

CRS Issue Brief for Congress

Received through the CRS Web

Military Retirement: Major Legislative Issues

Updated January 2, 2002

Robert L. Goldich
Foreign Affairs, Defense, and Trade Division

CONTENTS

SUMMARY

MOST RECENT DEVELOPMENTS

BACKGROUND AND ANALYSIS

Military Retirement: Key Elements and Issues

- Military Retirement: Conceptual and Political Setting

- Military Retirement: Program Summary

- “Redux”: Its 1986 Enactment and 1999 Repeal

- Entitlement to Retired Pay and Retired Pay Computation Base

- Retired Pay Computation Formula

- Temporary Early Retirement Authority (TERA)

- Military Retired Pay and Social Security

Modifying 20-Year Retirement

Retired Pay and Survivor Benefit COLAs

- What Was the Last COLA, and What is the Next COLA Likely to Be?

- Pre-August 1, 1986 Entrants

- Entrants On or After August 1, 1986

- COLA Miscalculation of December 1999/January 1, 2000

Military Retirement Budgeting and Costs

- Accounting for Military Retirement in the Federal Budget

- Unfunded Liability

- Military Retirement Cost Trends

Concurrent Receipt of Military Retired Pay and VA Disability Compensation

- Military Disability Retirement and VA Disability Compensation: Definitions and Interactions

- The Alleged “Surplus” in the Military Retirement Fund and Concurrent Receipt

- Financing Concurrent Receipt through Increased Amortization Payments to the Military Retirement Fund

- 107th Congress Action and Executive Branch Views on Concurrent Receipt

- Costs of Concurrent Receipt

- Pros and Cons of Concurrent Receipt

Military Retirement: Major Legislative Issues

SUMMARY

The military retirement system includes benefits for retirement after an active or reserve military career, disability retirement, and survivor benefits for eligible survivors of deceased retirees.

The proposed change to the system generating the most current legislative activity involves whether some or all military retirees should be allowed to receive both military retired pay and any VA disability compensation to which they are otherwise entitled; this is referred to as “concurrent receipt.” A longer-term issue beginning to attract some attention is whether some military personnel should be entitled to military retired pay with less than 20 years of service and whether many more personnel should serve well past the 20-year point before retiring.

Concurrent Receipt. Current law provides that military retired pay be reduced by the amount of VA disability compensation. Some maintain this is inequitable and unfair; it has been defended on grounds of cost and of the need to avoid setting a precedent for concurrent receipts of numerous other benefits.

Provisions of the FY2000 and FY2001 National Defense Authorization Acts authorized military non-disability and disability retirees with at least a 70% VA disability rating to receive a special payment, in effect a *de facto* kind of concurrent receipt, although the actual law banning concurrent receipt is still in effect.

Some recent assertions that there is a “windfall,” or “surplus,” in the Military Retirement Fund that could pay for some concurrent receipt costs are not valid; they are based on an incorrect understanding of how the amount of money in the Fund is determined.

Legislation to authorize concurrent receipt has been the object of intense legislative controversy since the early 1990s. A key issue is cost, which for a liberal concurrent receipt statute could be, according to the Congressional Budget Office, about \$3 billion annually. The FY2002 National Defense Authorization Act authorizes concurrent receipt only if the President submits authorizing legislation to do so as part of an annual DOD budget request, and if Congress passes legislation to offset the “PayGo” costs of the initiative; if the latter is not done, it would expand the scope and amounts of the “special compensation” to severely disabled retirees if concurrent receipt is not authorized..

Changing the 20-Year Retirement Paradigm. For more than 30 years, some have argued that requiring military personnel to serve at least 20 years before being eligible for retirement but encouraging most to retire at or shortly after reaching the 20-year mark is inefficient and expensive. Others have argued that it is essential to maintaining a high-quality career force capable of meeting wartime requirements. Senior defense officials of the current Bush Administration have stated in recent months that the 20-year retirement norm should be considerably modified, but one senior official has cautioned that any such change should not affect those personnel currently serving.

MOST RECENT DEVELOPMENTS

On January 1, 2002, the retired pay of military retirees was increased by a 2.6% COLA.

BACKGROUND AND ANALYSIS

Military Retirement: Key Elements and Issues

Military Retirement: Conceptual and Political Setting

Congress confronts both constituent concerns and budgetary constraints in considering military retirement issues. The approximately 2.0 million military retirees and survivor benefit recipients have been, and continue to be, an articulate and well-educated constituent group familiar with the legislative process and represented by associations staffed with military retirees with long experience in working with Congress. In recent years, the long-standing efforts by military retirees and their associations to secure more benefits for their members have been buttressed by (1) the outpouring of nation-wide nostalgia and support for the past heroism and current old-age needs of the “greatest generation” of World War II-era veterans, whether retirees or not; (2) concern over problems the military services were having in recruiting and retaining sufficient numbers of qualified personnel, which began in the mid-1990s, and the extent to which actual or perceived inadequacies in retirement benefits may have been contributing to these problems; and (3) the impression by many current or former military personnel that the Clinton Administration was not favorably disposed toward the military as an institution.

In general, in recent years Congress has been more aggressive than the executive branch in responding to the stated concerns of retirees about their benefits; the Department of Defense (DOD) and other executive branch agencies have, over time, tended to regard military retirement benefits as a place where substantial budgetary savings could be made. As noted below, Congress took the initiative in 1999 to repeal the “Redux” cuts in future military retired pay that was originally enacted in 1986.

Military Retirement: Program Summary

In FY2002, total federal budget outlays for military retirement will be an estimated \$35.0 billion and DOD budget outlays will be an estimated \$11.8 billion. (The differing figures for total federal and DOD outlays result from the use of the accrual method in accounting for the costs of military retirement. See the section below on Cost Data for a discussion of accrual accounting.) **Table 1** shows the estimated numbers of retirees and costs of their retired pay for FY2000-FY2002.

**Table 1. DOD Retired Military Personnel and Survivors:
Estimated Numbers and Costs, FY2000-FY2002**

	Total	Retirees from an Active Duty Military Career	Disability Retirees	Reserve Retirees	Survivor Benefit Recipients
FY2002	1,989,000/ \$34.99 billion	1,370,000/ \$28.98 billion	98,000/ \$1.31 billion	239,000/ \$2.60 billion	282,000/ \$2.10 billion
FY2001	1,974,000/ \$33.95 billion	1,366,000/ \$28.13 billion	100,000/ \$1.33 billion	237,000/ \$2.51 billion	270,000/ \$1.98 billion
FY2000	1,960,000/ \$32.93 billion	1,363,000/ \$27.28 billion	104,000/ \$1.35 billion	235,000/ \$2.44 billion	258,000/ \$1.86 billion

Sources: Office of the Actuary. Department of Defense. *Valuation of the Military Retirement System. September 30, 1999:* K-8, K-10, K-14, K-16, L-2, and L-4.

“Redux”: Its 1986 Enactment and 1999 Repeal

Cuts in retired pay for future retirees were enacted in the Military Retirement Reform Act of 1986 (P.L. 99-348, July 1, 1986; the “1986 Act,” now referred to frequently as the “Redux” military retirement system). Although enactment of Redux in 1986 represented a success for those who argued that the pre-Redux system was too generous, the repeal of compulsory Redux in late 1999 by the FY2000 National Defense Authorization Act indicated that, at least in Congress, those who defend the pre-Redux system are again ascendant.

Congress began taking notice publicly of potential problems related to Redux in 1997, well before the executive branch addressed the issue. During the fall of 1998, the Administration announced that it supported Redux repeal. Eventually, the FY2000 National Defense Authorization Act contained provisions for repealing compulsory Redux; it allows post-August 1, 1986 entrants to retire under the pre-Redux system or opt for Redux plus an immediate \$30,000 cash payment(see below).

Entitlement to Retired Pay and Retired Pay Computation Base

A service member becomes entitled to retired pay upon completion of 20 years of service, regardless of age. (The average nondisabled enlisted member retiring from an active duty military career in FY2000 was 42 years old and had 22 years of service; the average officer was 47 years old and had 24 years of service.) A member who retires from active duty is paid an immediate monthly annuity based on a percentage of his or her retired pay computation base. For persons who entered military service before September 8, 1980, the retired pay computation base is final monthly basic pay being received at the time of retirement. For those who entered service on or after September 8, 1980, the computation base is the average of the highest 3 years (36 months) of basic pay. (Basic pay is one component of total Regular Military Compensation, or RMC, which consists of basic pay, housing and subsistence allowances, and the federal tax advantage that accrues because the allowances are not taxable. Basic pay comprises approximately 70% of the total for all

retirement eligibles—75% for 30-year retirees and 66% for 20-year retirees. Thus, the 20-year retiree may get 50% of retired pay computation base upon retirement, but only 33% of RMC. The 30-year retiree will receive 75% of the computation base, but only 56% of RMC. Nor do any of these calculations include any of the many special pays, bonuses or other cash compensation to which many military members are entitled.)

Retired Pay Computation Formula

Military Personnel Who First Entered the Service before August 1, 1986.

All military personnel who first entered military service **before** August 1, 1986, have their retired pay computed at the rate of 2.5% of the retired pay computation base for each year of service. The minimum amount of retired pay to which a member entitled to compute his or her retired pay under this formula is therefore 50% of the retired pay computation base (20 years of service X 2.5%). A 25-year retiree receives 62.5% of the computation base (25 years of service X 2.5%). The maximum, reached at the 30-year mark, is 75% of the computation base (30 years of service X 2.5%).

Military Personnel Who First Entered the Service on or after August 1, 1986. Personnel who first enter service **on or after** August 1, 1986, in accordance with the provisions of the FY2000 National Defense Authorization Act, are required to select one of two options in calculating their retired pay within 180 days of reaching 15 years of service:

Option 1: Pre-Redux. They can opt to have their retired pay computed in accordance with the pre-Redux formula, described above, but with a slightly modified COLA formula, which is less generous than that of the pre-Redux formula (see below, under COLAs).

Option 2: Redux. They can opt to have their retired pay computed in accordance with the Redux formula and receive an immediate \$30,000 cash bonus.

The Redux Formula: Under Age 62 Retirees. Redux is different from the previous formula in two major ways. First, for retirees under age 62, retired pay will be computed at the rate of 2.0% of the retired pay computation base for each year of service through 20, and 3.5% for each year of service from 21-30. Under this new formula, therefore, a 20-year retiree will receive 40% of his or her retired pay computation base upon retirement (20 years of service X 2.0%), and a 25-year retiree will receive 57.5% of the computation base [(20 years of service X 2.0%) + (5 years of service X 3.5%)]. A 30-year retiree, however, will continue to receive 75% of the retired pay computation base [(20 years of service X 2.0%) + (10 years of service X 3.5%)]. The changed formula, therefore, is “skewed” much more sharply in favor of the longer-serving military careerist, theoretically providing an incentive to remain on active duty longer before retiring.

The Redux Formula: Retirees 62 and Older. Second, when a retiree reaches age 62, his or her retired pay will be recomputed based on the old formula — a straight 2.5% of the retired pay computation base for each year of service. Thus, beginning at 62, the 20-year retiree receiving 40% of the computation base for retired pay, according to the new formula, will begin receiving 50% of his or her original computation base; the 25-year retiree’s annuity will jump from 57.5% of the original computation base to 62.5%; and the 30-year retiree’s annuity, already at 75% of the original computation base under both the old and new

formulas, will not change. (Note: this change is an increase in monthly retired pay, not a lump sum at age 62.)

Temporary Early Retirement Authority (TERA)

The FY1993 National Defense Authorization Act (Sec. 4403, P.L. 102-484) granted temporary authority (now scheduled to expire on September 30, 2001) for the services to offer early retirements to personnel with more than 15 but less than 20 years of service. The retired pay is calculated in the usual ways except that there is an additional reduction of one percent for every year of service below 20. Part or all of this latter reduction can be restored if the retiree works in specified public service jobs (law enforcement, firefighting, education, and the like) during the period immediately following retirement, until the point at which the retiree would have reached the 20-year mark if he or she had remained in the service.

Military Retired Pay and Social Security

Military personnel do not contribute a percentage of their salary to help pay for retirement benefits. They have paid taxes into the social security trust fund since January 1, 1957, and are entitled to full social security benefits based on their military service. Military retired pay and social security are not offset against each other; military retirees receive full social security benefits in addition to their military retired pay.

Modifying 20-Year Retirement

For more than 30 years, the military retirement system, in particular, its central feature of allowing career personnel to retire at any age with an immediate annuity upon completing 20 years of service, has been the object of intense criticism and equally intense support among military personnel, politicians, and defense manpower analysts. Critics of the system have periodically alleged, since its basic tenets were established by legislation enacted in the late 1940s, that it costs too much, has lavish benefits, and contributes to inefficient military personnel management by inducing too many personnel to stay until reaching the 20-year mark and too few to stay substantially beyond the 20-year mark. At present, they say, too few people are willing to make the commitment to stay the full 20 years, causing DOD to lose too many talented people in the 8-12 year range. In addition, the requirement for officers to perform a certain amount of joint (interservice) duty, plus acquiring a well-rounded competence in their own services' capabilities, has created a situation in which 20 years is simply not enough time for an officer to serve in enough jobs to learn all that is needed to prepare for higher command and staff duties. This suggests the need for more officers to serve well past 20 years.

Others have strongly defended the existing system as essential to recruiting and maintaining sufficient high-quality career military personnel who could withstand the rigors of wartime service if necessary. They tend to agree with the statement that "20-year retirement makes up with power what it lacks in subtlety," by providing a 20-year "pot of gold at the end of the rainbow." Without the latter, it is argued, too few personnel would be willing to put up with the great stresses of a military career. At the same time, the incentive to depart soon after reaching the 20-year mark supposedly prevents the armed forces from

being saddled with over-age and unfit officers and NCOs, a major problem in the early stages of both World Wars, before 20-year retirement was adopted after World War II (1941-1945). It is also suggested that DOD already has the tools to cope with the problems of insufficient retention of middle-grade personnel and with overloaded officer career patterns: the former by using special pays and bonuses and adequate overall military compensation and the latter by exercising existing discretionary authority in statute to keep more personnel on active duty well past the 20-year mark.

Secretary of Defense Rumsfeld has suggested on several occasions that the existing 20-year retirement paradigm should be changed. He has also cautioned, however, that he does not want to cause undue alarm, or negate individual career decisions already made, by introducing such changes too abruptly. The Undersecretary of Defense for Personnel and Readiness, David Chu, has stated that senior leadership in DOD is leaning strongly toward ending the 20-year military retirement norm and replacing it with a system that would allow people to vest in retirement benefits earlier and encourage others to serve longer than 20 years. These are the most vigorous endorsements of such changes from the senior civilian leadership of DOD in well over 20 years. At the same time, Charles Abell, the Assistant Secretary of Defense (Force Management Policy) and therefore the senior manpower official of DOD, cautioned that “My recommendation would be that we not do anything that would reduce the benefit of those currently serving”—i.e., that he would prefer that such changes be fully “grandfathered.”

The issue of the 20-year retirement paradigm is discussed at length in CRS Report 95-1118, *Military Retirement and Personnel Management: Should Active Duty Military Careers be Lengthened?*

Retired Pay and Survivor Benefit COLAs

Military retired pay is protected against inflation by statute (10 USC 1401a). The Military Retirement Reform Act of 1986, in conjunction with recent changes in the FY2000 National Defense Authorization Act, provides for COLAs as indicated below. Congress has not modified the COLA formula since FY1996 (1995), although virtually every year since 1982 some COLA modifications—always with the aim of reducing costs, and hence the payments to retirees—have been at least discussed. Therefore, it is probably inadvisable to assume at any time that COLAs will be totally off the table in future Congresses. For further information on COLAs, see CRS Report 98-223, *COLAs for Military Retirees: Summary of Congressional and Executive Branch Action, 1982-2000 (FY1983-FY2001)*.

What Was the Last COLA, and What is the Next COLA Likely to Be?

The most recent military retirement COLA was **2.6%**, first applied to the retired pay disbursed on **January 1, 2002**. The most recent previous COLA was that of January 1, 2001, of 3.5%. For a discussion of proposed and actual COLA changes over the past 20 years, see CRS Report 98-223, *COLAs for Military Retirees: Summary of Congressional and Executive Branch Action, 1982-2000 (FY1983-FY2001)*.

Pre-August 1, 1986 Entrants

For military personnel who first entered military service before August 1, 1986, each December a cost-of-living-adjustment (COLA) equal to the percentage increase in the Consumer Price Index (CPI) between the third quarters of successive years will be applied to military retired pay for the annuities paid beginning each January 1. For example, assume that the Consumer Price Index rises from 400.0 in September 2005 to 412.0 in September 2006, an increase of 12.0 points or 3.0% of 400.0. The monthly retired pay that accrues during December 2006, and will actually be paid to retirees on January 1, 2007, would be increased by 3.0% above that amount paid the previous month.

Entrants On or After August 1, 1986

For those personnel who first entered military service on or after August 1, 1986, the FY2000 National Defense Authorization Act provides that their COLAs will be calculated in accordance with either of two methods, as noted below.

Non-Redux Recipients. Those personnel who opt to have their retired pay computed in accordance with the pre-Redux formula will have their COLAs computed as described above for pre-August 1, 1986 entrants.

Redux/\$30,000 Cash Bonus Recipients. Those personnel who opt to have their retired pay computed in accordance with the Redux formula, and receive the \$30,000 cash bonus, will have their COLAs computed as follows. Annual COLAs will be held to one percentage point below the actual inflation rate for retirees under age 62. Retirees covered by this new COLA formula would thus receive a 2.0% increase (rather than 3.0%) in their military retired pay under the hypothetical example described in the above paragraph. When a retiree reaches age 62, there will be a one-time recomputation of his or her annuity to make up for the lost purchasing power caused by the holding of COLAs to the inflation rate minus one percentage point. This recomputation will be applied to the old, generally more liberal retired pay computation formula on which retirees 62 or older will have their annuities computed (see the above subsection entitled Retired Pay Computation Formula), compounding, for most retirees, the size of this one-time annuity increase. After the recomputation at 62, however, future COLAs will continue to be computed on the basis of the inflation rate minus one percentage point.

Costs and Benefits of the Two Retirement Alternatives. An analysis of the economic effects for hypothetical retirees indicates that in almost all cases opting for the pre-Redux formula will pay the individual much more over time. A report of the Center for Naval Analyses states that the more liberal retired pay computation formula and COLA formula of pre-Redux far outweighs the short-term benefits of a \$30,000 pre-tax cash bonus. The report did say that it might be possible for an individual investor to “beat” these negative aspects of the bonus by wise investment decisions but that it would be difficult. Naturally, no study can know what an individual’s financial situation is.

The House version of the FY2002 National Defense Authorization Act (H.R. 2586, H.Rept. 107-194) contains a provision that would allow the \$30,000 bonus to be received in two, three, four, or five installments rather than a lump sum, thus potentially lowering the “tax bite” of the total amount.

COLA Miscalculation of December 1999/January 1, 2000

DOD is making small payments to military retirees to correct a small miscalculation the Bureau of Labor Statistics (BLS) made when it figured the COLA that was first paid on January 1, 2000. The figures provided by BLS, when applied to the COLA calculation formula, produced a January 1, 2000 COLA of 2.4%. However, it was later discovered that the COLA should have been 2.5%. To correct this problem (which applied to a wide variety of other federal payments as well, such as civil service retirement and Social Security), DOD is making special payments to the affected individuals in December 2001. The payments range between \$24 and \$100. In addition, all COLA calculations made since the erroneous one will be adjusted to avoid future underpayments.

Military Retirement Budgeting and Costs

Accounting for Military Retirement in the Federal Budget

All DOD budgets through FY1984 reflected the costs of retired pay actually being paid out to personnel who had already retired. Congress simply appropriated the amount of money required to pay current retirees each year. Since FY1985, the “accrual accounting” concept has been used to budget for the costs of military retired pay. Under this system, the DOD budget for each fiscal year reflects the estimated amount of money that must be set aside and accrued at interest – actually, invested in special, non-marketable U.S. government securities similar in some ways to Treasury bills and bonds – to fund the retired pay to which persons currently in the Armed Forces during that fiscal year, and who ultimately retire, will be entitled in the future. These estimated future retirement costs are arrived at by making projections based on the past rates at which active duty military personnel stayed in the service until retirement, and on assumptions regarding the overall U.S. economy, such as interest rates, inflation rates, and military pay levels. These DOD budget outlays for retirement are computed as a percentage of a fiscal year’s total military pay costs for each military service. Approximately 35-40% of military basic pay costs must be added to the DOD personnel budget each fiscal year to cover the future retirement costs of those personnel who ultimately retire from the military.

DOD budget outlays in each fiscal year that pay for the estimated cost of future retirees are transferred in a paper transaction to a Military Retirement Fund, located in the Income Security Function of the federal budget. The Military Retirement Fund also receives [paper] transfers from the General Fund of the Treasury to fund the initial unfunded liability of the military retirement system. This is the total future cost of military retired pay that will result from military service performed prior to the implementation of accrual accounting in FY1985. Money is disbursed from this Military Retirement Fund to current retirees. Individual retirees continue to receive their retired pay from DOD finance centers. Technically, however, because this money paid to individuals comes not from the DOD budget, but from the Fund, it is paid out by the Income Security function of the federal budget. Actual payments to current retirees thus show up in the federal budget as outlays from the federal budget as a whole, but not from DOD. Under accrual accounting, therefore, total federal outlays for each fiscal year continue to reflect only costs of payments to military members who have already retired, as was the case before accrual accounting began. Accrual accounting only changes

the manner in which the federal government accounts for military retired pay; it does not affect actual payments to individuals in any way.

Unfunded Liability

Current debates over both federal civilian and military retirement have included some discussion of the “unfunded liability” of both. As noted above, the military retirement system’s unfunded liability consists of future retired pay costs incurred before the creation of the Military Retirement Fund in FY1985. These obligations are being liquidated by the payment to the Fund each year of an amount from the General Fund of the Treasury, and will be fully paid, based on current calculations, by FY2043. The unfunded liability at the end of FY2000 was \$516.2 billion; the estimated liability for FY2001 is \$531.4 billion; and the FY2002 estimate is \$546.9 billion.

Some concerns have been voiced about the amount of unfunded liability. However, (1) the hundreds of billions of dollars of unfunded liability is a cumulative amount to be paid to retirees over about the next 50 years, not all at once; (2) by the time some persons first become eligible for retired pay under the pre-accrual accounting system, many others will have died; and (3) unlike the private sector, there is no way for employees to claim immediate payment of their future benefits. An analogy would be that most homeowners cannot afford to pay cash for a house, so they get a mortgage. If the mortgage had to be paid in full, almost no homeowners could afford to do so. However, spread out over 30 years, the payments are affordable. Similarly, the unfunded liability of federal retirement programs is affordable when federal retirement outlays are spread over many decades.

Military Retirement Cost Trends

Because military retirement is an entitlement paid to individuals, rather than a discretionary program, the retirement costs to the *total federal budget* (payments to current retirees and survivors) always rise modestly each year, to deal with an easily-predictable slow rise in the number of retirees and survivors. The cost to the DOD budget (estimated future retirement costs of current active and reserve personnel) declined after FY1989 (the beginning of the post-Cold War drawdown), as the size of the force — and hence, the number of people who will retire from it in the future — declined. However, as the drawdown stabilized, so did the DOD budget costs of retirement. **Tables 2 and 3** indicate the costs of military retired pay in terms of both federal budget outlays (payments to current retirees) and Department of Defense accrual outlays (money set aside to fund future retirees).

Table 2. Military Retirement: Total Federal Budget Outlays
(billions of current dollars)

Estimated FY2002	\$35.0
Estimated FY2001	34.0
Actual FY2000	32.9
Actual FY1999	32.1
Actual FY1998	31.1

Table 3. Military Retirement: Accrual Outlays from DOD Budget
(billions of current dollars)

Estimated FY2002	\$11.8
Estimated FY2001	11.4
Actual FY2000	11.6
Actual FY1999	10.4
Actual FY1998	10.4

Concurrent Receipt of Military Retired Pay and VA Disability Compensation

Many would argue that the most controversial military retirement issue that is currently the object of intense congressional interest is that involving concurrent receipt of military retired pay and Department of Veterans' Affairs (VA) disability compensation. Current law requires that military retired pay be reduced by the amount of any VA disability compensation received. For several years some military retirees have sought a change in law to permit receipt of all or some of both, and legislation to allow this has been introduced during the past several Congresses. This issue is frequently referred to as "concurrent receipt," because it would involve the simultaneous receipt of two types of benefits.

The **FY2000 and FY2001 National Defense Authorization Acts** authorized what is, in effect, *de facto* concurrent receipt for severely disabled military retirees. Monthly payments of \$100 are authorized for military retirees, both disability and nondisability, with 70% or 80% VA disability; \$200 for 90% VA disabled retirees; and \$300 for 100% VA disabled retirees, if the disability rating was received from the VA with four years of retiring from military service (Sec. 658 of the FY2000 Act and Sec. 657 of the FY2001 Act). The existing concurrent receipt restrictions remain in effect, and this special pay is taxable. Eligible personnel need not apply for the pay; their eligibility is identified by DOD and VA computers automatically. About 20,000 retirees qualified for these special payments as defined in the FY2000 and FY2001 laws.

Military Disability Retirement and VA Disability Compensation: Definitions and Interactions

Military Disability Retirement. To qualify for military disability retirement, a military member must be certified as permanently disabled by a DOD medical examination. The individual must have (1) at least 20 years of service, **or** (2) a disability of at least 30%

and have a disability incurred on active duty. That is, personnel with a disability rated at 30% or more by DOD, but who have less than 20 years of service, can be retired on disability (there is no minimum limit). Similarly, personnel with disability of less than 30% can be retired on disability as long as their disabling condition was incurred while on active duty.

Disability retired pay is computed on the basis of one of two formulae, whichever is more advantageous to the individual: (1) 2.5 % of the retired pay computation base for each year of service (which is, of course, identical to the non-disability retired pay computation formula described above) or (2) the retired pay computation base multiplied by the percentage of disability. DOD makes a determination of eligibility for disability retirement only once, at the time the individual is separating from the service. Although DOD uses the VA schedule of types of disabilities to determine the percentage of disability, DOD measures disability, or lack thereof, against the extent to which the individual can or cannot perform military duties, rather than his or her ability to perform post-service civilian work. A military retiree, regardless of his or her DOD disability status immediately upon retirement, can apply for VA disability compensation at any time after leaving active military duty.

Military disability retired pay computed according to the percentage of disability formula is fully taxable unless the person first entered the service after September 25, 1975, or the disability was combat-related. Disability retired pay computed according to the length-of-service formula (i.e., the formula that is the same as non-disability retirement) taxable to the extent to which it exceeds what the retiree would be entitled to if he or she had retired under the percentage-of-disability formula.

VA Disability Compensation. To qualify for VA disability compensation, a determination must be made by the VA that the veteran sustained a particular injury or disease, or had a preexisting condition aggravated, while serving in the Armed Forces. Some exceptions exist for certain conditions that may not have been apparent during military service but which are presumed to have been service-connected. The VA has a scale of 10 ratings, from 10% to 100%, although there is no special arithmetic relationship between the amount of money paid for each step. Each percentage rating entitles the veteran to a specific level of disability compensation. In a major difference from the DOD disability retirement system, a veteran receiving VA disability compensation can ask for a medical reexamination at any time (or a veteran who does not receive disability compensation upon separation from service can be reexamined later). All VA disability compensation is tax-free.

Interaction of DOD and VA Disability Benefits. Military disability retirees, as well as retirees not determined disabled by DOD, can also apply to the VA for disability compensation. This can be advantageous to retirees who have a DOD disability rating. For instance, a retiree whose retired pay is offset by the retiree's VA compensation nonetheless receives some advantage because the VA compensation is totally tax-free. Also, a retiree may (1) apply for VA compensation any time after leaving the service and (2) have his or her degree of disability changed by the VA as the result of a later medical reevaluation, as noted above. Many retirees seek benefits from the VA years after retirement for a condition that may have been incurred during military service but that does not manifest itself until many years later.

For further discussion of these and other relevant issues, see CRS Report 95-469, *Military Retirement and Veterans' Compensation: Concurrent Receipt Issues*.

The Alleged “Surplus” in the Military Retirement Fund and Concurrent Receipt

Recent assertions that there is a “windfall” or “surplus” in the Military Retirement Fund, which could be used to help pay for allowing some military retirees to receive their military non-disability retired pay and VA disability compensation concurrently are incorrect. They are based on an invalid assumption about how the amount of money in the Fund is determined. Complicated calculations are used to compute the amount of money which has to be transferred to the Military Retirement Fund from the DOD budget (see the section below on “Military Retirement Budgeting and Costs”) to pay for future retirement costs. These calculations do, in fact, include projections, based on past experience, on how many military retirees will probably be eligible for VA disability compensation as well as military retired pay—and, therefore, how much less retired pay the Fund will have to pay out to retirees because they are getting VA compensation instead. The idea of the “windfall” assumed that the calculations did not take the VA compensation offset into account.

Financing Concurrent Receipt through Increased Amortization Payments to the Military Retirement Fund

Some have suggested a so-called no cost method of financing the costs of concurrent receipt through technical aspects of the accrual accounting system (see above) for military retirement costs and budgeting. However, this proposed scheme, and the assertions supporting it, are invalid or irrelevant. The arguments in favor of it appear to be based on the assumption that the Military Retirement Fund established by accrual accounting is essentially a “pot of money” that could be dipped into to cover the increased costs generated by concurrent receipt. However, regardless of accrual accounting’s undeniably complex financing mechanism, the actual payments made by the federal government to individual retirees are “real money.” Implementation of concurrent receipt would involve incurring additional real outlays by the federal government that could not be avoided, no matter what complex paths or transfers, however circuitous they might be, that the money followed before it was ultimately paid to individual retirees. To use a variation on the old saying, the concurrent receipt “lunch” might appear to be free within the operation of accounting mechanisms, but once it is paid to entities outside the government it is real food and hence cannot be free.

107th Congress Action and Executive Branch Views on Concurrent Receipt

Bush Administration Position. In a July 2001 letter sent to various military retirees, the President stated his opposition to concurrent receipt. The letter was reported as stating that each of the two separate benefits were viewed as “full and fair compensation” for individuals in receipt of one and that no additional benefits from another federal source were required; it also stated that military personnel were never promised concurrent receipt.

FY2002 Budget Resolution. The final version of the FY2002 budget resolution was reported on May 3, 2001 (H.Rept. 107-55). It called for a DOD study of the issue. Although the study was due 180 days after adoption of the final resolution (presumably, therefore, November 10, 2001), it has not yet been forwarded to Congress.

FY2002 National Defense Authorization Act. On December 12, 2001, the conference version of the FY2002 National Defense Authorization Act was reported (H. Rept. 107-333). It includes a concurrent receipt section (Sec. 641, S. 1438) with two major provisions. The first would allow concurrent receipt only if the President proposed, and Congress passed, legislation other than an appropriations act that would provide offsetting budgetary cuts for the increased “PayGo” entitlement costs of the concurrent receipt. The second will broaden the scope of the “special compensation” for severely disabled retirees enacted in the FY2000-FY2001 National Defense Authorization Acts, assuming that the PayGo legislation is not enacted.

Concurrent Receipt if Offsetting Costs Are Found. The concurrent receipt benefits that would be authorized in the FY2002 defense authorization are identical to those in the House Armed Services Committee (H. Rept. 107-194) and full House versions of the FY2002 Act. They are also identical to the provisions of H.R. 303 (Representative Bilirakis) and S. 170 (Senator Harry Reid), 107th Congress stand-alone concurrent receipt bills. It would allow full concurrent receipt for military *nondisability* retirees. Military *disability* retirees would be allowed to receive, without regard to any VA disability compensation to which they were eligible, any retired pay to which they would have been entitled if they had retired on a nondisabled basis. However, any disability retired pay in addition to their nondisability entitlement would be subject to full offset — i.e., would be decreased by the amount of any VA compensation to which they were entitled. More specifically, the language would:

(1) Allow full concurrent receipt for *all* military **nondisability** retirees (i.e., those retired for meeting specified minimum lengths of service). This would include those retired with less than 20, but 15 or more years of service as part of the Temporary Early Retirement Authority (TERA) statutes enacted to facilitate the post-Cold War military drawdown (see above).

(2) Allow partial concurrent receipt for certain disability retirees, as follows:

(A) Disabled retirees would be allowed to receive, without regard to any VA disability compensation to which they were eligible, any retired pay to which they would have been entitled if they had retired on a nondisabled basis — i.e., had at least 15 years of service or more. However, any disability retired pay in addition to their nondisability entitlement would be subject to full offset—i.e., would be decreased by the amount of any VA compensation to which they were entitled.

(B) For example, imagine a retiree with 20 years of service who, if retired on the basis of that service, would receive \$20,000 yearly in retired pay. However, imagine also that, based on a substantial disability rating, the retiree would receive \$25,000 yearly in retired pay. Because, by law, the retiree would receive that pay which is most financially advantageous, he or she would get the \$25,000 yearly. Under H.R. 303/S. 170, if the retiree was entitled to VA disability compensation, only the \$5,000 extra the retiree gets from DOD due to using the disability formula would be subject to an offset — the \$20,000, which he or she would have been entitled to anyway even without any disability, would be protected from offset. Thus, if the retiree were entitled to receive \$3,000 yearly from the VA, his retired pay would be reduced by \$3,000, and any VA compensation up to \$5,000 would result in an offset. However, if the retiree was entitled to receive \$8,000 yearly from the VA, the retiree’s DOD retired pay would be reduced only by \$5,000 — that part of the DOD retired pay

attributable to disability. Because the remaining \$20,000 is protected from the offset, the retiree would receive a total of \$28,000 (\$20,000 from DOD and \$8,000 from the VA). In contrast, under current law, the \$8,000 of VA compensation would be offset against the full \$25,000 in DOD retired pay, so the retiree would receive a total of \$25,000 [\$17,000 from DOD (\$25,000 - \$8,000) + \$8,000 from the VA].

(C) The special compensation statutes enacted in 1999 and 2000 would be repealed.

Expansion of “Special Compensation”. The “special compensation” will be expanded in scope and the amounts available would be increased if the cost-offsetting legislation described above is not enacted. Beginning in the middle of FY2002 (February 2002), 60% disabled retirees will be eligible for it. In addition, from the current rates of \$100 monthly for 70% disabled retirees; \$200 for 80%; and \$300 for 90 and 100% retirees, the amounts will be progressively increased so that by FY2005, the monthly payments will be \$50 for 60%; \$125 for 70%; \$150 for 80%; \$250 for 90%; and \$325 for 100% disability. As is currently the case, to be eligible for the special compensation, military retirees will have to have received their VA disability rating within 4 years of retiring from the military. It is not yet clear how many more retirees will be eligible for special compensation because of the inclusion of 60% disabled people; according to The Retired Officers Association (TROA), 23,000 retirees are 60% VA disabled, but it is not yet known how many received their rating within 4 years of retirement.

Costs of Concurrent Receipt

Depending on the extent of concurrent receipt allowed, cost estimates have varied from an annual level of about \$50 million (allowing concurrent receipt for people who are rated by the VA as 100% combat-disabled) to over \$3 billion (allowing concurrent receipt for all individuals eligible for both types of benefits).

The Congressional Budget Office (CBO) has estimated that concurrent receipt along the lines that would be authorized by the FY2002 defense authorization, if it had been enacted in FY2002, would have cost the government in military retirement outlays alone \$2.88 billion in FY2002 in direct (mandatory or entitlement) spending, rising to an annual cost of \$5.07 billion in FY2011, and a total 10-year cost, FY2002-FY2011, of \$39.3 billion. VA disability compensation costs would also have risen slightly, by an average \$70 million yearly over the same 10-year period. These costs, involving the actual payments to individuals, would constitute total federal outlays, but not DOD or VA outlays, as they would come from the Military Retirement Fund and a VA equivalent (see the discussion of accrual accounting for military retirement in the section above on costs).

CBO also estimates that the same concurrent receipt provisions would increase payments to the Military Retirement Fund and thereby cost DOD (but not the overall federal government—see again the above discussion of accrual accounting) an additional \$997 million in FY2002, increasing to \$1.91 billion in FY2011, for a 10-year total of \$14.38 billion. Because these costs would not affect the overall federal budget, they would not figure in competition for resources between DOD and other federal agencies; however, because they would increase the DOD budget, they could affect internal DOD budget decisionmaking.

The special pays for certain retirees enacted in the FY2000-2001 defense authorizations in lieu of concurrent receipt, have annual estimated costs of \$83 million-\$125 million. No cost estimates have been issued yet about the expansion of the special compensation just authorized by the FY2002 defense authorization.

Pros and Cons of Concurrent Receipt

Arguments IN FAVOR of Concurrent Receipt.

(1) Military retired pay, it is argued, was earned for length of service; the VA disability compensation, for disability. They were therefore for two different things and did not constitute a duplication of benefits.

(2) If cost was an issue, partial concurrent receipt should be allowed for those most severely disabled, with combat disability, or whose benefits or total income are the least.

(3) VA disability compensation beneficiaries are entitled to other federal benefits; why not military retired pay?

(4) People receiving VA disability compensation can receive pensions from a wide variety of other sources without any offset; why target military retirees?

Arguments AGAINST Concurrent Receipt.

(1) The cost of full, or nearly full, concurrent receipt would be enormous — almost \$3 billion yearly in FY2002, according to CBO.

(2) Eliminating or reducing this offset would “be sticking the camel’s nose into the tent,” setting a precedent for the reduction or elimination of all kinds of similar offsets of one or more federal payments, possibly costing billions of dollars (a CRS study identified at least 25 such offsets; see pp. 43-47 of CRS Report 95-469, *Military Retirement and Veterans’ Compensation: Concurrent Receipt Issues*).

(3) Although some federal programs do not have an offset against VA disability compensation, there are no such offsets involving (1) disability and (2) retirement from the same job and agency where the disability occurred.

(4) VA disability compensation is arguably authorized on much more liberal grounds than others, and a disability can be certified many years after a person leaves active military service. Accordingly, allowing concurrent receipt could lead to a windfall for people whose VA disability appears to have had a tenuous connection with their military service.

(5) Concurrent receipt was never promised to those asking for it.