

The Effect of Voluntary Financial Incentives on Separation Rates for Mid-Career Military Personnel

At the end of the 1980s, the Department of Defense (DoD) began drawing down the size of the U.S. military's active force, from a post-Vietnam peak of 2.2 million in FY 1987 to 1.6 million by FY 1997, a decline of about 25 percent. Initially, the focus of the drawdown was on cutting the number of entrants into the armed forces, but DoD also needed to reduce the number of mid-careerists. To accomplish this reduction in personnel while treating service members fairly and maintaining a high state of readiness, DoD chose to rely on voluntary rather than involuntary separations.

Between January 1992 and October 1995, DoD instituted a temporary program to offer mid-career personnel a financial incentive to separate voluntarily from the service. The Voluntary Separation Incentive/Special Separation Benefit (VSI/SSB) program was offered to individuals who possessed certain combinations of occupation, rank, and years of service. Under the program, eligible service members could choose from two alternative separation benefits. VSI offered members an annuity payable for twice as long as their years of service and equal to 2.5 percent of basic pay times years of service. SSB offered members a one-time lump sum equal to 15 percent of basic pay times years of service. Both programs required takers of the benefit to serve in a reserve component. Since the program's completion, two key policy questions have remained: Did the program induce substantial separations over and above what would normally have occurred, and did it induce more low-quality than high-quality personnel to leave?

A newly published RAND study, *An Examination of the Effects of Voluntary Separation Incentives*, found that the VSI/SSB program doubled the number of separations that would otherwise have been expected. Moreover, lower-quality personnel were more likely than high-quality personnel to accept the VSI/SSB offer, and the program doubled the separation probability among this group. These

results have implications for the establishment of a permanent separation-pay program for military personnel.

ELIGIBLE INDIVIDUALS WERE MORE LIKELY TO BE FROM CERTAIN GROUPS

The RAND study focused on the effects of the VSI/SSB program on active-duty enlisted separations from the Army. The Army provided the best data source available and also had the biggest reduction to make of any service during the drawdown: 245,000 individuals.

Using data from the first year of the program, 1992, the researchers compared the characteristics of those eligible for the benefit with those who were not. To be eligible, members had to have at least 6 years of service and could not be immediately eligible for retired pay upon separation from service. Each service defined additional, specific eligibility criteria, based on pay grade, years of service, and occupation.

About half of those in the Army with between 7 and 15 years of service during the test year were eligible for the benefit. The Army's criteria for eligibility implicitly caused some groups to be more or less likely to be eligible. Those who were eligible tended to have lower Armed Forces Qualification Test (AFQT) scores, less education, and more years in their pay grade, suggesting slower promotion times. Thus, marginal performers were more likely to be eligible for the VSI/SSB benefit.

The results also indicated that those eligible for the program differed in their demographic characteristics from those who were ineligible. Being female reduced the likelihood of being eligible by about 6 percent. Those who were 5 years older than the average age of individuals from both groups were about 15 percent more likely to be eligible, if other characteristics were held constant.

THOSE WHO TOOK THE BENEFIT HAD DIFFERENT DEMOGRAPHIC CHARACTERISTICS FROM THOSE WHO DIDN'T

The analysis showed that, of those eligible for the program, those who took the benefit were more likely to be lower-quality personnel than those who did not. Those without a high school diploma were 19 percent more likely to take VSI/SSB than were those with a diploma, and those in the bottom half of the AFQT distribution were 6 percent more likely to take the benefit. Those with an additional year in their grade were 8 percent more likely to take the benefit. To assess the inducement effect of the program, researchers compared the separation behavior of those who were eligible with that of those who were not eligible in 1992. The separation choices of both groups were also compared with those of similarly defined groups in a pre-drawdown year: 1989.

Several demographic differences were found among takers and nontakers. Blacks were about 8 percent less likely to take the benefit than non-Hispanic whites, while eligible Hispanics and Asians were 11 percent less likely than eligible non-Hispanic whites. Although females were less likely to be eligible for VSI/SSB, those who were eligible were 4 percent more likely to take it than were eligible males. Taker rates differed significantly by occupation. Within a particular rank, taker rates tended to decline with years of service.

The study predicted that the taker rate would have been lower had those who were ineligible been offered the VSI/SSB option. Given the demographic characteristics of ineligible personnel, just over 21 percent were predicted to have taken the VSI/SSB offer, a figure smaller than the actual taker rate of the eligible group, which was almost 32 percent.

These results indicate that the Army chose eligibility criteria in such a way that a high rate of acceptance of the VSI/SSB offer was achieved.

THE PROGRAM INCREASED SEPARATION RATES, ESPECIALLY AMONG LOWER-QUALITY PERSONNEL

When other observable characteristics are held constant, the VSI/SSB program was shown to increase separa-

tion rates among both high-quality and low-quality personnel:

- For high-quality personnel, the VSI/SSB program increased the probability of separation by 10 percentage points from what it would have been without the program.
- For lower-quality personnel, the program more than doubled the separation probability, from about 13 to more than 29 percent, a 116-percent increase.
- Across both low-quality and high-quality personnel, the program increased the separation probability by more than 13 percentage points—a 100-percent increase over the separation rate without the program.

These results are consistent with the results of pre-drawdown studies of the effect of Selective Reenlistment Bonuses on retention rates. The similarity in estimates of retention found in the current study and those of previous studies suggests that the current study was successful in disentangling the effects of the VSI/SSB program on separations from the effects of the drawdown in general.

CONCLUSION

The RAND study provides insights into how a voluntary separation-pay program might provide an alternative to the current military retirement system or be used in conjunction with the current system to induce members to choose separation times other than 20 years of service. The study suggests that, during the VSI/SSB program, lower-quality personnel viewed their future career opportunities in the Army as being more limited as a result of the drawdown and the Army's tighter up-or-out rules.

Thus, the results indicate that it is possible to design a separation-pay program that will successfully target lower-quality and marginal performers. To the extent that the researchers successfully controlled for the effects of the drawdown, the findings can also be applied more broadly, suggesting that it is possible to design a permanent separation-pay program for military personnel.

RAND research briefs summarize research that has been more fully documented elsewhere. This research brief describes work done for the National Defense Research Institute; it is documented in An Examination of the Effects of Voluntary Separation, by Beth Asch and John T. Warner, MR-859-OSD, 2001, 56 pp., \$7.50, ISBN: 0-8330-2566-X, available from RAND Distribution Services (Telephone: toll free 877-584-8642; FAX: 310-451-6915; or Internet: order@rand.org). Abstracts of all RAND documents may be viewed on the World Wide Web (<http://www.rand.org>). Publications are distributed to the trade by NBN. RAND® is a registered trademark. RAND is a nonprofit institution that helps improve policy and decisionmaking through research and analysis; its publications do not necessarily reflect the opinions or policies of its research sponsors.

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