WRITTEN TESTIMONY FOR THE RECORD

of

The

ASSOCIATION of the UNITED STATES NAVY

Submitted to the
Senate Armed Services Committee

Hearing on
Military Compensation

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Submitted By

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National Executive Director

The Association of the United States Navy (AUSN) continues its mission in support of our nation's Sailors and Veterans alike. Formerly known as the Naval Reserve Association which traces its roots back to 1954, AUSN was established on 19 May 2009 to expand its focus on the entire Navy. AUSN works for not only its members but for the Navy and Veteran community overall by promoting the Department of the Navy's interests, encouraging professional development of officers and enlisted and educating the public and political bodies regarding the nation's welfare and security.

AUSN prides itself on personal career assistance to its members and successful legislative activity on Capitol Hill regarding equipment and personnel issues. The Association actively represents its members by participating in the most distinguished groups protecting the rights of military personnel. AUSN is a member of The Military Coalition (TMC), a group of 34 associations with a strong history of advocating for the rights and benefits of military personnel, active and retired. AUSN is also a member of the National Military Veterans Alliance (NMVA) and an associate member of the Veterans Day National Committee of the Department of Veterans Affairs (VA).

The Association's members include Active Duty, Reserve and Veterans from all 50 states, U.S. Territories, Europe, Asia, South America and Australia. AUSN has 81 chapters across the country. Of our over 20,000 members, approximately 80 percent are Veterans, with the remaining 20 percent Active Duty and Reserve. Our National Headquarters is located at 1619 King Street in Alexandria, Virginia, and we can be reached at 703-548-5800.

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SUMMARY

Chairmen Levin, Ranking Member Inhofe and Members of the Senate Armed Services Committee, the Association of the United States Navy (AUSN) thanks you and your Committee for the work that you do in support of our Navy, Veterans, Retirees and their families. Your efforts have allowed significant progress in creating legislation, through 50 plus years of consecutive National Defense Authorization Acts (NDAA), that has left a positive impact on our Navy and military community.

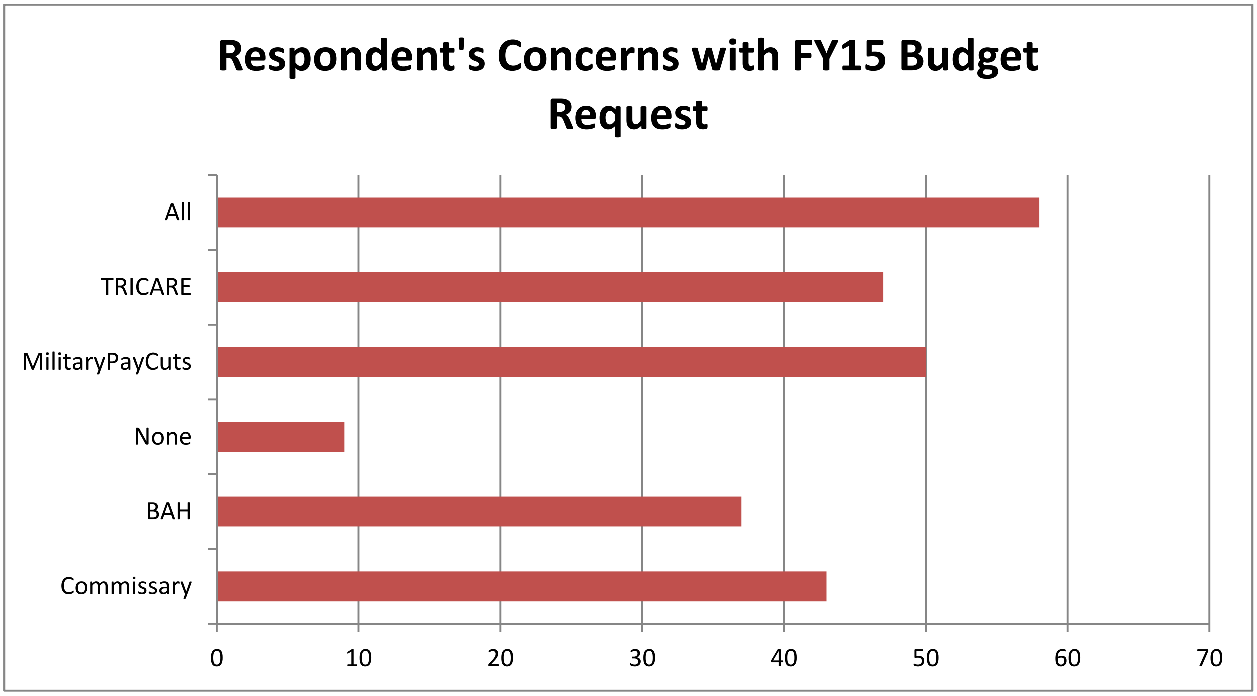
On 4 March 2014, the Administration sent to Congress the President's Budget (PB) request for Fiscal Year 2015 (FY15). The PB requests a total of **$495.6 billion** for the Department of Defense (DOD) budget, about **$31 billion** less than Fiscal Year 2014 (FY14) requested levels. Despite some programs seeing positive steps forward, there are significant 'cost saving' measures being proposed which could impact overall morale, recruitment, retention and readiness in the military. Of particular concern are proposals within DOD's budget to reduce military pay raises, lower Commissary subsidies, reduce the Basic Allowance for Housing (BAH) and merge three different TRICARE plans: Prime, Standard and Extra into one Consolidated TRICARE Health plan, while instituting TRICARE for Life (TFL) enrollment fees and increasing pharmacy copays. All of these changes are being proposed before the Military Compensation and Retirement Modernization Commission (MCRMC), mandated by Congress in the Fiscal Year 2013 (FY13) NDAA, which has finished its work and should come up with its final report in February 2015.

The six percent reduction in BAH will result in higher out-of-pocket costs for those servicemembers living off base. Base barracks are not built to accommodate 100 percent of the servicemembers stationed there, so this will undoubtedly affect many Sailors. The housing allowance is calculated based on the average cost-of-housing for the area and is meant to provide servicemembers with the ability to live in satisfactory accommodations. The proposed budget also puts the base pay cap below private sector pay growth determined by the Employment Cost Index (ECI), with an increase of one percent rather than 1.8 percent. This is the second year that DOD has tried to cap the pay increase at one percent. Before last year, servicemembers' last three pay increases averaged at 1.4 percent, and the FY14 NDAA pay increase was the smallest in almost 50 years. In addition, the proposed reduction in savings at the Commissary would result in a roughly 20 percent price spike. The PB also plans for TRICARE pharmacy copay increases and the establishment of enrollment fees, while also creating a consolidated TRICARE plan, eliminating the managed care option and leaving only a fee-for-service option for retirees and families.

We have heard DOD officials say that the cuts will not harm quality of life; however, there is no doubt that it will have a substantial effect on purchasing power and affect day-to-day financial decisions. For instance, the total loss in purchasing power for an Active Duty E-5 family of four would be **$4,993** per year based on the proposed changes to TRICARE, BAH, pay raise cuts and Commissary savings put together. For an Active Duty O-3 family, the total loss of purchasing power would be **$5,890**. There are some who justify these cuts by saying military compensation is already very generous, but that's not necessarily true. Military compensation is fair and carefully constructed to sustain the stability of the all-volunteer force. AUSN shares the concern, along with many lawmakers, that these cuts will end up being a disincentive to serve. As the "Voice for America's Sailors," AUSN has always been a people first association, since it is our servicemembers, Veterans and retirees who help/helped make our Navy the finest force in the world. The readiness of our Navy follows in importance since our Sailors need the training, resources and modern equipment to carry out its mission.

AUSN Questionnaire of Active Duty, Reserve, Veteran and Retirees on FY15 Proposals
In order to better understand the concerns of the military and Navy community, beginning in mid-April, AUSN conducted a questionnaire of a couple hundred of our members who also passed along to friends and shipmates to hear how they were impacted or not impacted by the proposals being vetted in regards to military compensation and benefits. Overall, with results compiled on 28 April 2014, of the over 100 participants in the poll, 59 percent of respondents were Veterans/Retirees and 41 percent were Active Duty. Respondents were asked, "In the FY15 PB Request, I am most concerned with…" and had the choice of Military Pay Raise Cut, BAH Reductions, TRICARE Proposals, Commissary, None or All of the proposals. Comments were also submitted whereby one Active Duty Sailor stated, "I understand the need to tighten our belts, but [military personnel accounts] are not the places to do it," whereby another Active Duty Sailor stated, "Enlisted are already severely underpaid. Taking away more of their pay would be detrimental to morale." An additional comment came from one Active Duty Sailor who said that, "The cost of living has not gone down in our area, yet [DOD] has made the decision to knock down the BAH for Hampton Roads Virginia!" A Navy Veteran commented, "I appreciate the opportunity to have my input considered. DOD is breaking faith with all of us who serve/served faithfully, and I consider these proposals will negatively affect retention and recruiting." Another Navy Veteran stated in his submission, "While good equipment is important, it seems that the DOD has misplaced their priorities and are not taking care of the troops." The final compiled results showed that ALL of the proposals had a majority of concerns with TRICARE, with the Military Pay Raise cuts following

behind.



Source: *AUSN Legislative Questionnaire results of amount of polled individuals, impacted by category, [DISCLAIMER: Compiled by website visitors, where each respondent could select multiple subject areas of impact, and may not be a 'properly scientific poll,' but represents good dialogue on the subject]*

Before going into detail on the Military Compensation FY15 Budget proposals, we'd like to take the time to discuss a few pending concerns which are driving many of the proposals coming out of DOD. Most notably we will address sequestration and ask ourselves: is the current military compensation and benefits system truly unsustainable as many DOD officials claim, and haven't we seen the mistakes of drastic changes before?

SEQUESTRATION IMPACT

The national security environment we face today is as perilous as any in recent memory. Over the past several years, our defense budget has been struck time after time with reductions. The Budget Control Act (BCA) of 2011 started a **$487 billion** loss in the defense budget, and now we are at even greater risk threatened by a sequestration law cutting another **$500 billion** over the next decade.

We were told sequestration would never happen. But here we are in year two facing the blunt and irresponsible approach to taming our annual deficits and reining in the enormous debt we and future generations face. Despite sequestration being 'held at bay' for now due to the Bipartisan Budget Act (BBA) of 2013 agreement, the ongoing threat of it returning for Fiscal Year 2016 (FY16) continues to have looming consequences that must be paid attention to.

Under sequestration, defense, which accounts for less than 15 percent of the budget, is forced to take 50 percent of sequester cuts. It is disproportionate by any measure of understanding and incredibly detrimental to our national security. The results of these cuts have already been devastating to our national security, with our Navy alone at a historic low level of ships, facing worse than pre- World War II levels, should sequestration persist.

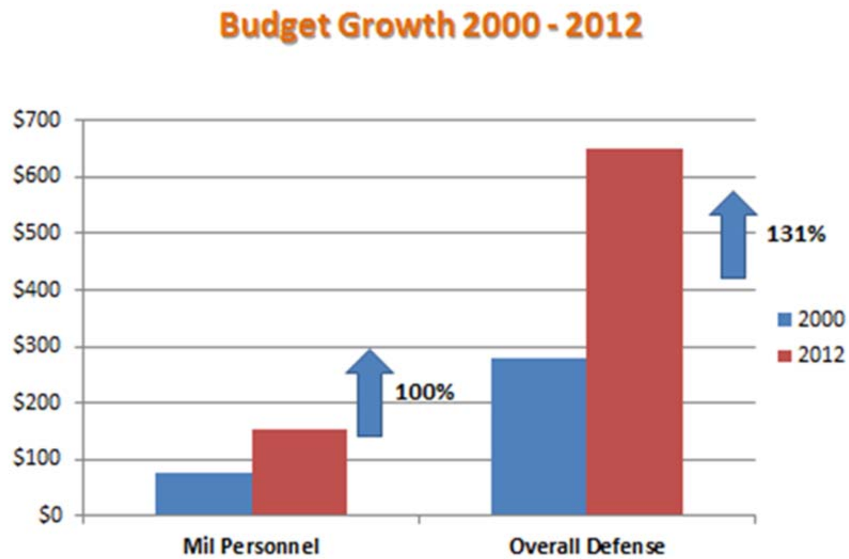
The readiness impact of sequestration not only threatens our military and forward presence but also has a significant impact upon the Navy family. For instance, the recent announcement in the FY15 PB to defer the decision on whether or not to early retire the USS *George Washington* (CVN-73) in FY16 has dire consequences for our fleet's capabilities. Scheduled to undergo Refueling and Complex Overhaul (RCOH), this vital but costly regularly scheduled carrier maintenance, threatens to reduce the fleet of Carrier Strike Groups (CSGs) from 11 to 10 and with any further delays of the Ford Class aircraft carrier, potentially down to nine. What is missing from this discussion to the effect on our national security that this has is the impact upon our military families, as we have seen with other RCOH delays of carriers. Delays and reduction in ships means longer deployments for other CSGs and, consequently, more time our Sailors are away from their families, impacting overall morale of our Navy community.

In addition, DOD recently released an April 2014 report titled "Impacts of Sequestration Level Funding" which noted not only the RCOH concerns with CVN-73 but also the Navy consequently having eight fewer ships procured throughout the remainder of the Future Years Defense Program (FYDP). Three fewer *Arleigh Burke* Class destroyers (DDGs) would be procured from Fiscal Year 2017 (FY17) through Fiscal Year 2019 (FY19), resulting in a smaller and less capable surface combatant force. Sequester level funding would also result in the FY16 *Virginia* Class Submarine procurement to be unaffordable and prolong the period where the force is below the desired level of fast attack submarines by four years. The Navy would also delay six P-8A "Poseidon" aircraft until Fiscal Year 2020 (FY20), substantially increasing per unit costs, and would procure two fewer F-35C variants in FY16. The entire Armed Services would also lose more than 530 Advanced Medium-Range Air-to-Air Missiles, and the Tomahawk Cruise Missile program would be eliminated. Perhaps the largest impact would be to the Operation and Maintenance (O&M) accounts, which include installation services and service readiness, which could be reduced by **$40 billion** over the course of the FYDP. Not funding Navy O&M accounts severely limits force structure, readiness and capability.

AUSN insists Congress eliminate sequestration and fund our military to levels that enable all components of the Armed Forces to be adequately manned, trained and equipped to focus on the mission— and not on fighting over an arbitrarily depressed defense budget. While debt reduction is a national priority, we believe that such a disproportional share of this burden must not be imposed upon DOD and especially on the backs of military members and families who already have sacrificed more for their country than any other segment of Americans.

SLOWING THE GROWTH? (Is it really that bad? Are we repeating past mistakes?)

Today sequestration is still the 'law of the land' and continues to impact the decisions made regarding cost savings within DOD, particularly when it comes to military compensation and benefits. We have faced similar budget scrutiny before, and the impact upon our military had significant consequences. AUSN is concerned that attempts to change compensation and retirement will cause the same negative effects that have been seen in the past. Military compensation and benefit changes, like our overall military readiness, should not be so heavily budget driven but rather should reflect strategy and modernizing for a 21st Century force. Recent military compensation studies within DOD have leaped to the erroneous conclusion that the cost trends of the last decade will continue indefinitely. This is not so. Yet, Pentagon leadership continues to focus on "recent growth trajectory." For example, the military personnel account, according to Office of Management and Budget's (OMB) historical table 3.2, has doubled between 2000 and 2012, from **$76 billion** to **$152 billion**. What the Pentagon doesn't advertise is that the overall defense budget grew over the same period from **$281 billion** to **$651 billion**, a 131 percent increase. This alone shows personnel costs are consuming a smaller share of the budget. So if any costs are "spiraling out of control," they're not personnel costs.



Source: *TMC Testimony to HASC- Military Personnel Subcommittee, April 2014*

While AUSN supports responsible spending in defense, past attempts to alter military compensation and retirement benefits have had significant negative impacts. For example, the REDUX program in the 1980's comes to mind, which was cancelled in 1999, when its attempts to reduce 20-year retirement benefits by 25 percent caused drops in retention and readiness levels.

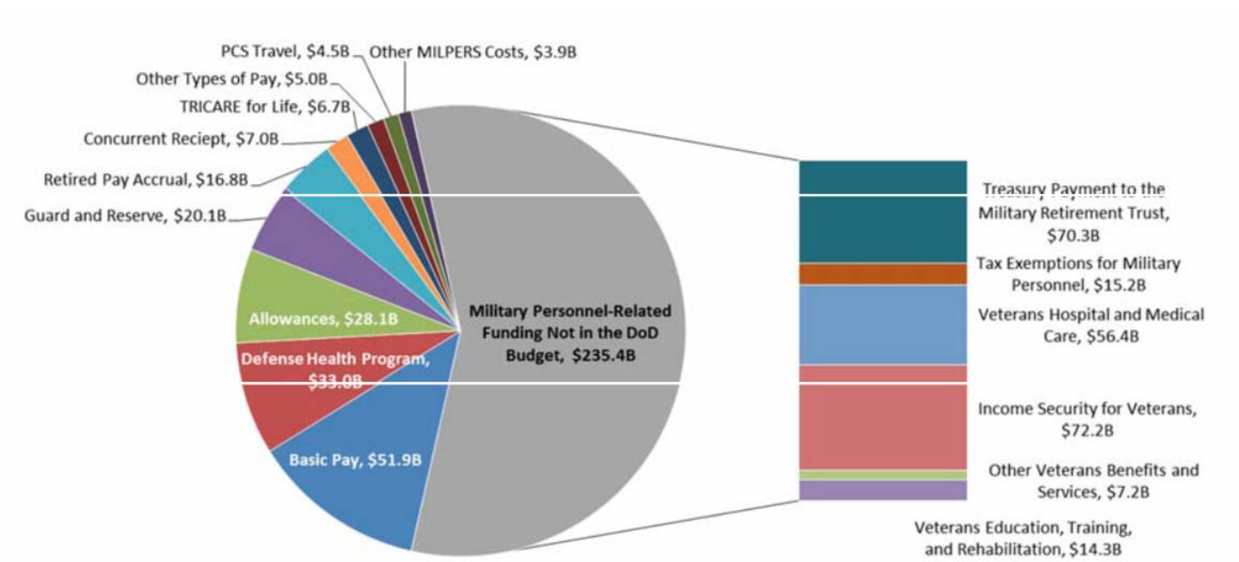
The REDUX system, enacted in 1986, was applied to service entrants on or after 1 August 1986. It provided 2.5 percent times high-36-month basic pay per year of service, except that one percent was subtracted for each year of service less than 30 (e.g., 40 percent of high-36-months basic pay after 20 years of service). Furthermore, REDUX retiree Cost-of-Living-Adjustments (COLAs) adjusted annually at a rate one percent less than the Consumer Price Index (CPI); (CPI-1). Under the REDUX law, retired pay was recomputed on a one-time basis when the retired member attains age 62. At that point, retired pay was recalculated to the amount that would have been payable under the high-36-month average system. After age 62, CPI-1 COLAs continued for life. The REDUX system further reduced lifetime retired pay value by up to 27 percent!

Congress repealed REDUX as the default system for post-1986 entrants in 2000, after the Joint Chiefs of Staff (JCS) complained that it was undermining career retention and readiness. At the time, the REDUX system was the most frequently mentioned reason for leaving service among separating personnel.

Under current law, the high-36-month retired pay system is the default option, but servicemembers have the option at the 15-year point of electing the REDUX option in return for a one-time **$30,000** taxable career retention bonus. Only a minority of servicemembers choose this option, and AUSN, as well as our counterparts, believe strongly that accepting this option is a very unwise decision.

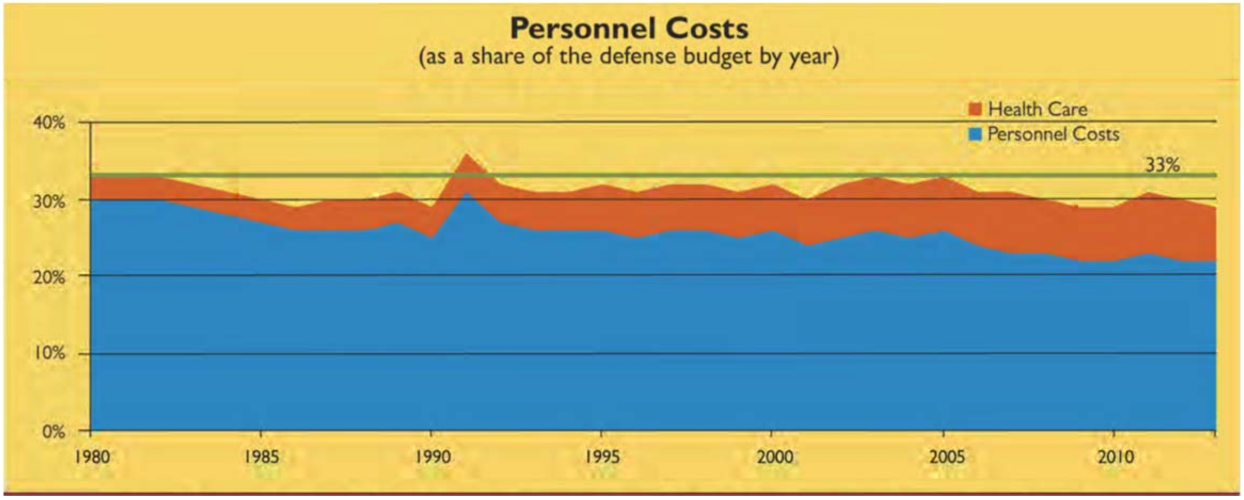
Additionally, past attempts at military pay caps have caused significant problems. A series of annual pay raise caps in the 1970s led to major negative impacts on retention and necessitated a pair of large "catch up" raises in 1981 and 1982. The same problem occurred again in the 1980s and 1990s, with pay caps contributing to an eventual peak "pay comparability gap" of 13.5 percent below the private sector.

There have been three areas where DOD has stated that Military Compensation and Benefits are becoming "unsustainable" and urged a need to "slow the growth," regarding "spiraling" compensation and benefit costs. Those areas are pay, healthcare and retirement. All three areas are vitally important to the recruitment and retention of our all-volunteer force, and all three are areas that DOD constantly sends proposals to change in each of the President's Budgets. Personnel and healthcare costs have represented the same share of the defense budget, about a third, which they have for the last 30 years, indicating that these costs are not spiraling out of control as DOD has claimed. In fact, looking at last year's FY14 Budget alone, as requested in the PB request, there was **$412 billion** allocated for total Military Personnel Costs, LESS THAN HALF of which is actually in the DOD budget. That means, of the PB requested **$526.6 billion** for the Base Budget of DOD, only **$176.6 billion**, about a third, is dedicated to ALL Military Personnel Costs for DOD, which, again, is about the same share of the DOD budget for the past 30 years. Hardly "unsustainable."



Source: *Center for Strategic and Budgetary Assessments*

Our successful all volunteer-force has been accomplished with the same portion of the DOD budget being allocated for human resources as there has been for the last 30 years. Less than one-third, of the total DOD budget goes towards pay, healthcare, retirement and other compensation, so, again, these are exaggerated claims that military compensation programs are the most impactful financial issue.



Source: MOAA 2013 Report titled, "A Bargain, Not a Liability"

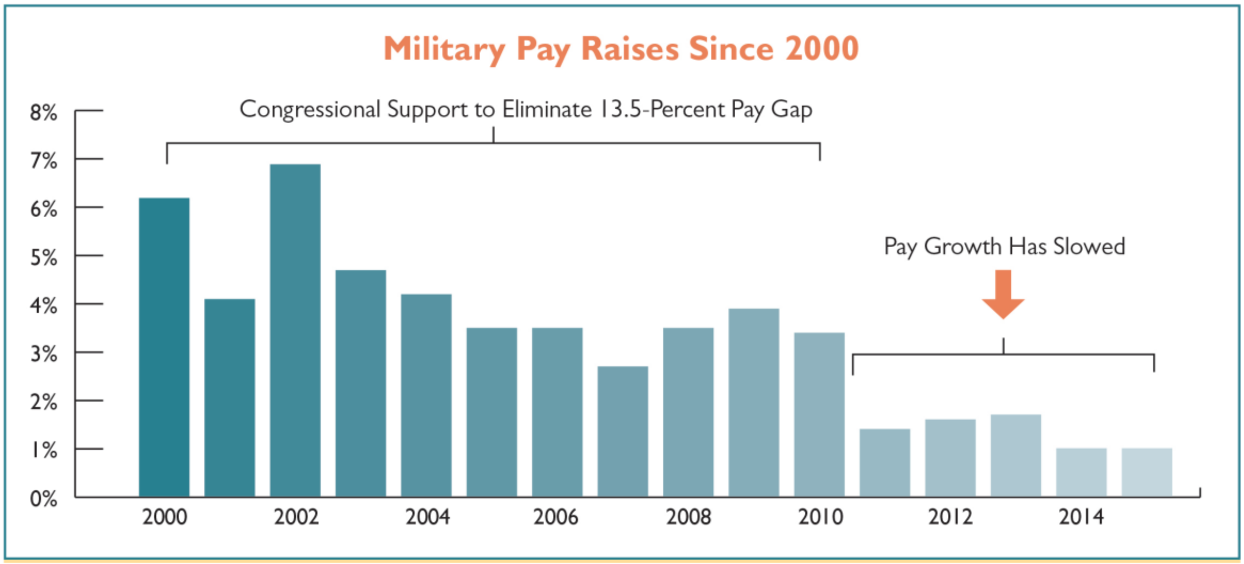
Thus, if we continue to let budget drive the conversation, like REDUX did, then we risk consequences of adopting many of the proposals within the FY15 Budget request as noted below which may be detrimental to our military's most important asset, our people.

MILITARY COMPENSATION PROPOSALS IN FY15 PRESIDENT'S BUDGET

Military Pay Proposals in FY15 Budget

Military pay is meant to offset the massive personal cost that accompanies a servicemember's career. In exchange for their pay, members of the military not only serve in foreign and often dangerous locations but also accept abridgments of speech and organizational rights enjoyed by those they protect. Military pay is a huge motivating factor in attracting new recruits as well who are willing to make these sacrifices as part of joining the all-volunteer force. Pay comparability is also one of the most important factors in maintaining stable retention. All of this has been accomplished with the same portion of the DOD budget being allocated for military compensation as there has been for the last 30 years. AUSN is very concerned that many in the Administration, and some Members of Congress, are unaware of the history of compensation changes and their unforeseen outcomes. Moreover, we are alarmed that some view these vital compensation programs as a source of budget savings without regard to the impact they may have on long term readiness, but most importantly, the livelihoods of the all-volunteer force.

The historical context of military pay provides ample evidence that capping military raises is an exceptionally slippery slope which has never ended well with past attempts at military pay caps causing significant problems. A series of annual pay raise caps in the 1970s led to major negative impacts on retention and necessitated a pair of large "catch up" raises in both 1981 and 1982. The same problem occurred again in the 1980s and 1990s, with pay caps contributing to an eventual peak "pay comparability gap" of 13.5 percent below the private sector. To correct this, Congress has made great strides to restore military pay comparability over the past 13 years. In 2003, for the Fiscal Year 2004 (FY04) NDAA, Congress tied the basis of pay increases for military personnel to be equal to the Department of Labor's ECI, so that increases in military pay matched the bare minimum increases that civilians in the private sector received. Congress has even had the ability to enact raises that exceed these ECI percentages, as they did for 2008 and 2009 (see chart on following page for recent increase in pay raises).



Source: MOAA 2014 Report titled, "Slow the Growth? — That Train Has Left the Station"

Through these measures, the pay gap was closed, and servicemembers were compensated at a fair rate equal to those in the civilian sector. However, now that erosion of pay and associated retention-related problems have abated, there are renewed calls to cut back on military raises, to either create a new comparability standard or substitute more bonuses for pay raises in the interests of deficit reduction. For Congress to override the statutory linkage that they themselves have passed does not bode well for our men and women in uniform, especially in the midst of an on-going conflict. History shows that, once military pay raise caps are implemented, the tendency has been by Congress to continue them until retention problems arise, which then have to be addressed through significant pay raise plus-ups. AUSN believes such proposals are exceptionally short-sighted in light of the extensive negative experiences we have had with military pay raise caps. The whole purpose of sustaining pay comparability through both good times and bad is to prevent significant fluctuations in retention and readiness; to avoid going through an endless cycle of causing problems and then repairing them.

A 2010 Congressional Budget Office (CBO) report asserted that, considering adjustments in housing allowances, many military people were actually paid more than their civilian counterparts in terms of Regular Military Compensation (RMC), composed of basic pay, food and housing allowances and the tax advantage that accrues because the allowances are tax-free. Developed in the 1960s when all servicemembers received the same allowances, regardless of location, and the allowances were arbitrarily established, the RMC was an inaccurate calculation of servicemember compensation. Since the 1960s, Congress has transformed the allowances into reimbursements for actual food costs and for median locality-based housing costs. Consequently, AUSN believes the CBO's assertions to be fundamentally flawed and that Congress would have a hard time explaining to troops why their pay raises should be reduced because their taxes are rising. However, in 2013, the PB request for FY14 established the one percent smaller pay raise, instead of the 1.8 percent dictated by the current ECI, which affected a total of 2.2 million Active Duty and Reserve Component members in order to save DOD **$536 million**, a small cut in a **$526.6 billion** budget. AUSN was then exceptionally disappointed that Congress agreed to that cap on Active Duty pay raises, as this sends the wrong message to our servicemembers saying in order to save a small amount of money, we are cutting your pay raise mandated by current law by almost half. DOD continues to claim it would save over **$3.5 billion** if pay increases were reduced at this rate in future years. Yet, as previously mentioned, personnel costs have represented the same share of the defense budget, about a third, for the last 30 years, indicating that these costs were not spiraling out of control as DOD claims.

Furthermore, a one percent boost in military pay would continue to be, as it was for FY14, the lowest pay increase since 1963, when no pay raise was authorized. This would represent a historically significant reduction, as well as explicitly increasing the pay of servicemembers less than the bare minimum that a similarly-employed civilian would receive (which, in all honesty, both career paths cannot and should not be compared). These actions are of significant concern, since annual pay increases are not just raises or bonuses for servicemembers but vital adjustments that are counted on by military families as part of military service. For example, an E-5 Active Duty family of four stands to lose a total of **$593,** and an O-3 Active Duty family of four stands to lose a total of **$1,130** aggregate loss for FY14/FY15 in military pay. AUSN advocates for the specified 1.8 percent increase as determined by the ECI for the current FY15 NDAA to ensure that servicemembers receive a fair increase. AUSN encourages DOD and Congress to adhere to this standard of pay increases. As past experiences have shown, pay raise caps tend to cause major problems in exchange for minor short-term savings, which are then undone when larger adjustments must be made to make up for the caps. If pay raise caps are instituted again by the Administration, ignoring current law from the FY04 NDAA, we will likely see retention problems reemerge in exchange for an extremely small cost reduction. In short, pay raise caps are not worth the negative consequences, and therefore, AUSN strongly encourages Congress not to approve the FY15 PB request for having military pay raises set at 1 percent instead of the mandated ECI rate of 1.8 percent. By adding language to the FY15 NDAA supporting current law of the FY04 NDAA stating military pay should match the ECI rate, Congress will have re-asserted it's authority and counter the Administration's use and interpretation of Title 37 powers to change military pay rates as they please.

Basic Allowance for Housing Proposals in FY15 President's Budget

In addition to base pay, servicemembers also receive a supplement for housing. BAH is an allowance paid to Active Duty servicemembers based on pay grade, dependency status and geographic location within the United States. The PB request for FY15 proposes to gradually slow the annual BAH increases until rates cover only 95 percent of housing rental and utility costs on average. Additionally, it proposes to eliminate renter's insurance from the housing rates. The Administration argues that this change only results in an out-of-pocket cost of six percent on average, emphasizing that such a change is far less than the 20 percent out-of-pocket costs in the 1990s. However, by the late 1990s, the Defense Department persuaded Congress to make military housing allowances meaningful by setting BAH at 100 percent of median local housing costs. This standard was codified after years of budget cuts reducing BAH rates below actual housing costs. Furthermore, they maintain that in areas where average rates increase, DOD will slow the growth of that increase until the six percent target is reached. Additionally, the Administration claims that the actual percentage will vary by area, because it would be unfair to those who live in high rental cost areas to make this change on a strict percentage basis. Therefore, the Administration proposes that servicemembers in the same pay grade, but living in different areas, should see the same dollar amount of out-of-pocket cost. In order to accomplish this, the individual servicemember will know the amount he will contribute toward housing and can make informed trades in his own budget. The rate protection feature will also remain in effect. In other words, no one who is currently living in a particular area will see his BAH decrease. If the survey data in an area indicate that the BAH rate should decrease, only members moving into the area will receive the lower rate, which already happens under the current rules. Finally, the Administration expects that the out-of-pocket target of six percent will take several years to achieve because the DOD is just starting to slow the growth of future increases.

AUSN, however, disagrees with the Administration's assessment and asserts that the FY15 PB proposal of a six percent reduction in BAH will, because of its even spread over the entire force, prevent troops in high-cost living areas from paying out more of their base pay than troops in low cost of living areas. Under the Administration's proposal, servicemembers will only receive 95 percent of the BAH for their rank and location, resulting in greater out of pocket housing costs. This "slowed growth" of the BAH will affect families, whether they rent or own their own home. All told, for example, an E-5 Active Duty family of four under this proposal would stand to lose a total of **$1,224,** and an O-3 Active Duty family of four under this proposal would stand to lose a total of **$1,584** annually. Additionally, the FY15 budget eliminates compensation for renter's insurance, which is an important component that goes into a servicemember's monthly housing cost. While AUSN is appreciative that the lower BAH will not affect a military family until their next duty assignment, we are concerned about the long-term impact on families' ability to find and pay for appropriate housing. BAH has a tremendous impact on servicemembers and their families' lives and is an important service that military families depend on to afford reasonable housing wherever it is they are stationed. As a result, AUSN urges Congress to reject the BAH proposals in the FY15 PB and provide full BAH for any Active Duty servicemember at the current BAH rate.

TRICARE Proposals in FY15 President's Budget

As you know, the military healthcare system is built mainly to meet military readiness requirements rather than to deliver needed care efficiently to beneficiaries. These readiness requirements result in increased costs across the healthcare system, as the system needs to be able to not only provide for beneficiaries but also be able to meet the readiness requirements the military has. But because the increased costs have been incurred as a result of military readiness requirements and out of convenience for the military, beneficiaries should not be expected to bear any share of the military-driven costs. Instead of imposing higher fees on beneficiaries as the first budget option, DOD leaders should be required to fix/consolidate redundant, counterproductive DOD health systems.

Currently, TRICARE is managed by the Defense Health Agency (DHA), formally the TRICARE Management Activity (TMA). On 1 October 2013, TMA was disestablished, whereby DHA took over. As a major component of the Military Health System (MHS), TRICARE combines the healthcare resources of the uniformed services with networks of civilian healthcare professionals, institutions, pharmacies and suppliers to provide access to high-quality healthcare services, while maintaining the capability to support military operations. This integration allows for the men and women of our Armed Forces to readily access care whether it is within VA healthcare centers or the private sector. The healthcare needed for servicemembers varies greatly throughout their military careers as they transition throughout the stages of their service. This variety, with multiple TRICARE plans, is designed in order to provide for the 9.66 million Americans who are eligible for benefits under TRICARE and have different degrees of healthcare. However, out of that 9.66 million, only just fewer than 5.5 million users are actually enrolled in a TRICARE program as many eligible beneficiaries receive healthcare via their current employers. In Fiscal Year 2012 (FY12), more than 84 percent of eligible TRICARE beneficiaries used some form of Military Health System service, highlighting just how important the MHS and TRICARE systems are to providing care for the members of our Armed Forces and their beneficiaries.

The FY15 PB provides for **$47.4 billion**, spanning Defense Health Program, personnel and healthcare accrual. Despite large savings in recent years, DOD feels it must pursue Veteran and military retiree healthcare reform. As part of this reform, the DOD has proposed a "Consolidated" TRICARE plan, as opposed to the current system with varied plans. Although there would be no change for Active Duty servicemembers, the remaining TRICARE beneficiaries would see changes to their plan. Cost shares would be implemented across all beneficiary levels, excluding Active Duty, in an attempt to facilitate the effective use of military clinics and increase the efficiency of the military's fixed facility cost structure. Additionally, there would be an annual TRICARE participation fee for retirees, their families and survivors of retirees, which if unpaid, would result in the forfeiture of coverage for that year. The annual consolidated TRICARE participation fee would be inflated annually according to the cost-of-living-adjustment but would start at **$286** per person or **$572** per family in 2016. Meanwhile, the cost sharing initiative would see an in-network catastrophic cap of **$3,000** per fiscal year and a combined (in and out of network) cap of $**5,000**. The budget request goes on to propose increased copays for pharmaceutical prescriptions, with significant increases in what TRICARE beneficiaries must pay every time they fill or re-fill a necessary prescription over the next 10 years. Finally, there is a proposal to implement an enrollment fee for TRICARE for Life (TFL) beneficiaries. TFL, enacted in 2001, is an additional payment plan for eligible beneficiaries over the age of 65 who are also enrolled in Medicare Part B, which only covers about 80 percent of normal healthcare costs. The TFL fee proposal would grandfather current members in but would begin charging an annual fee, phased in over a four-year period, based on a percentage of the beneficiary's military gross retired pay. This would result in annual fee ceilings above **$600** per beneficiary starting in Fiscal Year 2018 (FY18).

In recent years, emphasis has been placed on achieving savings and efficiency within the MHS. On the other hand, approximately **$3 billion** are being saved annually in MHS with programs such as the Prospective Payment system and the Federal Ceiling Pricing (a discount drug program). There have also been increases to fees for TRICARE beneficiaries, tied to annual COLA increases, over the past couple of years, and those would continue to increase under the current TRICARE system, in addition to savings seen via TRICARE Service Center closures. Additionally, as mentioned in the Federal Ceiling Pricing program, there have been significant savings achieved in pharmacy costs, as major changes have been enacted to double and triple pharmacy copays for military beneficiaries, and these will continue to increase in future years. Even more savings would be achieved under the current TRICARE system when the significant reductions in end-strength are enacted. Currently there are plans for the end-strength of the Active and Reserve forces to be cut by 124,000 troops over five years, and the FY15 budget proposes an additional cut of 78,000 troops. Such significant reductions will reduce military healthcare costs, as there will be 202,000 fewer troops (and their family members) eligible for TRICARE benefits.

AUSN continues to be alarmed at the many attempts over past PB submissions for DOD to find savings off of those who have served and looking at military healthcare as a solution. Healthcare costs are only 10 percent of DOD's base operating budget. Put in the proper context, this is not very much. Healthcare costs account for 27 percent of the Federal budget, 32 percent of the average state budget, 16 percent of household discretionary spending and 17.2 percent of U.S. Gross Domestic Product. This shows that the current system which DOD uses to provide healthcare for nearly 10 million servicemembers and their families does not need to see such drastic changes, changes which will greatly impact the standard of living and quality of life many of our military members currently experience. AUSN recommends that fee increases be limited to the annual Cost of Living Adjustment (COLA) and is opposed to any increase in TRICARE costs for users that is not directly related to COLA. AUSN also advocates that the healthcare provided by TRICARE (physical, behavioral, mental or otherwise) be up-to-date with the most current form of coverage and not consolidated for the needs of servicemembers and their families, and not just the budget needs of

DOD.

Commissary Proposals in FY15 President's Budget

The military Commissary system is administrated by the Defense Commissary Agency (DECA) and provides food supplies, beyond that official rations, and savings to supplement the pay received by the military. The Commissary system has been a cornerstone of the military's non-pay benefits and has become an integral part of ensuring that our young servicemembers and their families have the best possible quality of life. Particularly, the benefits the system provides are of great assistance to families stationed in high cost-of-living areas. On average, servicemembers and their families save more than 30 percent on grocery bills, which translates to around **$4,400** in savings per year. All the while, DECA strives to develop the Commissary system while balancing cuts to Commissary subsidies.

The FY15 PB proposes that the **$1.4 million** funding for DECA should be reduced to **$400 million** over the course of the next three years. This is a two-thirds slash to DECA's budget and will eliminate many of the discounts Commissaries provide. Overall, a military family stands to lose a total of **$2,970** of Commissary savings per year if the FY15 proposal is adopted. According to the FY15 PB, for the system to survive, prices will have to be raised, but this could further alienate the customer base who can no longer afford its services. DECA operates 243 stores total, which includes 178 domestic locations. Commissaries overseas or in remote American territories are exempt from these cuts, but domestic bases will suffer a 20 percent price spike in goods and services based on the proposal. The military Commissary exchange and Moral Welfare and Recreation (MWR) programs are contributing factors to national defense by sustaining livelihoods and morale of its military and improving their quality of life.

AUSN supports responsible spending; however, lowering Commissary subsidies causes several consequences. First, according to Title 10 U.S. Code, Section 2485, the Commissary stores' operations are, by law, required to reflect the cost of the items to DECA. Therefore, though price changes will vary, the prices in the commissaries are only set high enough to cover the recovered item cost. Also, built in Title 10, these savings are inherent features of the military Commissary system. Second, the savings commissaries provide is known to be a motivating factor in recruiting those who are willing to make the sacrifices associated with the military. Lack of proper compensation affects the military's ability to retain and recruit, which adversely affects its readiness capability. Third, these are not only incentives for servicemembers but promises made to protect and benefit their families upon joining the military. By cutting benefits there is a direct reduction to quality of life and stability. These are services that our military families rely on to fulfill their needs. While it affects military preparedness and readiness, the cuts are a greater disservice to the men and women who have defended our nation who are left wondering if their families are being properly taken care of on bases when they are gone. Finally, AUSN is a strong supporter of two pieces of legislation moving through Congress that have recognized the detriment of lowering subsidies. H.R. 4215 and S. 2075, The Military Commissary Sustainment Act of 2014, both seek to prohibit any cuts in DOD's funding for commissaries until a final report has been filed by MCRMC next year. These bills protect against unnecessary stresses that military families might suffer due to a rise in cost of living and also provide proper focus to an important benefit area that is owed to servicemembers.

COLA, RETIREMENT AND PROPOSAL IN DOD WHITE PAPER

The Administration has already expressed a desire to wait on decisions regarding military retirement overhaul until the report from the MCRMC, established in the National Defense Authorization Act for FY13, is submitted in February 2015. The MCRMC is currently meeting to review findings and come up with options for improvements to the current military compensation methodology. However, DOD released its own report in early March—"*Concepts for Modernizing Military Retirement*"— that proposes two slightly different design concepts for modernizing the military retirement system. The proposals, which AUSN appreciates and is interested in learning more about, would create a "hybrid" structure that combines a defined benefit plan (similar to the current system), a defined contribution component (similar to a civilian 401k plan) and supplemental pays. Secretary of Defense (SECDEF) Chuck Hagel has also made it very clear that he would wait to ask Congress for any proposed changes in retirement until next year; however retirement, as well as the ongoing COLA debate, is important to mention.

Ongoing Cost-of Living-Adjustment (COLA) Concerns
AUSN was pleased to see the one percent reduction of COLA established in the Bipartisan Budget Act (BBA) of 2013 addressed with the partial fix in the FY14 Omnibus Appropriations bill, passed January of this year, which exempted disabled Veterans and survivors. Additionally, the passage in February of S. 25 covered the remainder of current retirees under 62. Despite this, there are still many concerns. First, while S. 25 seemed to have largely bipartisan support, some Members of Congress were disappointed with the "funny money" additional one year of sequestration offset, saying the Federal government was "robbing one part of the budget to pay another." In particular, some Members of Congress argue, and AUSN agrees, that no one can be sure what the budget climate will be like for all Executive Branch departments, including DOD and the Department of Veterans Affairs (VA) after 10 years of sequestration (2013-2023), much less adding on one more for an eleventh year of sequester cuts (to 2024). Other Members of Congress were displeased that the mandatory sequestered accounts being affected were unrelated to defense spending at all. As of now, it appears that there would be only two major DOD mandatory accounts that would be impacted by the extension of sequestration: TFL and DOD Retirement Contributions. This is, of course, relatively loose and subject to change, but at this point, those would be the primary accounts impacted by tagging on an additional year of sequestration to offset the COLA cuts from the BBA of 2013. Among the defense community, however, aside from the two mentioned mandatory accounts, it is hard to determine what money will be available given the uncertainty surrounding the future of sequestration.

Second, there are additional concerns regarding how the final bill, S. 25, with the COLA repeal was negotiated. It appears that the deal was brokered among the senior leadership of the House and Senate and not vetted by major stakeholders such as the Chairmen and Ranking Members of the House Armed Services Committee (HASC), the House Veterans' Affairs Committee (HVAC), the Senate Armed Services Committee (SASC) and the Senate Veterans' Affairs Committee (SVAC). During a 28 January 2014 hearing of this Committee, both defense officials and SASC members stated that they were not consulted during negotiations on the budget deal, the 2013 BBA, and wanted to be part of the conversation in the future to exempt current servicemembers and retirees from any changes to the pension system. This continues to set what appears to be a dangerous precedent where the process of bringing legislation through Committees is undermined by Senate and House leadership taking control of forming bills and putting them through each chamber for consideration. AUSN asks the Committee to keep these potential consequences in consideration moving forward, as the full impact of these repeal provisions will surely manifest themselves in the coming years.

Finally, while Congress has seemingly corrected the wrong that is the reduction in COLA calculations (for disabled Veterans and survivors through the FY14 Omnibus Appropriation bill and passage of S. 25 for all other affected current and future retirees for their COLA calculations), the impact this will have on future servicemembers, Veterans and retirees, moving forward is unclear. Although the COLA cut repeal provisions passed earlier this year will grandfather those who joined the service before 1 January 2014, the BBA COLA cut will still apply to all those who joined after 1 January 2014. AUSN recommends that that the Committee keeps an eye on the impact this will have upon the livelihoods of future retirees and Veterans who will be joining the Armed Forces after 1 January 2014.

Retirement Proposals and DOD White Paper

Critics of the current military retirement system cite costs spiraling out of control, yet as the numbers have shown, retirement as a percentage of DOD's total budget has remained steady for the past decade, while other portions of the DOD budget increase every year. Currently, the military retirement system is non-contributory, meaning that servicemembers do not have to pay into their own retirement plans. To qualify for retirement pay, servicemembers must serve at least 20 years, upon which they will be eligible to receive a fixed, inflation-protected lifetime annuity beginning immediately following retirement from service. Generally, members of the Reserve Component who qualify for retirement pay do not begin receiving benefits until age 60. All retired servicemembers can apply for a Survivor Benefit Plan (SBP), providing surviving spouses with a lifetime annuity. Retirees with service-related disabilities, who receive both disability compensation and regular retirement benefits, experience a dollar-for-dollar offset, also known as concurrent receipt. Programs such as the Combat Related Special Compensation (CRSC) and Concurrent Retirement and Disability Pay (CRDP) are in place to counter this offset. However, the sacrifices made by servicemembers are not found in the civilian sector, and this could have harmful effects on retention rates if servicemembers decide that the compensation they receive does not compare to the unique costs they face in their military careers.

In both of the DOD's proposed concepts, servicemembers would qualify for full retirement after 20 years of service, but the annuity would be reduced compared to current benefits, resulting in decreased compensation in the long-term. Both design concepts plan to offset this reduction by shifting some deferred compensation, payment received upon retirement, to current pay. The difference between the two is most apparent in how they actually dispense this pay.

Concept 1 is a two-tiered system, offering partial benefits to members (both Active Duty and Reserve) after their retirement from service but during their employable years. It does not begin to pay members their full benefits, calculated with the same multiplier as the current system, until after the servicemembers reach their 60s. *Concept 1* assumes that most servicemembers hold civilian jobs after retiring from the military, and therefore, are less dependent on their retirement at that time. This might be a harmful assumption, as not all military skills translate to the civilian sector. On the other hand, *Concept 2* is a single-tier system that pays the member full benefits each year immediately following retirement from service. However, members of the Reserve Component would not receive retirement compensation until reaching the age of 60, and the multiplier for calculating payments would be lower for all members than the one that is used today.

Both concepts offer supplemental pay: continuous pay after 12 years and transitional pay at retirement, though the amounts would differ slightly. Both concepts include a 401K-type contribution-based component as well, the Thrift Savings Plan (TSP), for those who serve beyond 6 years. The proposal also calls for modifications in the method of calculating disability payments and the elimination of the dollar-for-dollar offset currently required for servicemembers who receive both retirement pay from DOD and disability compensation from the VA. This would make the concurrent receipt programs in place today obsolete. Additionally, survivors will also be able to receive unused funds in TSP accounts in exchange for a cut in annuity payments from the SBP. The cost for SBP premiums will also increase, from 6.5 percent to 10 percent, but this will enable the elimination of the offset when the survivor also qualifies for Dependency and Indemnity Compensation (DIC) from the VA.

The report estimates that the modifications to the military retirement system could save DOD anywhere between **$500 million** and **$2.7 billion** for Active Duty members and about **$200 million** for members of the Reserve Component. The timeline for visible DOD savings is uncertain and will depend on the rate at which current servicemembers, who are grandfathered into the current retirement system, retire, are paid out and then are replaced by the new servicemembers receiving benefits based on the new system. While overall payouts to retired servicemembers will be less under both new proposals than in the current system, the inclusion of TSPs, continuation pay and transition pay offset some of the reductions in benefits. AUSN appreciates and acknowledges this thoughtful proposal as well as the concept of receiving a payout sooner, which could prove more valuable to some servicemembers, as could the opportunity for growth in the TSP accounts, which guarantee retirees compensation.

AUSN is also pleased that the white paper addresses areas of concern such as the SBP and DIC offset, concurrent receipt for disability and retirement pay and the Integrated Disability Evaluation System. The proposal acknowledges that disabled retirees could have had careers worth more had they been able to continue on and earn more benefits in addition to regular pay. The proposed disability benefits would be greater than the current compensation, mostly due to the elimination of the offset. However, other issues can be found in the details, such as the fact that to claim unused TSP funds and eliminate the offset from the DIC payments survivors would face an increase in SBP premiums and decreased pay-back. This could potentially devalue the benefit.

Retirement Conclusion

An effective modernization of the retirement system needs to ensure four things: that military careers are competitive with other opportunities in the job market, that promotion opportunities are available for young servicemembers, that retired servicemembers can enjoy a certain level of economic security and that there is a pool of experienced personnel capable of being recalled to Active Duty in the event of wartime or an emergency.

AUSN is open to thoughtful dialog on retirement and recognizes the need to 'modernize' the current system. The 20-year benchmark has a proven tool useful for recruitment and retention; however, AUSN understands that providing more retirement options and/or a tiered system for certain retirement 'packages' that allow Sailors to begin to receive compensation earlier in their careers may be better suited in the 21st Century. Changes that ultimately improve the military retirement system for servicemembers and lead to cost-savings for DOD are welcomed by AUSN, provided that current servicemembers are grandfathered into the system into which they signed. It is important to keep faith with our men and women currently serving. Nonetheless, AUSN is mindful of lessons of the past, such as the REDUX reforms of the 1990s, where cuts to compensations resulted in harmful effects on recruitment and retention. Grandfathering the current servicemembers at the time did not mitigate the negative impact from REDUX, which had to be repealed a decade later, and AUSN asks that the Committee also be mindful of the results from these changes in the past.

TESTIMONY CONCLUSION

The Association of the United States Navy understands that a good, thorough and honest look is needed in regards to the future of military compensation and benefit programs for our current and future force. However, we firmly believe that this must be done in a way that doesn't inhibit the recruitment and retention within our military. Many of these proposals are already being looked at by the MCRMC to examine and send to lawmakers a report on recommendations for establishing a new set of pay, compensation and benefits for our future forces. The MCRMC has not yet finished its mandated duties and investigations, yet DOD is moving forward with an aggressive set of compensation changes in its proposals within the FY15 Budget. With an extension on the report going into 2015, and a forthcoming preliminary report in May 2014, the Commission itself is still holding hearings, open and closed door Executive sessions, listening to testimony and gathering expert advice. AUSN's own Vice-Chairman of the Board, MCPON Jim Herdt, USN (Ret), has already testified in a public hearing before the Commission in November 2013, in an Executive session in March 2014 and has met with Commission staff many times throughout the year. Consequently, it seems rather premature to be taking action to change compensation, benefits and retirement when a proper analysis being done by the MCRMC is incomplete and such a detailed report with recommendation will not be shown until at least 2015. AUSN has been very pleased with the open dialog the MCRMC has had with Military and Veteran Service Organizations (MSO/VSO) and expects their report to reflect many of the thoughtful discussions on these issues being discussed in today's hearing.

Finally, while the COLA cut issue has been extremely important to AUSN and our members in the past few months, with its ability to affect the finances of a multitude of retired and current servicemembers, there is uncertainty about how the COLA reduction impacts our future servicemembers after 1 January 2014. Those who have signed up and joined the Armed Forces between 1 January 2014 and when S. 25 passed, 13 February 2014, will still see their COLAs reduced when they retire before the age of 62. A "breach of faith" with our servicemembers argument can be made to that effect and will be a future consequence moving forward. In addition, an argument can be made that we will now have servicemembers who joined prior to 1 January 2014 receiving one type of retirement compensation serving with servicemembers receiving a different type of compensation, whereby having a scenario of "haves" vs. "have nots." Again, this is an issue that may or may not manifest itself as a major problem, but concerns and questions on the impact of the passage of S. 25 still lie ahead.

AUSN appreciates the work of this Committee and this hearing which seeks to look into how the future of our military compensation system will be sustained to reflect the current needs of our military. AUSN stands ready to be the "Voice for America's Sailors," abroad and upon their return home, and looks forward to working with Congress, the Navy and DOD on serving our nation's Sailors, Veterans, Retirees and their families. Thank you.

Vice Admiral (VADM) John B. Totushek
U.S. Navy (Retired)
Executive Director, Association of the U.S. Navy
President and CEO, U.S. Navy Memorial Foundation

Vice Admiral John Totushek is a native of Minneapolis, MN. He is a 1966 graduate of the University of Minnesota where he earned his commission through a Naval ROTC scholarship and was designated a pilot upon completion of flight training in June 1968.

Admiral Totushek began his Naval Aviation career flying the F-4 *Phantom* in Florida and Virginia-based squadrons. In November 1973, he resigned his regular commission and accepted a commission in the Naval Reserve. During the next 24 years, Vice Admiral Totushek served in numerous capacities with the Naval Reserve and several civilian companies.

In the Naval Reserve, he held senior strategic and management positions within the Navy, including command of the Atlantic Fleet's Logistics Task Force and the Southeast Region's Naval Reserve Readiness Command. In addition, he served as the deputy director for Naval Air Warfare.

In his civilian career, Admiral Totushek he was involved with a series of construction companies including The Murray Company as its regional manager. While with the firm, he completed some of the best-known office buildings and parks in the Tidewater area of Virginia.

In early 1997, Vice Admiral Totushek was asked to return to active duty to lead the Navy's environmental, safety and occupational health programs. He then was selected as Commander, Naval Reserve Force on Oct. 17, 1998. He was promoted to Vice Admiral on 24 May 2001.

On November 1, 2003 he retired from active duty and became a Senior Vice President of The Staubach Company where he headed the Public Sector Practice. In July, 2008 The Staubach Company was purchased by Jones Lang LaSalle where Admiral Totushek worked as a Managing Director.

Vice Admiral Totushek's awards include the Defense Distinguished Service Medal, Legion of Merit (two awards), Meritorious Service Medal (three awards), and various service and campaign awards. He currently resides in Arlington, VA with his wife, Janet.