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**THESIS**

**REDUX AND READINESS: CONGRESS, THE DEFENSE  
BUDGET, AND MILITARY RETIREMENT IN 1999.**

by

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**REDUX AND READINESS: CONGRESS, THE DEFENSE BUDGET, AND  
MILITARY RETIREMENT IN 1999**

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## ABSTRACT

In 1999, the 106<sup>th</sup> Congress enacted military retirement reform for personnel entering the military after 31 July 1986. This thesis examines the process by which this reform was enacted and its impact on defense spending. To conduct the analysis, a review of articles, journals, government reports, and legislation related to retirement reform was completed. The estimated cost of reform was \$796 million for FY 2000 and totaled nearly \$6 billion by FY 2004. Congress modified military retirement by offering members the choice of remaining under Redux and receiving a \$30,000 bonus or retiring under the High Three Plan. The 1999 Emergency Supplemental appropriated \$10.9 billion dollars to improve military readiness, including funds for retirement reform assuming that it would improve retention and readiness. Congress approved the changes in the 2000 Authorization Act. Reform was facilitated by the designation of the funds as an emergent requirement to improve readiness and the emergence of an on-budget surplus of \$14 billion for FY 2000.



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## I. INTRODUCTION

### A. BACKGROUND

In the mid 1980's, the United States Congress faced mounting budgetary pressure to reduce the federal deficit. One of the cost-cutting measures it enacted was military retirement reform. The Military Retirement Reform Act of 1986 (Public Law 99-348), also known as Redux, changed the military retirement plan for certain members who served in the military for at least 20 years. Redux reduced the military retirement benefits for personnel entering the military after 1 August 1986. The retirement pension for personnel serving 20 years was cut from 50 percent to 40 percent of base pay and their cost-of-living-adjustments (COLAs) were also reduced [Ref. 1].

The purpose of Redux was to persuade military personnel to stay in the military beyond 20 years. Many of the military's most capable members would opt to retire after 20 years of service to begin careers in the civilian sector. Under Redux, military personnel still received 75 percent of their base pay after 30 years of service, but their annual COLA was reduced to one percentage point less than the rate of inflation. Lawmakers hoped military personnel would opt

to stay in the military for 30 years to earn the higher retirement benefits [Ref. 2, p. 36].

Due to declining defense budgets and increased peacetime engagement activities throughout the 1990's, there has been an increased strain on the military, creating concern among the military leadership and Congress about the readiness of the military. The service chiefs testified before Congress in September of 1998 that military readiness was slipping and that retention of key personnel was eroding and fixing Redux was their top priority [Ref. 2, p. 38]. In order to boost retention and recruitment of quality personnel, the Clinton Administration proposed reforms in the military retirement system in the FY00 budget submission. A key component of the administration's reform package was elimination of Redux.

This thesis will thoroughly examine the changes to the military retirement system enacted by the 106<sup>th</sup> Congress. Specifically, this thesis will track the proposed changes to Redux, examining congressional action in response to the administration's proposal, and the impacts such actions may have on the defense budget.

## **B. OBJECTIVES**

This thesis will focus on the relationship between the military readiness crisis of 1998-1999 and the military retirement system. The primary objective of this thesis is to examine changes to the military retirement system enacted by the 106<sup>th</sup> Congress. It will begin by providing an overview of the current military retirement system, followed by a description of the administration's proposal for change and an analysis of the changes enacted by Congress within the legislative and budgetary process.

## **C. RESEARCH QUESTIONS**

The primary research question to be addressed in this thesis is: How did the 106<sup>th</sup> Congress address military retirement reform in 1999?

Subsidiary research questions include the following:

- What is the relationship between the readiness crisis of 1998-1999 and military retirement?
- What is the Redux retirement policy?
- How is military retirement treated in the congressional budget process?
- How did the Clinton Administration propose to change Redux in the FY00 budget submission?

- What were the policy and budget changes made by the defense budget committees during the FY00 budget cycle?
- What was the impact of final congressional action on Redux in the FY00 budget?

#### **D. SCOPE OF THESIS**

This thesis will: (1) review the Redux retirement policy, (2) review congressional testimony and other evidence related to military readiness, (3) track legislation that changes or repeals Redux, (4) identify and assess the procedures used by Congress to address Redux, and (5) analyze budgetary impacts associated with changes to the military retirement system.

#### **E. METHODOLOGY**

The methodology used for this research consisted of the following steps:

(1) Conducted a literature review of journals, newspaper articles, government reports, web sites, congressional records and legislation related to Redux and military retirement reform.

(2) Conducted a review of congressional testimony concerning military readiness and military retirement reform.

(3) Examined those portions of the FY00 President's budget submission that propose changes to and financing of the military retirement systems.

(4) Analyzed the impacts on the Department of Defense budget of military retirement reform enacted by Congress.

#### **F. ORGANIZATION OF STUDY**

The thesis begins by providing an overview of the three military retirement plans that are available for active duty personnel who serve at least 20 years in the armed services. The three systems include the Final Pay plan for members who entered the service before September 1980, the High Three plan for personnel who entered the service between September 1980 and August 1986, and Redux for members entering after August of 1986. Additionally, the thesis explains how the Department of Defense uses the Military Retirement Fund with an accrual based accounting system to set aside money to pay for the retirement systems.

Next, the thesis examines the military readiness crisis of 1998-1999. Specifically, the thesis examines the relationship between the military readiness crisis and military retirement reform. The thesis provides an in-depth look at the Department of Defense perspective of the readiness crisis and how it relates to personnel issues and

retention. The study also provides insight into congressional policy on military retirement and examines the congressional perspective of the readiness crisis, retention, and Redux.

The thesis then examines the legislative process and how it relates to military retirement reform. It examines the changes to Redux and how these changes were made within the congressional budget process. The thesis provides a detailed and comprehensive review of important events and key legislation that resulted in the changes to the military retirement system.

Finally, the thesis summarizes the changes to the military retirement system. It presents a concise presentation of the benefits and offers insights on the new system.



## II. THE MILITARY RETIRMENT SYSTEM

### A. INTRODUCTION

To fully understand and appreciate the relevance of the congressional policies and changes to the military retirement benefit program, a full description of the current system is appropriate. This chapter explains the origins and major components of the three military retirement plans that are currently available to service members. This chapter also explains the accrual accounting system used to budget for the nondisability retirement of military members.

### B. HISTORY OF THE MILITARY RETIREMENT SYSTEM

Except for an 1855 statute that provided for the retirement of certain Navy officers, there was no legislative authority that provided for either the voluntary or involuntary retirement of active duty members of the military prior to 1861. The 1855 statute permitted the Secretary of the Navy to convene boards to determine the capability of officers. Officers who could not perform their duties due to no fault of their own were removed from the active list and placed on the reserved list with either leave-of-absence pay (75 percent of sea duty pay) or

furlough pay (50 percent of leave-of-absence pay) [Ref. 3, p. 511].

The military retirement system of today underwent many changes during its evolution. Voluntary non-disability retirement was first established on August 3, 1861 allowing regular officers of all services to retire after 40 years of service at the discretion of the President [Ref. 3, p. 512]. In 1855, the first non-disability retirement law for enlisted personnel was enacted, allowing for voluntary retirement after 30 years with 75 percent of pay [Ref. 4, p. B-4].

The Act of August 29, 1916 introduced two principles to non-disability retirement that set the basis for the retirement systems of today. First, it established the up-or-out selective promotion plan, and it initiated the formula of 2.5 percent of final monthly basic pay for each year of service up to 30 years, or a maximum of 75 percent of basic pay [Ref. 3, p. 513]. Standardized non-disability retirement for all Services was enacted in 1948, establishing 20 years as the minimum for voluntary retirement for all Services [Ref. 4, p, B-4]. Other changes to the retirement system have taken place over the years to effect force structuring and deficit reduction. These changes have produced three voluntary non-disability

retirement plans for active duty members of the military. The military retirement benefit plan that a member falls under is dependent upon the date that military member entered the service.

## **C. THREE RETIREMENT PLANS**

### **1. Overview**

The current military retirement system is a funded, noncontributory defined benefit plan that includes non-disability retired pay, disability retired pay, retired pay for reserve service, and survivor annuity programs [Ref. 4, p. A-2]. The current system allows voluntary retirement upon completion of at least 20 years of service at any age, subject to the approval of the Service Secretary. Retirement pay is calculated using one of three different non-disability benefit formulas based upon the date the military member entered the service [Ref. 4, p. A-3].

### **2. Cost-Of-Living-Adjustments**

The nondisability retirement benefit is received throughout the lifetime of the retiree. The retirement pay is adjusted annually for inflation with cost-of-living adjustments (COLAs). The COLAs are automatically scheduled to occur every 12 months, on December 1<sup>st</sup>, to be included in the checks issued at the beginning of the following January

[Ref. 4, p. A-6]. The benefits associated with members entering the service before August 1, 1986 are adjusted by the percentage increase in the average Consumer Price Index (CPI). This is commonly referred to as CPI indexing or full CPI protection. For personnel entering the service on or after August 1, 1986 under the Redux retirement plan, the retirement benefits are annually adjusted by the percentage change in the CPI less one percent. When the member reaches 62 years of age, the benefits are restored to the amount that would have been payable had full CPI protection been in effect. However, after the one-time restoral, partial indexing (CPI minus one percent) continues annually for life [Ref. 5, pp. 1-5].

### **3. The Final Pay Plan**

For military members who entered the service prior to September 8, 1980, the formula used to calculate the retirement pay benefit is commonly referred to as the "Final Pay Plan" because the monthly retirement benefit is calculated using the basic pay of the last month the member was on active duty. The monthly benefit payment is calculated by multiplying the number of years of service by 2.5 percent to determine the annuity factor. The annuity factor is multiplied by the amount of basic pay the member earned during the last month of active duty service. Only

the member's basic pay (and not any other incentive pay) is multiplied by the annuity factor to determine the monthly retirement payment [Ref. 3, pp. 528-529]. For example, if a service member's basic pay during the last month of active duty before retirement is \$3301.40 and that member served exactly 20 years, the annuity would be calculated as follows:

$$20 \text{ years} \times .025 \times \$3301.4 = \$1650.70/\text{month}$$

For periods beyond the 20 years, the annuity factor is increased by 2.5 percent per year to a maximum of 75 percent after 30 years of service. Beyond 30 years, the annuity factor remains at 75 percent [Ref. 6, p. 9].

#### **4. The High Three Plan**

The High Three Plan is the retirement annuity for military members who entered the service on or after September 8, 1980 and before August 1, 1986. This plan is calculated using a similar formula to the Final Pay plan described above. The annuity factor calculation is identical, i.e., the number of years of service is multiplied by 2.5 percent. The difference is that instead of using the terminal basic pay of the retiree as the multiplier, the average of the highest 36 months of basic pay is used. As in the Final Pay plan, the retirement

benefit is adjusted for inflation and is subject to full CPI protection [Ref. 5, pp. 1-5].

#### 5. Redux

The Military Retirement Reform Act of 1986 reduced the retirement benefit for military members who entered the service on or after August 1, 1986. Like the other plans, Redux established the life long annuity plan for military personnel who served for at least 20 years on active duty. However, the formula used to calculate the monthly retirement payment was changed for members who served less than 30 years, which significantly reduced the retirement benefits for these members.

Just as in the High Three plan, the number of years of service is multiplied by 2.5 percent which is multiplied by the average of the highest 36 months of basic pay. However, for members who retire with less than 30 years of service, the retirement pay is reduced by 1 percentage point for each year of service less than 30 years. For example, if a service member's basic pay during the last 36 months of active duty before retirement is \$3301.40 and that member served exactly 20 years, the annuity would be calculated as follows:

$$20 \text{ years} \times .025 = .50$$

Since the member served only 20 years, the multiplier is reduced one percentage point for each year less than 30 years.

$$.50 - .01(30 \text{ years} - 20 \text{ years}) = .40$$

The multiplier (.4) is then multiplied by the basic pay to calculate the monthly retirement benefit amount.

$$.4 \times \$3301.4 = \$1320.56/\text{month}$$

The COLA is not fully indexed to the CPI and is adjusted annually by the CPI minus one percent. There is a one-time restoral of the benefits at the age of 62 to the amount that would have been payable had full CPI protection been in effect. However, after this one-time restoral, the retirement benefit continues to be partially indexed for the rest of the service member's life [Ref. 3, pp. 522-523]. Table 1 below provides a comparison of the actual annuity values for selected retirement grades based on years of service (YOS). The table is based on 1996 basic pay tables.

Table 1  
Annual Retired Pay Under the Three Current  
Military Retirement Plans, 1996

Grade/YOS	Final Pay	High Three	Redux
0-4/20	\$24,979	\$23,603	\$18,883
0-5/24	\$35,852	\$33,799	\$30,419
0-6/30	\$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: Ref. 6, p. 13

**D. MILITARY RETIREMENT FUND**

**1. Background**

Prior to the establishment of the Military Retirement Fund in October of 1984, the military retirement system was funded as a "pay-as-you-go" system. Each year as part of the budgetary process, the Department of Defense submitted to Congress, through the President, estimates of the aggregate retired and retainer pay entitlements of personnel on, or expected to be on, the retired lists of the various military departments for that year. Congress, through the



appropriations process, appropriated funds to pay for those entitlements [Ref. 3, p. 799, Ref. 6, p. 15].

## **2. Military Retirement Fund Authorization**

The Department of Defense Authorization Act of 1984 (Public Law 98-94), amended Title 10, United States Code (U.S.C.) and established, effective October 1, 1984, the Military Retirement Fund (MRF). Chapter 74 outlined the purpose and implementation of the Military Retirement Fund.

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 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 [Ref. 7].

## **3. Accrual System**

The MRF changed the funding of the retirement system from "pay-as-you-go" to an accrual system. Accrual accounting is a method of recording costs as they are incurred rather than when they are paid. The MRF basically sets aside funds in current budgets to pay the retirement annuities that eventually will be received by military personnel who are in the military now [Ref. 8, p. ix, p. 2].

## **4. Funding the Military Retirement Fund**

The MRF is funded from three different sources. First, the Secretary of Defense is required to pay into the Fund at

the end of each month a contribution designed to fund the retirement liability created by current military personnel. The amount contributed is computed using actuarial techniques, as a percentage of the total basic pay paid that month to military members on active duty and in the Ready Reserve [Ref. 3, p. 800].

Second, the Secretary of the Treasury is required to make an annual contribution at the beginning of each fiscal year from the General Fund of the Treasury. The purpose of this contribution is to amortize the original unfunded liability of the military retirement system and to account for cumulative gains and losses to the MRF. The original unfunded liability is the funds needed to pay for the retirement cost of members prior to FY85 [Ref. 10, p. 28]. This liability for past service was determined to be \$528.7 billion as of September 30, 1984 and is being amortized over a 60-year period [Ref. 3, p. 800].

The third source of assets for the Fund is the interest earned from the Fund's resources.

The Secretary of the Treasury shall invest such portion of the Fund as is not . . . required to meet current withdrawals. Such investments shall be in public debt securities with maturities suitable to the needs of the Fund, as determined by the Secretary of Defense, and bearing interest at rates determined by the Secretary of the Treasury, taking into consideration current market yields on outstanding maturities. The income on such investment shall be credited to and form a part of the Fund [Ref. 9].

## E. SUMMARY

There are three non-disability, active-duty retirement systems currently in effect for members of the military service. The retirement plan that is applicable to a particular individual depends on when that individual entered military service. All of the retirement plans are similar in that a member who serves for at least 20 years on active duty is entitled to lifetime annuity benefits without having vested anything in the retirement plan. The retirement plans differ in the calculation formula of the retirement benefit and retirees are entitled to different amounts of benefits under the different systems.

The Military Retirement Fund was established in 1984 and changed the military retirement system from a "pay-as-you-go" system to an accrual method of paying for liabilities as they are incurred. This change in funding methods made the cost of the retirement compensation and changes to retirement system readily apparent.

The legislative changes to the military retirement system over the years indicate that the military retirement system has been used as a force management tool. Most of the legislative changes to the military retirement system since 1981 have reduced the costs and benefits of the system [Ref. 11, p. 33]. Many within the military and Congress

believe the reduction in retirement benefits has been too severe. These reductions, coupled with shrinking defense budgets and the military's increased participation in small-scale operations, have caused a military readiness crisis. The relationship between the military readiness crisis, retention, and Redux will be examined in the next chapter.

### **III. MILITARY READINESS, RETENTION, AND REDUX**

#### **A. INTRODUCTION**

Over the past several years, the U.S. military has been increasingly called upon to participate in peacekeeping and humanitarian operations around the world. The increased use of the military has occurred during a period when the size of the U.S. military has been reduced due to the end of the Cold War with the former Soviet Union. There is growing concern among congressional and military leaders that the reduced defense spending of the 1990's, increased military operations, and a smaller military force may be creating a readiness problem within the U.S. military.

This chapter will look at the military readiness "crisis" of 1998-99. Specifically, this chapter will address the relationship between the readiness problem that emerged during this time frame and personnel retention issues. Additionally, this chapter will discuss the relationship of the personnel retention problem and Redux.

#### **B. MILITARY READINESS**

##### **1. Military Readiness Defined**

Military readiness is a general term that refers to the military's ability to meet a wide range of military

requirements. Readiness is defined by the Department of Defense as "the ability of U.S. military forces to fight and meet the demands of the national military strategy" [Ref. 12, p. 370]. A slightly more specific approach to readiness is the concept of operational readiness. Operational readiness is "the capability of a unit/formation, ship, weapon system or equipment to perform the missions or functions for which it is organized or designed. May be used in a general sense or to express a level or degree of readiness" [Ref. 12, p. 327].

These definitions do not take into account what some policymakers and military leaders have recently characterized as future readiness, which is defined as the investment in new weapon systems that may be necessary to ensure that future capabilities are adequate [Ref. 13, p. 1].

When military professionals refer to readiness, they are generally indicating whether a military force has all its component parts in good working order to meet mission requirements. The emphasis is on existing forces rather than prospective forces. The focus on readiness tends to be on the ability to deploy forces upon notice and the effectiveness of those assets upon arrival [Ref. 14, p. 11].

In order to achieve readiness requirements, four components must be in place. First, a sufficient number of high-quality personnel must be available, through recruitment and retention. Second, equipment must be maintained and ready for use. Third, units must be properly supplied. Finally, there must be an effective training program in place [Ref. 14, p. 11]. It is the first of these components, retention of quality personnel and its impact on readiness that will be the focus of this chapter.

## **2. Declining Military Readiness**

Top U.S. military leaders and Secretary of Defense William Cohen met with President Clinton on 15 September 1998 to discuss the readiness of U.S. forces. At the meeting, the military leaders addressed their concerns about the U.S. military's ability to meet current and future assignments. The service chiefs relayed to the President that the U.S. military could fulfill national security requirements, but rising problems heightened risks to U.S. interests [Ref. 15, p. 1].

The military leadership relayed stories of how planes were being cannibalized to keep other aircraft flying and how military personnel were working longer hours to keep older equipment up and running. Readiness reports backed up the anecdotal evidence. The readiness of the follow-on

forces was down, older equipment was breaking more often, and the services were facing manning shortages [Ref. 16, pp.1-2]. The military leaders warned the President of a potential nosedive in military readiness.

These same leaders later testified before Congress on September 29, 1998 that U.S. military readiness had significantly declined during the late 1990's. The members of the Joint Staff warned Congress that the U.S. military could return to the "hollow force" of the 1970's unless readiness and modernization concerns were addressed. General Henry H. Shelton, Chairman of the Joint Chiefs of Staff (CJCS), indicated that the readiness of U.S. military forces was declining. "Our forces," the Chairman stated, "are showing increasing signs of serious wear. Anecdotal and now measurable evidence indicates that our current readiness is fraying and that the long-term health of the Total Force is in jeopardy" [Ref. 17, p. 1]. He explained that while the U.S. had successfully maintained the readiness of the forward-deployed forces, it had come at the expense of the rest of the force.

This trend continued as evidenced by the U.S. Air Force's decline in readiness. General Michael E. Ryan, Chief of Staff for the U.S. Air Force, testified before Congress in January of 1999 that the overall readiness of



the U.S. Air Force was down 15 percent since 1996. He also stated that stateside readiness had declined by 40 percent during that same period [Ref. 18, p. 5].

According to the CJCS, several factors contributed to the readiness crisis of 1998-1999. First, the spending caps on discretionary spending in the federal budget during the late 1980's and 1990's forced the military to perform its mission of national defense with smaller budgets. The Fiscal Year 1998 budget was particularly challenging in balancing the competing priorities of maintaining current readiness, taking care of people, and providing for future readiness through modernization.

General Shelton explained several other unanticipated factors had contributed to the detriment of the military readiness. First, the U.S. military had been far busier than anticipated. Second, the higher operational tempo meant more wear and tear on equipment. Third, DoD officials had planned personnel and base reductions that weren't carried out. Fourth, Congress changed priorities and money in the defense budget. And finally, the good U.S. economy helped create shortfalls in military recruiting and retention [Ref. 17, pp. 1-2].

### C. READINESS AND RETENTION

Retention and recruitment of quality personnel is essential in order for the U.S. military to maintain the necessary levels of readiness to carry out the National Military Strategy. If retention in critical and technical ratings dropped below required levels, military readiness may be significantly impacted. Admiral Jay L. Johnson, Chief of Naval Operations (CNO), emphasized this point by testifying before Congress that "recruiting and retention are inseparable from readiness" and that if retention continues to decline, "the hollow force will be unavoidable" [Ref. 19, p. 3]. General Ryan, Chief of Staff, U.S. Air Force, agreed, stating, "people continue to be our most vital resource-they are the most critical component of readiness" [Ref. 18, p. 6]. General Shelton argued that "the best tanks, planes, and ships in the world are not what make our military the superb force that it is today. The most critical element of both current and future readiness is the men and women . . . serving in uniform" [Ref. 17, p. 4].

All of the services faced retention problems and manning issues during the late 1990's. The CJCS reported that retention rates were continuing to decline, particularly in some of the most critical skills like

aviation and electronics. The CNO testified before Congress that Navy Aviation, Surface, Subsurface, and Special Warfare were projecting significant shortages of mid-grade officers which would adversely impact sea-duty tours in FY99 and FY00. While extending sea duty tour lengths was the only immediate option to preserve near-term readiness, this would likely reduce retention rates in the future [Ref. 20, p. 5]. The CNO also reported that both enlisted retention and recruiting levels were below required levels for FY98. The CNO cited shortfalls in technical skill ratings and general detail (GENDET) personnel, with GENDET manning at sea at only 78 percent [Ref. 20, p. 5].

The Air Force was experiencing similar personnel shortages, reporting that the reenlistment rate for personnel entering their second reenlistment contract (eight to ten years of service) was below required levels and declining. Additionally, many key career fields such as avionics specialists, aircraft crew chiefs, and air traffic controllers were experiencing even larger drops in reenlistments. Finally, the Air Force faced severe shortages in highly skilled and experienced pilots. In 1999, the Air Force faced a shortage of over 700 pilots and the number continued to grow. If the pilot retention didn't

improve, the Air Force would be short 2000 pilots by 2002 [Ref. 18, pp. 6-7].

The U.S. Army was also suffering from retention problems. General Dennis J. Reimer, Chief of Staff of the U.S. Army, reported to Congress that the major concern for most units during 1998 had been personnel shortages and that personnel shortages were having an adverse impact on current readiness [Ref. 21, p. 3].

#### **D. RETENTION AND REDUX**

Retention is closely related to the quality of life for the uniformed members of the military service. Quality of life for military personnel encompasses many things including pay, retirement benefits, housing, medical and dental benefits, and operational tempo (OPTEMPO), to name the most important. In other words, quality of life refers to how well the military member perceives the military is providing for his/her needs and the needs of his/her family. The better the quality of life is for a person in the U.S. military, the more likely that person will be willing to stay in the military and perhaps make the military a career.

The Joint Chiefs reported to Congress that the quality of life for the personnel in uniform was their greatest concern [Ref. 17, p. 3]; notably, reforming military

retirement and military pay was their highest priority [Ref. 22, p. 3]. Their argument was that by improving military retirement, retention rates would improve and overall military readiness would increase.

The Joint Chiefs and the Secretary of Defense believed that Redux was adversely impacting retention. Secretary Cohen stated, "the 1986 changes made to military retirement were meant to make it attractive enough to keep people in past 20 years . . . it's having the opposite effect" [Ref. 23, p. 1]. General Shelton made the repeal of the Redux his top recommendation to Congress as a way to improve retention and quality of life for service members [Ref. 17, p. 4]. The CNO testified to Congress that "pay and retirement benefits rank among our Sailors' top dissatisfiers" [Ref. 19, p. 3]. He noted that Secretary Cohen's triad of initiatives--repeal of Redux, a 4.4 percent across the board pay raise, and pay table reform--in the FY00 defense budget submission was essential to reverse the negative trends in recruiting and retention [Ref. 19, p. 3].

Others agreed with the military leaders that the repeal of Redux would increase retention. In a study performed in early 1999 by the Rand Corporation, a federally funded research and development center, the researchers determined that "relative to Redux, we predict that moving to the High-

3 retirement system will raise overall retention in the steady state by 4 percent" [Ref. 24, p. 28]. The study concluded that the DoD triad would increase retention by about six percent [Ref. 24, p. 28, 41].

However, others disagreed with the Joint Chiefs' assessment that Redux was having a negative effect on retention. The Congressional Budget Office conducted an analysis of Redux and its effect on retention. CBO examined the retention decisions of individual officers and enlisted personnel who started active duty at about the same time but under different retirement systems. CBO created a model of the retention decisions of military personnel by using a statistical method known as a logistic regression. In the regression model, CBO isolated the effects of Redux on retention from the others factors that might influence retention such as occupation, age, education, marital status, sex, and race [Ref. 25, p. 3-4].

CBO asserted that if the new retirement system was having a strong negative effect on retention their model would have captured that effect. CBO concluded, however, that "the changes enacted in 1986 are not having a discernable effect on midcareer retention" [Ref. 25, p. 1].

CBO further suggested that any large declines in midcareer retention were probably due to factors other than

Redux, such as frequent, unscheduled deployments or attractive civilian job opportunities. In their analysis, CBO did not examine the overall trends in retention in the military and could neither verify nor dismiss reports of serious retention problems. However, its analysis did indicate that Redux was unlikely to be the cause of any marked change in retention patterns [Ref. 25, p. 1].

#### **E. SUMMARY**

The military leadership stated in late 1998 that military readiness had deteriorated during the 1990's and that immediate action in 1999 followed by a long term plan in 2000 would be required in order to avoid a hollow force. Military retirement reform was one of the top priorities in the battle to improve retention and military readiness. While it was difficult to measure the exact effects of Redux on retention and morale, military retirement reform became a topic of serious debate during the late 1990's. Because of the emphasis the Joint Chiefs placed on military retirement reform, the retirement system was changed in 1999. The next chapter will focus on the military retirement reform proposals of the Clinton Administration and Congress that were presented in 1999.

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#### IV. THE BUDGET PROCESS AND THE CLINTON ADMINISTRATION'S RETIREMENT REFORM PROPOSAL

##### A. INTRODUCTION

In order to enact military retirement reform in 1999, Congress and the President had to work together. The President submitted his proposed changes to the military retirement system along with his budget submission. Congress analyzed his proposals and enacted their own changes to the military retirement system. The President approved the changes enacted by Congress and signed the changes into law.

This was a complicated process because Congress did not enact the changes to military retirement system using the normal legislative process. Normally, Congress authorizes changes and then appropriates enough money to pay for the changes authorized, within a single fiscal year. In the case of military retirement reform in 1999, Congress appropriated the money for reform in the FY 1999 Emergency Supplemental and then authorized the changes in the FY 2000 Authorization Act. Once both houses of Congress agreed to the changes to the retirement system, the legislation was forwarded to the President for signature. This process took nearly a year to complete.

This chapter and the next will examine the changes to the military retirement system that were enacted in 1999 in the defense budget process. Specifically, this chapter first provides a brief overview of the congressional defense budget process. Next, the chapter examines the Clinton Administration's proposed changes to the military retirement system. In the next chapter, we will focus on the congressional changes to the military retirement plan and examine how those changes were enacted.

#### **B. CONGRESSIONAL BUDGET PROCESS**

The congressional budget process begins with the President's budget submission. The law stipulates that the President's budget must be submitted to Congress on or after the first Monday in January but not later than the first Monday in February of each year for the following fiscal year, which begins on October 1 [Ref. 26, p. 394]. For example, the President's budget for fiscal year 2000 had to be submitted to Congress by 1 February 1999, the first Monday of February 1999. This allowed Congress eight months to develop the budget and forward it to the President for signature prior to the beginning of the new fiscal year.

Congress considers the President's budget proposals and approves, modifies, or disapproves them. Congressional

action on the defense budget is a three-step process established by the Congressional Budget Act of 1974 (P.L. 94-344]. The congressional budget process has been amended by five laws--the Balanced Budget and Emergency Deficit Reduction Act of 1985 (P.L. 99-177), better known as the Gramm-Rudman-Hollings (GRH) Act; the Balanced Budget and Emergency Deficit Control Reaffirmation Act of 1987 (P.L. 100-119, also known as GRH-2; and the Budget Enforcement Act (BEA) of 1990, the Omnibus Budget Reconciliation Act of 1993 (P.L. 103-66), and the Budget Enforcement Act of 1997 (P.L. 105-33) [Ref. 27, p. 29].

#### **1. Congressional Budget Resolution**

The first step of the congressional budget process is the passage of the Concurrent Budget Resolution (CBR). The budget resolution establishes revenue targets and sets ceilings on budget authority and outlays for the federal budget in total and by functional category [Ref. 27, p. 31]. Budget authority (BA) is the authority provided by law to a federal agency to enter into obligations for the provision of goods and services that will result in immediate or future outlays of government funds [Ref. 26, p. 407]. Outlays are the payments made by a federal agency from the funds provided to it by Congress [Ref. 27, p. 63]. In

simple terms, "budget authority is permission to spend; outlays are the actual spending" [Ref. 28, p. 55].

Under the procedures of the Congressional Budget Act of 1974, Congress decides on budget totals before completing action on individual appropriations. Each standing committee in the House and Senate recommends budget levels and reports legislative plans to their respective Budget Committee [Ref. 26, p. 394]. The House and Senate Budget Committees are responsible for reporting the budget resolution to Congress with recommendations on funding for the national defense budget function [Ref. 27, p. 32].

Once both the House and the Senate pass their own version of the budget resolution, the budget resolutions are sent to a conference committee made up of members from both the House and the Senate to iron out the differences in the two versions. The conference committee reports out the final resolution, which is passed by the House and Senate [Ref. 28, p. 52]. The congressional timetable calls for the budget resolution to be adopted by Congress by April 15, but these timetables are regularly missed.

It should be noted that the annual budget resolution establishes overall targets for budget authority and outlays, but the resolution does not say how these funds should be allocated to specific defense programs. Actual

decisions on defense funding priorities are determined by the authorization and appropriations acts [Ref. 27, p. 33]. Additionally, budget resolutions are not laws, and therefore, do not require the President's signature.

## **2. Authorization Process**

The next step of the defense budget process is passage of authorization legislation. Authorization acts provide the legislative authority to establish or maintain a Government program or agency and to appropriate funds for governmental activities. Authorization acts define the scope of programs and authorize funding levels for programs either in terms of a specific amount or authorize funding levels "as may be necessary" to implement the program [Ref. 27, p. 34].

Each chamber of Congress has its own authorizing committee for the defense budget known as the Armed Services Committees. The authorizing committees are the policy-making centers on Capitol Hill, proposing solutions to defense problems and suggesting what they believe to be the necessary level of appropriations for new and existing defense programs [Ref. 28, p. 56].

The Armed Services Committees are responsible for reporting defense authorization legislation to Congress. Until 1959, most authorizations were permanent, with no time

limit. Since 1959, defense programs have increasingly been made subject to annual authorizations, including major procurement programs for aircraft, missiles, and naval vessels [Ref. 27, p. 35]. Funding for military personnel programs are not specifically authorized in the defense authorization act; however, it does authorize personnel end-strength levels, pay raises, and other policy changes including military retirement reform [Ref. 27, p. 35]. Since the authorization committees are often setting policy on defense issues, they usually hold hearings and receive testimony concerning these issues prior to making their recommendations on the defense budget.

The process for moving annual authorization acts through Congress is the same as for any other regular piece of legislation. The Armed Services Committees mark up the authorization acts and report the bills to the full floor of each House for debate and approval. Differences between the House and Senate versions are resolved in conference committees and the resulting bills are returned to each House for final approval. The approved measure is then sent to the President for approval or veto [Ref. 27, p. 35].

### **3. Appropriations Process**

The final phase in congressional defense budgeting is the appropriations process, which provides budget authority

to fund defense programs [Ref. 27, p. 37]. The defense appropriation act is one of thirteen annual appropriations subject to annual approval by Congress and the President.

In each House, the Defense Subcommittee of the Appropriations Committee has jurisdiction over military programs administered by the Department of Defense. These subcommittees hold hearings to review the President's defense budget request and prepare the defense appropriations legislation before full committee mark-up [Ref. 27, p. 39].

Appropriation bills are initiated in the House of Representatives. The Defense Subcommittee drafts the defense appropriation bill and reports it out to the Appropriations Committee. The Appropriations Committee and then the entire House debates and approves the bill. The House then forwards the bill to the Senate, where a similar review process follows. Once the Senate approves the appropriation bill, a conference committee is formed to resolve the differences between the House and Senate versions. Once the bill is agreed to in conference, it is returned to both legislative bodies for approval. When the final version of the Appropriations Bill is approved, first in the House and then in the Senate, Congress sends it to the President for signature or veto. Once the President

signs the Appropriations Act, the funds are allocated to the federal agencies to incur obligations on behalf of the government [Ref. 26, p. 395].

#### **4. Budget Enforcement Act of 1990**

One final item that should be noted concerning the congressional budget process is the Budget Enforcement Act (BEA) of 1990. The BEA significantly amended the laws pertaining to the budget process, including the Congressional Budget Act and the Balanced Budget and Emergency Deficit Control Act. The BEA, extended through 2002, constrained legislation that would increase federal spending or decrease receipts [Ref. 26, p. 396].

Within the federal budget, there are two types of spending categories, discretionary spending and mandatory spending. Discretionary spending is controlled through annual appropriations acts and includes funding for defense as well as the salaries and other operating expenses of the various agencies of the federal government. Mandatory spending provides funding for the entitlement programs of the federal government, such as the Social Security and Medicare programs, and interest on the debt. Mandatory spending is controlled by permanent laws and is not subject to the annual appropriations process [Ref. 26, p.396].



The BEA's fundamental focus was on spending and revenue controls. There were two enforcement mechanisms within the BEA. First, the BEA enforced spending caps on discretionary spending divided into categories. If the spending caps were breached within a category, the BEA required a procedure, called sequestration, that reduced the spending in that category [Ref. 26, p. 396, Ref. 27, p. 64].

When the BEA was first enacted, there were three categories established within discretionary spending--defense, domestic, and international--that were subject to spending caps for fiscal years 1991-1993 [Ref. 29, p. 3]. Although spending in any category could be below the caps, spending within a given category could not exceed the spending cap for that category. These categories were collapsed into a single general discretionary cap for fiscal years 1994 and 1995 [Ref. 29, p. 3].

Subsequent laws created new categories and extended the caps. For fiscal years 1995 through 2000, a new category, the violent crime reduction trust fund, was created with a separate spending limit carved out from the general purpose spending caps. In 1997, the BEA changed the cap structure again for fiscal years 1998 through 2002. For fiscal years, 1998 and 1999, three discretionary spending categories were established: defense, violent crime reduction, and

nondefense. For fiscal year 2000, defense and nondefense were combined and for 2001 and 2002, all three were combined into one discretionary spending category [Ref. 29, p. 3].

Additionally, the Transportation Equity Act for the 21<sup>st</sup> Century (TEA-21) established two new outlay caps that applied separately to highway and mass transit programs for 1999 through 2003 [Ref. 29, p. 3]. Tables 2 summarizes the discretionary spending categories by fiscal year.

Table 2  
 Discretionary Spending Categories  
 By Fiscal Year  
 (1991-1996)

1991	1992	1993	1994	1995	1996
Defense	Defense	Defense	Discretionary	Violent Crime Reduction	Violent Crime Reduction
International	International	International		Discretionary	Discretionary
Domestic	Domestic	Domestic			

Source: Ref. 29, p. 3

Table 2 (Continued)  
 Discretionary Spending Categories  
 By Fiscal Year  
 (1997-2002)

1997	1998	1999	2000	2001	2002
Violent Crime Reduction	Violent Crime Reduction	Violent Crime Reduction	Violent Crime Reduction	Discretionary	Discretionary
Discretionary	Defense	Defense	Discretionary		
	Nondefense	Nondefense			
		Highway	Highway	Highway	Highway
		Mass Transit	Mass Transit	Mass Transit	Mass Transit

Source: Ref. 29, pp. 3,4

The second major enforcement mechanism of the BEA made mandatory spending and revenues subject to "pay-as-you-go" (PAYGO) procedures. PAYGO required that any tax reductions or increases in mandatory spending programs must be offset by tax hikes or reductions in other mandatory spending programs [Ref. 28, p. 84]. The PAYGO rules did not apply to increases in mandatory spending or decreases in receipts that are not the result of new laws. For example, PAYGO did not apply to an increase in Social Security outlays that were a result of an increase in the age of the population making more people eligible for the benefit.

#### **C. THE CLINTON ADMINISTRATION BUDGET SUBMISSION**

##### **1. Budget Request**

The President's budget set forth the President's comprehensive financial plan for allocating resources, including defense spending, and indicated the President's priorities for the federal government [Ref. 26, p. 407]. The President requested \$268.2 billion in new budget authority and \$261.8 billion in outlays for the Department of Defense as part of the FY00 budget submission to Congress [Ref. 30, p. 153]. This was approximately 15 percent of the total budget submission [Ref. 30, p. 12].

The centerpiece of the defense budget request was an attempt to improve recruiting and retention of military personnel with improvements to the military compensation package for active duty personnel. The President's budget proposal included a 4.4 percent across the board pay raise for all military personnel, improved retirement benefits for some members, and pay table reform. The President's proposed pay table reform initiative increased the pay of military personnel up to 5.5 percent in addition to the across the board pay raise and focused on improving the pay of personnel following promotion [Ref. 31, p. 2].

## **2. Proposed Changes to Redux**

Although the Administration proposed modifying the Redux retirement benefits package, the plan did not simply repeal Redux and put all military members who entered the service after 1 August 1986 under the High Three Plan. The Clinton plan proposed overturning provisions that lowered the base annuity, thus allowing service members covered by Redux to receive the same multiple of their highest three years of base pay as people who entered military service between September 8, 1980, and July 31, 1986 [Ref. 32, p. 47]. In other words, President Clinton's proposed retirement plan reversed the retirement changes enacted in 1986 under the Military Retirement Reform Act. His plan

raised the retirement benefits from 40 percent back to 50 percent of base pay for members who entered the military after 1 August 1986 and retired after 20 years [Ref. 31, p. 2]. For military personnel under Redux, the annuity factor would be calculated the same as for those under the High Three Plan, i.e., the number of years of service multiplied by 2.5 percent with a maximum at 75 percent of base pay.

However, the Administration's plan altered the COLA of the Redux plan. Redux did not provide full CPI protection to the COLA as was the case under the High Three Plan. Under the High Three Plan, the COLA adjustment was equal to change to the CPI index. Under Redux, the COLA adjustment was equal to the change in the CPI less one percentage point. The President's proposal made the COLAs for post-2006 retirees more generous than Redux, but less generous than the COLA in effect for those who joined before 1986 [Ref. 33, p. 72].

Additionally, the Administration's plan included a proposal to change the scoring of the military retirement benefits in the federal budget. Under current law, the actuarially determined cost of future retirement benefits of current employees must be paid into the military retirement trust fund out of annual appropriations. The Administration proposed scoring the costs of increased benefits, estimated

at \$5.6 billion over the next six years, as mandatory funds [Ref. 34, p. 8]. This would mean that the actuarially determined cost to be paid into the military retirement trust fund would be permanent law and not subject to the annual appropriations budgetary process. It would also mean that any changes to the military retirement benefits would be subject to PAYGO rules and not limited to the discretionary spending caps.

### **3. The Cost of the President's Retirement Proposal**

CBO estimated that the Administration's proposals for modifying the military retirement system would cost about \$0.8 billion in FY 2000 and would eventually cost about \$2 billion a year. The cost to the Department of Defense would be about 12 percent higher under the President's proposed military retirement system than under the Redux plan [Ref. 32, p. 47].

#### **D. SUMMARY**

Approving the defense budget is a long and complicated process. It begins with the President's budget submission to Congress, which outlines his priorities and allocation of resources to be used for national defense. Congress spends several months going through the budgetary process formulating their own priorities and plans for the use and

allocation of government resources in the defense of the United States.

This chapter reviewed the complicated defense budget process and examined how the Department of Defense is normally funded and how the changes in defense policy are usually enacted. Then, the chapter examined the President's proposal for military retirement reform in the FY00 budget request and the cost impacts it would have on the Department of Defense. The next chapter examines the changes to the military retirement system enacted by Congress in 1999 and how those changes came about.



## V. CONGRESSIONAL ACTION

### A. INTRODUCTION

In the previous chapter, this thesis examined the federal budget process and the President's FY 2000 defense budget submission. Specifically, it reviewed the Administration's proposed changes to the military retirement system within the President's budget request and discussed the cost associated with those proposed changes.

This chapter examines the proposed changes to the military retirement system enacted by Congress in 1999. Specifically, this chapter examines the critical legislation enacted by the 106<sup>th</sup> Congress, which reformed the military retirement system. Additionally, this chapter examines the cost associated with this legislation.

### B. THE SOLDIERS', SAILORS' AIRMEN'S AND MARINES' BILL OF RIGHTS ACT OF 1999 (S.4)

Early in 1999, the U.S. Senate passed the Soldiers', Sailors', Airmen's and Marines' Bill of Rights Act of 1999 (S.4), one of the first pieces of legislation enacted by the Senate in 1999. Following the President's budget submission requesting funds for improving military pay and retirement benefits, the Senate acted quickly to show their support for improving the quality of life for military members and

passed S.4 on February 24, 1999 by a vote of 91-8 [Ref. 35, p. 495].

The Senate's legislation went beyond the President's budget request to improve the quality of life of military members. In the Senate's proposal, S.4 authorized a 4.8 percent across the board pay raise for all military personnel effective 1 January 2000, reformed the military pay tables, and revised the military retirement system. Additionally, S.4 authorized active duty military personnel to participate in the Thrift Savings Plan, revised the benefits of the Montgomery G.I. Bill and authorized a special subsistence allowance for junior enlisted military personnel who demonstrated eligibility for food stamps [Ref. 36, p. 1].

#### **1. Proposed Changes to Military Retirement Benefits**

S.4 introduced a new initiative in its version of the military retirement reform. S.4 gave members of the military who entered the service after 1 August 1986 a choice upon reaching 15 years of service. Under the first option, these members could elect to retire under the pre-1986 military retirement, the High Three Plan [Ref. 36, p. 4,5].

S.4 also offered those military members a second option. Under section 201, military personnel under the

Redux retirement plan could elect to receive a one-time \$30,000 lump sum bonus and remain under the Redux retirement plan. Service members who elected to accept the lump sum bonus would be obligated to serve the remaining five years to become retirement eligible. Those who did not complete the required service would be required to repay a prorated amount based on the unserved amount of the obligation [Ref. 36, p. 5].

## **2. The Cost of S.4's Changes to the Retirement System**

CBO estimated that the costs to the Department of Defense under the provisions of S.4 due to the changes in the retirement package would total about \$674 million in 2000 and almost \$6 billion for the period 2000-2004 [Ref. 37, p. 5].

The primary budget impact of S.4's changes to Redux would stem from the accrual payments that DoD would have to make to the military retirement trust fund. The military retirement system is financed, in part, by annual appropriations to make payments to the military retirement trust fund based on an estimate of each year's newly accrued liabilities. Repealing Redux under the S.4 plan would require an increase in these payments to finance the increased liability under the more generous system [Ref. 37, p. 5].

In addition to the increased cost associated with the increased accrual payments to the military retirement fund, CBO estimated that DoD would also spend about \$500 million a year for the lump-sum payments. This figure was based on an assumption that 50 percent of enlisted personnel and about 40 percent of officers would elect to receive the lump-sum payment and lower retirement annuity. CBO used DoD's experience under two previous buy-out programs, the Voluntary Separation Incentive (VSI) and the Special Separation Benefit (SSB) programs [Ref. 37, p. 5], in developing this estimate.

S.4 was a significant piece of legislation because it demonstrated that there was large support for military retirement reform in Congress. S.4 was also important because it was the first plan enacted that proposed a significant deviation from the President's proposal for retirement reform. Specifically, S.4 was the first piece of legislation that provided the option for military members under Redux to choose between the High Three Plan or the \$30,000 lump-sum option. Additionally, S.4 was significant because the Senate passed S.4 prior to passing the Budget Resolution. Normally, the Budget Resolution, which provides fiscal guidance, is enacted prior to passing any other legislation changing revenues or outlays:

### C. THE 1999 EMERGENCY SUPPLEMENTAL APPROPRIATIONS ACT

In April of 1999, President Clinton sent a \$5.46 billion emergency supplemental appropriations request to Congress to cover the costs associated with military operations in Kosovo and air strikes against Iraq. Five billion dollars was requested to pay for the U.S. military operations in Kosovo that began in March of 1999 and \$453 million was requested to replace cruise missiles fired at Iraqi targets in the fall of 1998. The five billion dollars would pay for the U.S share of NATO air strikes as well as humanitarian support for ethnic Albanians driven out of the Serbian province of Kosovo [Ref. 38, p. 1138].

The 1999 Emergency Supplemental Appropriations Act (P.L. 106-31) passed by Congress appropriated a total of \$14.5 billion in supplemental funds. President Clinton signed it into law on 21 May 1999 [Ref. 39, p. 1226]. Not only did the emergency supplemental appropriate funds for military operations in Kosovo, it also provided \$1.838 billion in emergency appropriations for fiscal year 2000 for increases in military basic pay and for increases in payments to the Department of Defense Military Retirement Trust Fund [Ref. 40, p. 28) for military retirement reform. Of the \$1.838 billion designated for the military personnel

accounts, \$796 million was appropriated to pay for Redux reform based on the President's request [Ref. 41, p. 1].

Since the President and Congress had proposed different approaches to military retirement reform, the availability of the funds for retirement reform was conditional upon the enactment of authorizing legislation and the designation of the funds as "emergency appropriations" by the President. The increased funding was provided in expectation of Congress authorizing a change in the military retirement system that would allow 20-year veterans to retire at 50 percent of basic pay instead of 40 percent as enacted in 1986 [Ref. 39, p. 1226].

The 1999 Emergency Supplemental Act was a significant piece of legislation because the appropriated funds were not subject the strict budget caps passed in the 1997 Balanced-Budget Law (PL 105-33) [Ref. 38, p. 3]. Congress, seeing an opportunity to appropriate money that would not be scored against the discretionary spending caps, significantly increased the President's emergency supplemental request.

The legislative process used to provide the funds for military retirement reform was quite different from the normal budgeting process. Rather than authorizing the change to the military retirement system and then appropriating the money to pay for those changes, Congress

appropriated the funds first and made the funds subject to authorization. The following sections examine the House and Senate versions of FY 2000 Authorization Acts that approved the changes to the military retirement system.

**D. SENATE ACTION**

**1. The National Defense Authorization Act for FY 2000 (S.1059)**

The Senate passed its version of the FY 2000 Authorization Act (S.1059) on May 27, 1999, authorizing appropriations totaling \$289 billion for fiscal year 2000 for the military functions of the Department of Defense and the Department of Energy. S.1059 contained provisions that authorized changes to the military retirement system. CBO estimated that over the long run the provisions in S.1059 that changed the military retirement system raised the cost of this entitlement program by about 11 percent [Ref. 42, p. 1].

The Senate's changes to the military retirement system in its authorization bill were very similar to the changes proposed in the Soldiers', Sailors', Airmen's, and Marines' Bill of Rights Act of 1999 (S.4). The Senate's bill gave military members who entered the service after 1 August 1986 an option at their 15-year point. They could choose to

retire under the High Three Plan or opt to be paid a \$30,000 lump-sum payment and remain under Redux [Ref. 43, p. 323].

The Senate provided full CPI protection of the COLAs for members choosing the High Three Plan. Under S.1059, members electing the High Three Plan received COLAs equal to the CPI. If they remained under Redux and accepted the \$30,000 lump-sum payment, those members received COLAs equal to the CPI minus one percentage point [Ref. 43, p. 323].

## **2. The Cost of S.1059's Changes to the Retirement System**

CBO estimated that the cost of S.1059 to the Department of Defense due to the changes to the military retirement system would be \$674 million in FY 2000 and nearly six billion dollars by 2004 [Ref. 42, p.4]. Just as in S.4, the primary budget impact of S.1059's changes to the military retirement system would stem from the increased accrual payments that DoD would have to make to the military retirement trust fund.

In addition to the higher accrual charges, CBO estimated that DoD would spend about \$500 million a year for lump-sum bonuses based on the assumption that 50 percent of enlisted personnel and about 40 percent of officers would elect to receive the lower annuity in retirement [Ref. 42, p. 8].



## **E. HOUSE ACTION**

### **1. The National Defense Authorization Act for FY 2000 (H.R. 1401)**

The House passed its defense authorization bill for FY 2000, H.R. 1401, on June 10, 1999, authorizing appropriations totaling \$291.0 billion for the military functions of the Department of Defense. H.R. 1401 included provisions that would affect direct spending through changes to the military retirement system. CBO estimated the provisions to change the retirement system would increase the cost of this entitlement program by about six percent [Ref. 44, p. 1].

The House's changes to the military retirement system in its authorization bill were different than the changes proposed in the Senate's version. The House's version of the FY00 Authorization Act, like the Senate's, gave military members who entered the service after 1 August 1986 an option at their 15-year point. They could choose to retire under the High Three Plan or opt to stay under Redux and immediately receive a \$30,000 lump-sum payment [Ref. 45, p. 189].

However, the House's version provided less COLA protection than the Senate's version. Under the Senate's version, members electing the High Three Plan received COLAs

equal to the CPI. In the House's version, personnel who elected not take the \$30,000 lump-sum payment and chose to retire under the High-Three plan received COLAs that were less than the CPI. In the House's version, if the member elected the High Three Plan and the CPI was equal to or greater than three percent, that member's COLA would be equal to CPI less one percent. If the CPI was less than three percent, the member's COLA was equal to two percent [Ref. 45, p. 190].

If the member opted to receive the \$30,000 lump sum at the 15-year point and remain under Redux, the member's COLA would be equal to the CPI less one percent. If the CPI was one percent or less, the COLA would be increased by one percent [Ref. 45, p. 189]. In effect, the House established a floor for the COLAs: a one percent floor for those electing the lump-sum payment and a two percent floor for those selecting the High Three Plan.

## **2. The Cost of H.R. 1401's Changes to the Retirement System**

CBO estimated that the resulting cost from the accrual payments associated with H.R. 1401's changes to Redux would be \$443 million in 2000 and \$4.5 billion by 2004. In addition to the higher accrual charges, CBO estimated that DoD would spend about \$500 million a year for lump-sum

bonuses. This was based on the assumption that 50 percent of enlisted personnel and about 40 percent of officers would elect to receive the lower annuity in retirement.

**F. THE NATIONAL DEFENSE AUTHORIZATION ACT FOR FY 2000  
(H. REPT. 106-301)**

**1. The Authorized Changes to the Military Retirement System**

President Clinton signed into law the National Defense Authorization Act for fiscal year 2000 (H. Rept. 106-301) on 5 October 1999. The FY 2000 Authorization Act authorized appropriations totaling \$288.8 billion for the military functions of the Department of Defense and Department of Energy. It also increased the retirement benefits for members of the armed forces who entered the service on or after 1 August 1986 [Ref. 46, p. 1].

H. Rept. 106-301 closely resembled the provisions in the Senate's version of the Authorization Bill (S.1059). Under H. Rept. 106-301, personnel entering the military after July 31, 1986 had to choose between the High Three Plan and the modified Redux Plan at their 15-year career point [Ref. 47, p. 151].

The bill provided full COLA protection for personnel electing to retire under the High Three Plan. For these personnel, COLA increases will equal the CPI. For personnel

selecting the modified Redux retirement plan and the \$30,000 lump-sum payment, COLA increases will remain as they were under Redux, i.e., annual COLAs will equal the CPI less one percentage point [Ref. 47, p. 151].

## **2. The Cost of H. Rept. 106-301's Changes to the Retirement System**

The Senate Budget Committee (SBC), based on CBO calculations, estimated that the cost of the changes to the Redux retirement approved in the FY 2000 Authorization Act was \$674 million for fiscal year 2000, increasing to \$1.5 billion in 2004. The five-year cost was estimated at nearly six billion dollars [Ref. 48, p. 1]. Because the increased benefits applied only to members who entered the service after July 31, 1986, CBO estimated that the annual costs would rise sharply in 2007 as the first full wave of military members under the new law became eligible to retire. In the long run, CBO estimated spending for military retirement would be about 11 percent higher than under the previous military retirement system [Ref. 49, p. 3].

Because H. Rept. 106-301 offers increased retirement benefits based on service prior to the effective date, payments from the military personnel accounts would not cover the entire cost of the increased benefits. As a

result, the unfunded liability of the military trust fund increased by approximately \$4.5 billion. The Department of the Treasury would pay the trust fund that amount over many years [Ref. 49, p. 3].

**G. SUMMARY**

In 1999, the 106<sup>th</sup> Congress, along with President Clinton, enacted military retirement reform. The enactment process varied significantly from the normal defense budget process. Rather than first authorizing the changes to the military retirement system and then appropriating funds in the annual appropriations bill, Congress appropriated the funds in a FY 1999 emergency supplemental bill and made the release of those funds subject to an authorization process that occurred in FY 2000.

There were different versions of military retirement reform proposed by the President, the House, and the Senate. After much deliberation and debate, the military retirement system was changed in the FY 2000 Authorization Act and offered military members a choice in their retirement plan. Those members who entered the service after July 31, 1986 had to choose at their 15-year point whether to accept a \$30,000 lump-sum payment and remain under Redux or opt for the High Three Plan. The Act that altered the retirement

benefits was signed into law by the President on October 5, 1999.

Table 3 below provides a comparison of the estimated cost of the authorizations of appropriations of the various retirement plan proposals.

TABLE 3

Estimated Costs of Authorizations of Appropriations For  
 Various Military Retirement Proposals  
 (By fiscal year, in millions of dollars)

PROPOSAL	2000	2001	2002	2003	2004	TOTAL
President's Request	796	888	983	1049	1082	4,798
S.4	674	862	1,437	1,453	1,541	5,967
S.1059	674	862	1,437	1,453	1,541	5,967
H.R.1401	443	596	1,136	1,137	1,187	4,499
P.L. 106-65	674	862	1,437	1,453	1,541	5,967

Source: Ref. 37, p. 2; Ref. 42, p. 4; Ref. 44, p. 4, Ref. 50, p. 1

## VI. SUMMARY AND CONCLUSIONS

### A. SUMMARY

The military retirement system has undergone many changes since its beginning in 1861, when voluntary non-disability retirement was first established. In 1999, the 106<sup>th</sup> Congress and President Clinton enacted another significant change to the military retirement system.

Prior to the enactment of retirement reform in 1999, there were three military retirement plans, the Final Pay Plan, the High Three Plan, and Redux. The retirement plan that a service member fell under was dependent upon when that member entered military service. Service members who entered the service prior to 8 September 1980 were under the Final Pay Plan. This plan allowed service members to retire at 50 percent of their final base pay after 20 years of service with full CPI protection of their COLAs. Members who entered the military after 8 September 1980 and before 1 August 1986 fell under the High Three Plan. This plan was similar to the previous plan except that the retirement benefit was based on the average of the member's basic pay over the last 36 months of service.

The Military Retirement Reform Act of 1986 reduced the retirement benefit for military members who entered the

service on or after August 1, 1986. Instead of 50 percent of their basic pay after 20 years, these members received only 40 percent of their basic pay and their COLAs were not increased as much as before. Instead of full CPI protection, their COLAs were equal to CPI minus one percent.

In the late 1990's, the military leadership was convinced that the readiness of the U.S. military was declining. The Joint Chiefs of Staff testified before Congress in September of 1998 that the U.S. military could return to the "hollow force" of the 1970's unless readiness and modernization concerns were addressed. The Service Chiefs attributed part of this downward turn in readiness to poor retention of experienced and quality service members. The Joint Chiefs reported to Congress that the quality of life for the personnel in uniform was their greatest concern and that reforming military retirement and military pay was their highest priority [Ref. 22, p. 3]. The Service Chiefs believed that by improving military retirement by modifying the Redux retirement plan, retention rates would improve and overall military readiness would increase.

In 1999, Congress enacted legislation to improve the quality of life for service members, including pay raises, pay table reform, and military retirement reform. However, the process by which this was accomplished differed from the



normal budget process. Instead of authorizing the changes to the military retirement system and appropriating funds to pay for the changes, Congress appropriated the money for military retirement reform in the FY 1999 Emergency Supplemental Act. These funds were made subject to authorizing legislation in the FY 2000 Authorization Act.

The changes to the military retirement system were part of the FY 2000 Authorization Act that was signed into law on 5 October 1999. The new retirement system offered service members who entered the military on or after 1 August 1986 a choice at their 15-year point. They could remain under the Redux retirement plan and accept a \$30,000 lump-sum payment or retire under the High Three Plan. These members still had to serve 20 years to be retirement eligible.

## **B. CONCLUSIONS**

### **1. Retirement Modifications Will Help, But Not Enough**

The changes made to the retirement system should help to improve retention by convincing experienced and well-trained personnel to stay in the military. The increased retention of quality personnel will improve the overall readiness of the U.S. military.

However, the changes to the retirement system by themselves will not significantly increase the retention of

military personnel. The modifications to the retirement system, coupled with the across-the-board pay raises and pay table reform enacted in 1999, will positively impact retention and readiness.

Even these improvements in compensation and benefits may not be enough to achieve the appropriate retention and recruitment levels. Many factors determine whether an individual decides to stay in the military, including operations tempo, medical benefits, and family housing to name a few. GAO recently completed a survey of approximately 1,000 service members. Of those surveyed, more than half intended to leave the military. While no single factor accounted for these results, the majority of reasons (62 percent) for leaving the military were related to work circumstances. Some of these reasons included the lack of equipment and materials to complete daily tasks, undermanning of units, frequency of deployments, and lack of personal time with their families [Ref 52, p. 2-3]. If some of these critical areas affecting the quality of life of service members are not addressed, the U.S. military will continue to face retention and readiness challenges.

## **2. Surplus, Spending Caps Remain Intact**

The right circumstances were in place in 1999 making it easier for Congress to enact legislation that improved the

retirement benefits of military personnel. First, CBO estimated an on-budget surplus of \$14 billion for FY 2000, assuming Congress complied with the statutory caps on discretionary outlays [Ref. 51, p. 6]. Additionally, CBO estimated the on-budget surpluses would continue to increase, reaching \$178 billion by 2009 if the U.S. economy remained strong [Ref. 51, p. 21]. With a significant budget surplus for FY 2000 and increasing surpluses forecasted for well out into the future, the 106<sup>th</sup> Congress was not under the extreme budgetary pressures as previous sessions of Congress, especially those of the late 1980's and early 1990's. This made it much easier for Congress to pass legislation increasing the retirement benefits of certain military members.

Since the funds appropriated in the FY 1999 Emergency Supplemental were not scored against the discretionary spending caps, Congress seized the opportunity to increase the retirement benefits because they didn't have to worry about the increases counting against the spending caps. This allowed Congress to increase the retirement benefits while simultaneously freeing up this money in the FY 2000 annual appropriations bill for other purposes.

This combination of events, the FY 1999 Emergency Supplemental and the on-budget surplus, made increasing the

retirement benefits of certain military members by the 106<sup>th</sup> Congress a reality.

### C. RECOMMENDATIONS FOR FUTURE RESEARCH

In answering the research questions of this thesis, other questions have been raised. The purpose of this section is to briefly describe potential areas of interest for further research relating to this topic.

First, the Joint Chiefs of Staff reported to Congress that the quality of life for personnel in uniform was their greatest concern and reforming military retirement and military pay was their highest priority [Ref. 22, p. 3]. The service chiefs argued that by improving military retirement, retention rates would improve and overall military readiness would increase. Congress, in response to the military leaders' request, enacted retirement reform in 1999, improving the retirement benefits of certain military members. An examination of whether the changes enacted 1999 actually improved retention and readiness would provide useful information on the success of these policy changes. Additionally, this information could prove useful in determining whether changes in the military retirement benefits should be used as a force management tool.

The military retirement benefits were reduced in 1986 by the Military Retirement Reform Act. Congress reduced the retirement benefits during a time of rising budget deficits and mounting budgetary pressures to reduce government spending. In 1999, Congress improved the military retirement benefits while enjoying an on-budget surplus estimated to be \$14 billion and growing. Further research may provide useful insights if Congress decides to reduce the military compensation package including military retirement benefits if the federal budget begins to run smaller surpluses than predicted or begins to run deficits again.

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