Executive Summary

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A FRAMEWORK FOR RESTRUCTURING THE MILITARY RETIREMENT SYSTEM

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For more than a century, the military has provided a defined benefit pension to service members who render 20 or more years of active duty service. The U.S. civilian labor force has long since replaced defined benefit pension programs with defined contribution pension programs where employers and employees contribute to a 401(k)-type account. The military, however, has continued to provide a defined benefit pension plan worth in excess of a million dollars to veterans who retire as early as 38 years of age. With annual military retirement system outlays exceeding $50 billion, senior officials have begun calling for pension reform on the grounds that the current system is fiscally unsustainable.

In the fall of 2011, the Department of Defense Business Board (DBB) proposed several reforms to reduce military pension costs to include: establishing a 401(k)-type account with employer contributions, allowing service members to vest in this retirement account after 4 years of service; restructuring the defined benefit portion so that individuals could not begin receiving benefits until they are 67 years of age; providing pension bonuses for deployments; and, substantial transition pays. While reporting significant cost savings to the tune of $3.65 billion (2034 dollars), service members end up losing 39 percent of the value of the existing pension program.

Simply adopting best practice from the civilian sector, however, is somewhat naïve. The unique structure of the current military manpower model, which has at its basis the All Volunteer Force (AVF), demands a correspondingly unique pension plan. Military service places significant demands on its service members. Motivating individuals to volunteer for a career of selfless service, personal sacrifice, hardship, frequent household relocations, and inherent danger requires a compensation program commensurate with the demands. Since the inception of the AVF in 1973, the military's pension plan has been instrumental in meeting military manpower requirements across the ranks. Any future pension reform must consider the second and third order impacts to military manpower, or more specifically, personnel inventory, service member well-being, public perception, and overall program cost.

We begin by providing a framework that addresses these four considerations as a benchmark for all future pension reform. We adopt some of the ideas presented by the DBB study, but tailor them to the framework to ensure that the military maintains its personnel inventory, promotes service member well-being, increases public perception of the military pension, and reduces overall program costs.

Our proposal is called the 10-15-55 plan. Service members and the military contribute to a 401(k) account as soon as they enter service. At any point, a service member may leave the military with his or her contributions to the 401(k). At 10 years of service, the service member controls 50 percent of what the military contributed to the 401(k). That percentage increases by 10 percentage points each year for 5 years until the service member reaches 15 years of service, at which time the service member controls 100 percent of employer contributions. In addition to the 401(k) account, service members who continue to 20 years of service also receive the defined benefit pension plan as it currently exists, with the exception that they may not receive payments until they turn 55 years of age. While all current service members would be grandfathered under the existing pension system, new entrants would be covered by the 10-15-55 proposal. The 10-15-55 proposal would likely be more desirable to new entrants than the existing pension plan because of the uncertainty that most new recruits face about serving a full 20-year career. When evaluated against our current pension framework and other proposals, the 10-15-55 pension proposal has many attractive features.

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