided the savings to replace those that would have occurred had High-One been implemented.

This sequence of events seems to present contradictory legislative behavior. However, understanding the Congressional mandate to reduce the deficit, and the budget process, helps explain these events. It also suggests the kind of pressure military retirement programs will face with continued public concern about budget deficits and the role that entitlement spending, which includes military retirement, in the growth of those deficits.

C. THE BUDGET PROCESS

Both the military retirement COLA adjustments from the OBRA of 1993 and High-One, a 1995 legislative initiative, grew out of the budget process. The Budget Committees begin the Congressional budget processes by establishing general spending and deficit reduction guidelines. In its final form, the Concurrent Resolution on the Budget Conference Report represents an agreement in general fiscal terms about what spending limits and deficit reduction targets are to be achieved. Authorizing and appropriating committees in both the House and Senate then consider legislative changes necessary to achieve the limits or reductions specified in the budget resolution.

This is what occurred in both 1993 and 1995 with respect to military retirement. The budget resolution called for cuts in mandatory spending from defense. Because most mandatory spending within the defense budget is composed of retirement expenditures, the authorization committees were forced to consider military retirement.

In 1993 the deficit reduction target was \$2.4 billion. The authorizing committees elected to delay military retiree COLAs over 5 years to achieve this target. This was the military retirement deficit reduction contribution to the OBRA of 1993. Subsequent pressure persuaded Congress to partially reverse these delays. While Congress was involved in the COLA delay rollback in 1995, new deficit reduction targets emerged from the Budget Committees.

Again engaging a deficit reduction agenda, the Budget Committees of the 104th Congress presented new deficit reduction objectives for the authorizing committees in 1995. The House National Security Committee and the Senate Armed Services Committee were tasked with achieving \$338 million in mandatory spending deficit reduction during fiscal 1996-2000. [Ref. 68: 132] This led to the High-One initiative.

In both cases, the House National Security Committee and the Senate Armed Services Committee were given deficit reduction targets from mandatory defense spending. Because the overwhelming majority of the defense spending within the committees' jurisdiction is discretionary, they were forced to focus on military retirement. The COLA reversals represent a reasonable legislative response to public feedback. Legislation was considered, adopted and when the full social and political consequences were illuminated, legislators reconsidered and chose an alternative. However, while this was ongoing, the budget process and the pressure to reduce spending, including entitlements, also continued, and the committees were required to revisit military retirement. So while events seem contradictory, they represent the legislative and budget process working within a deficit-driven environment.

Instead of suggesting a contradictory pattern, these events appropriately highlight the deficit reduction pressure Congress experiences. Additionally, they suggest the attention entitlement reform, in this case military retirement, might experience in the future. With ongoing budget and deficit reduction pressures, Congress must continue to seek methods to achieve spending and deficit reduction.

As the process is repeated again in 1996, the Senate Budget Committee gave the Senate Armed Services Committee another new deficit reduction objective of \$649 million during fiscal 1997-2002 to be achieved through mandatory spending reductions. While the committee assumptions presume that strategic mineral sales will generate the necessary revenue, the budget resolution and reconciliation process may yield different legislative initiatives. [Ref. 86: pp. 40-41] With limited mandatory spending programs within the House National Security Committee and Senate Armed Services Committee jurisdictions, military retirement may experience renewed deficit reduction attention in the coming months, demonstrating the ongoing deficit reduction pressure Congress is experiencing.

D. CONCLUSIONS

The military retirement structural reforms, including High-3, Redux, and the High-One attempt, all emerged in response to expenditure reduction pressures. Establishing the MRF represents a budgetary change designed to capture savings more immediately. And most of the COLA initiatives, including the original transition to a CPI-based COLA, represent changes designed to reduce expenditures. The pattern is clear. From 1958 through 1995, Congress has viewed military retirement as a potential

source of expenditure savings. High-One, where retirement benefit reductions were attempted while restoring a previous reduction, highlights the enormity of the deficit reduction pressure Congress is under and the contribution they see military retirement making.

Therefore, it seems a reasonable to conclude that mandatory defense spending, and more specifically, military retirement, will come under similar deficit reduction pressure in the future. The questions then become, what form of contribution military retirement might be expected to make. Past adjustments suggest that two primary forms, including more COLA adjustments and additional military retirement structural changes, are possible.

1. COLAs

The pattern and history of previous COLA changes, essentially annual adjustments or delays since 1978, suggest these types of adjustments will continue. This seems consistent with other political pressure with respect to CPI-based entitlement increases. Initiatives to reduce CPI-based increases, because of a perceived bias of the CPI to overstate inflation, have gained momentum. [Ref. 84: p. 25, Ref. 85: pp.1-6] If the CPI overstates inflation, CPI and COLA-based reforms offer significant potential savings. Considering that federal programs with automatic COLAs will account for \$518 billion in FY 1996 federal expenditures, even minor reductions in the CPI can yield potentially large savings. In FY 1996, Congress estimated that a 0.2 percent reduction in the CPI would save \$19.5 billion in fiscal 1999-2002. [Ref. 85: pp. 1-2] Certainly with ongoing deficit reduction pressure and the large potential savings from CPI reductions, it

is likely that Congress will continue to pursue such changes, military retirement benefits included.

2. Military Retirement Structural Reform

Certain aspects of structural reform, that is changing the military retirement system, suggest Congress may revisit this as a means to achieve deficit reduction. First, there has not been a structural change since 1986 suggesting this area has been overlooked in recent years. Next, considering High-One, Congress has demonstrated its willingness to attempt such a change. And finally, the accrual accounting aspect of the MRF offers a means to capture structural change savings immediately, creating another inducement for reform in light of deficit reduction pressures.

However, other aspects suggest structural reform does not offer reasonably feasible contributions to deficit reduction. First, High-One demonstrated that pressure to grandfather military retirement reform, that is, change benefits for future members only, is significant. This is based on an understanding of an implied commitment. Service members understand the benefits and any subsequent changes in mid-career are viewed as a breach of faith. They argue that doing so poses potential detriment to morale, recruiting and retention. High-3, Redux, and the High-One debate all demonstrate Congress's resolve to maintain its commitments to service members by honoring the grand fathering principle.

Therefore, any future retirement reform initiatives to contribute to deficit reduction will likely fall to future service members. While High-3 and Redux demonstrated Congress's willingness to do this, the potential savings absent radical

change suggest only marginal contributions. Consider additionally that the DoD would probably oppose such reforms. Opposition from the Defense leadership is likely to suggest that further reductions in military retirement benefits will adversely impact their ability to attract and retain high quality service personnel. And finally, the political outcry over High-One, which affected only 20 percent of forces and offered a relatively small contribution to deficit reduction from a total defense perspective, suggests that larger reforms will be more forcefully opposed. The political response to High-One would probably be mirrored in future retirement reform attempts.

Consequently, it seems reasonable to conclude that while Congress may consider future military retirement benefit reduction initiatives as a means of achieving deficit reduction, structural reform initiatives would generate stiff opposition. Further, in attempting any such change, the secondary consequences such reforms might have would have to be carefully considered. As with High-One, which was originally expected to reduce expenditures but might in practice actually have increased expenditures, future reforms would have to be similarly evaluated. Certainly the impact of change on military retirement as a force management tool would have to be considered. These considerations make the prospect of military retirement benefit changes and significant savings from military retirement reductions less probable than CPI and COLA-based reforms.

E. RECOMMENDATIONS FOR FURTHER RESEARCH

This thesis concentrated on the budgetary aspect of military retirement. Certainly, the military retirement benefit plays another important role in its use as a force management tool. Further study might evaluate what and how well defense force

structure requirements are served by the current systems. To the extent that these benefit systems are sufficient or deficient, further analysis might suggest alternative structures to more accurately achieve long-term defense manning goals.

From a budgetary perspective, additional future research might consider other retirement reforms and how they might serve to both reduce federal expenditures and enhance service member financial well-being. Suggestions include switching from the current defined benefit plans to defined contribution plans. Another possibility includes establishing tax advantaged retirement-related savings accounts similar to Individual Retirement Accounts or 401k type contribution plans. Similar initiatives have been successfully employed in the private sector and might possibly, through further study, offer insight into how Congress and the DoD might both enhance benefits and reduce expenditures.

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