

Prepared Statement
of
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Principal Deputy Under Secretary of Defense
(Personnel and Readiness)
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INTRODUCTION

Mr. Chairman and members of this distinguished Subcommittee, thank you for the opportunity to be here today and thank you for your continuing support of the men and women who serve in our Armed Forces. Last year the Department developed a comprehensive Human Resource Strategic Plan. With direction from the Quadrennial Defense Review and Defense Planning Guidance, we collaborated with the Secretaries of the Military Departments and the component heads to develop a strategic human resource plan that encompasses military, civilian, and contractor personnel. The plan identified the tools necessary to shape and size the force, to provide adequate numbers of high-quality, skilled and professionally developed people, and to facilitate a seamless flow of personnel between the active and reserve forces.

The Department continues to refine the Human Resources Strategy designed to provide the military force necessary to support our national defense strategy. We face an increasingly challenging task to recruit, train, and retain people with the broad skills and good judgment needed to address the dynamic challenges of the 21st century, and we must do this in a competitive human capital environment. Consequently, we seek a mix of policies, programs, and legislation to ensure that the right numbers of military personnel have the requisite skills and abilities to execute assigned missions effectively and efficiently.

COMPENSATION

Attracting and retaining high caliber individuals for a trained and ready All-Volunteer Force require a robust, competitive and flexible compensation system. In addition to basic pay,

compensation includes all pays and allowances, such as housing and subsistence allowances, and special and incentive pays. Over the past several years the Administration and the Congress have worked closely together to make significant strides in improving the pay and allowances of our men and women in uniform. We look forward to working together again this year to continue this effort that is so important to our troops and their families.

Military Pay

As noted by the 9th Quadrennial Review of Military Compensation, increased educational attainment on the part of the enlisted force made the existing military pay structure less competitive. We appreciate the Congress' direction on the 2002 and 2003 pay raises to target additional raises for NCOs, as well as mid-level officers. Targeted pay raises are again needed but can be more narrowly focused to NCOs and some warrant officers. We are proposing raises of up to 6.25 percent for NCOs, with most other members getting 3.7 percent, or Employment Cost Index (ECI) + ½ percent. The average raise would be 4.1 percent. We recommend the Congress adopt our proposed targeted pay raises for our mid-level and senior NCOs and warrant officers for FY 2004.

Housing Allowance

In addition to maintaining efforts to achieve competitive pay tables, the Department intends to continue significantly increasing military housing allowances, with the goal of eliminating average out-of-pocket costs by 2005. Only a few years ago, members' average out-of-pocket costs were more than 20 percent. Building on the current year's increases, the FY 2004 budget requests further improvements in the allowance, reducing the average out-of-pocket costs from

7.5 to 3.5 percent. Further, continued refinements in data collection processes have led to improved allowances in numerous local areas where the measured housing costs were understating the costs borne by our members in obtaining safe and adequate housing.

Special and Incentive Pays

While comparability of basic pay and adequate allowances are extremely important, special and incentive pays provide the critical flexibility for military compensation to be competitive in highly technical, scientific areas where we have shortages. Successful retention of enlisted members in vital skills such as special operations, aviation maintenance, information technology, electronics, intelligence, linguists, and air traffic control depend on judicious use of bonuses and special pays. Likewise, officer retention challenges exist in career fields whose technical and scientific skills are easily transferable to the private sector and demand high salaries. In the FY 2001 National Defense Authorization Act, Congress enacted the Critical Skills Retention Bonus (CSRB) program, adding significant flexibility that allows the Services to more quickly react to emerging shortages and improve retention in targeted, critical skills. But appropriations for these bonuses were cut in FY 2003, severely limiting the Services' ability to use this new authority. We hope the Congress will support these important and cost-effective investments this year.

Thrift Savings Plan

In January 2002, the Department implemented a new authority provided by Congress to allow the uniformed forces to participate in the Thrift Savings Plan (TSP). This opportunity represents a major initiative to improve the quality of life for our Service members and their families, as well as becoming an important tool in our retention efforts. In its first year of

operation, TSP attracted nearly 303,000 enrollees, 241,000 active duty and 62,000 guard and reserve members. The Department projected that 10 percent of active duty members would enroll in the first year; in fact, we had 17 percent sign up, exceeding our expectations.

Reserve Compensation

In 2003, we are examining compensation programs for Reserve component members. The current and anticipated military environments require employment of Reserve forces in ways not imagined when current compensation programs were designed. Current thresholds for housing allowances, per diem, some special skill and duty pays, and a range of benefits may not fully support the manner in which Reserve component members may be employed in the future. Compensation programs must be sufficient to attract and retain capabilities to meet continuous, surge and infrequent requirements. As we examine options and formulate alternatives, we will adjust our regulations and include proposed statutory changes as part of the Department's legislative program.

RETIREMENT ISSUES

Military retired pay is a key component of the military compensation system. Recent improvements enacted by Congress once again make military retirement a strong positive factor in the retention of career service members and their overall satisfaction with military service. But, one of the most difficult issues that the Administration and the Congress have dealt with over the past several years involves military retired pay and the issue of "Concurrent Receipt."

Concurrent Receipt

Concurrent Receipt involves the long-standing prohibition against retired military personnel receiving both retired pay from the Department of Defense (DoD) and disability benefits from the Department of Veterans Affairs (VA). Consistent with long-standing Administration policy, DoD opposes members receiving both benefits concurrently because these two programs were intended for two entirely separate populations: retirees and non-retired veterans. Originally, the law provided that members, active or retired, could not receive VA disability compensation. In the 1940's the law was modified to ensure no retiree could get less than a similarly disabled veteran who had not retired. If VA compensation was more than military retired pay, the member could be paid the higher VA amount. If the military retired pay was greater, the retiree could receive all of the VA pay, which is tax free, and then any remaining military retired pay in excess of that amount. This change, which is reflected in the current law, allows retirees to obtain the best combination of tax free and taxable income. Unfortunately, some retirees interpret this long-standing provision as a denial of entitlements.

Some military retirees strongly believe they deserve both benefits, claiming that one is for years of service and the other is for an injury or illness they received during that service. The Department's position has been that the purpose of disability compensation is to overcome the impact of lost income compared to the person who has no disability and should not be additive to retired pay. Providing both retired pay and disability compensation is contrary to the long-standing principle that no one should be able to receive concurrent retirement benefits and disability benefits based upon the same service. All Federal compensation systems aim for an

equitable percentage of income replacement in the case of either work-related injury or retirement.

The Congress has considered numerous bills over the past few years to partially or completely repeal the prohibition against concurrent receipt. The 108th Congress so far has been presented with two bills that would allow full concurrent receipt for retirees with at least 20 years of service: H.R. 303 sponsored by Congressman Bilirakis, and S. 392 sponsored by Senator Reid. Both of these bills would remove the prohibition against concurrent receipt for all retirees with 20 plus years of service. However, any amount of disability retired pay that exceeds what the member would receive for longevity retirement remains subject to offset. In effect then, payments under H.R. 303 and S. 392 would work in much the same way as the recently enacted Combat-Related Special Compensation program, but without the requirement that the disabilities be combat-related. No added benefits would apply to those retired for disability with less than 20 years of service. But, full repeal of the existing prohibition is very expensive—our previous estimate is \$58 billion over ten years. The Administration is on record as strongly opposing the changes included in these bills. Last year, the President's senior advisors recommended that he veto such legislation if it were presented to him.

Nonetheless, we all acknowledge a great debt of gratitude to all veterans, particularly those serving long and faithful careers. In response to the veterans' concerns over the last few years, Congress passed and the President signed legislation to provide special compensation to two groups of retirees. First, Special Compensation for Severely Disabled (SCSD) pays up to \$300 a month to retirees with severe disabilities, those rated as 60% or more within 4 years of retirement. This is being paid to more than 30,000 of the most severely disabled retirees. More recently enacted and pending implementation in June, Combat-Related Special Compensation

(CRSC) will allow many retirees to receive total compensation in an amount equivalent to both their military retired pay and their VA disability compensation. This program is described in detail below.

Combat-Related Special Compensation (CRSC)

The National Defense Authorization Act for FY 2003 provided a new Combat-Related Special Compensation for military retirees with combat-related disabilities. While this is not concurrent receipt of military retired pay and VA disability compensation, the new program will have the effect of providing the same total benefit for many qualifying retirees. To be eligible, retirees must have 20 years of service for retired pay computation and have disabilities resulting from combat injuries for which they have been awarded the Purple Heart or are rated at least 60 percent disabled resulting from armed conflict, hazardous duty, training exercises, or mishaps involving military equipment.

We are working closely with the Department of Veterans Affairs to identify potentially eligible members and establish and implement application procedures and requirements. We have so far identified 16,500 retirees who have the requisite 20 years of service and have been awarded the Purple Heart. This list was drawn from a list of 160,000 veterans who receive disability compensation from the VA and who identified themselves (and submitted supporting documentation) as Purple Heart recipients. We have thousands of retirees currently receiving Special Compensation for the Severely Disabled, many of whom will qualify for significantly higher payments of the Combat-Related Special Compensation. All of these retirees already

meet the criteria of having 20 years of service and being rated at least 60 percent disabled. The remaining factor to be determined is whether their disability is combat-related.

We intend to have applications and instructions available by late spring, as well as a website where members can complete and download their application, so eligible retirees can begin applying. The website and Service retiree newsletters should provide the first information about when and where eligible retirees may submit claims for compensation. We will keep the Service-related associations and other appropriate organizations informed as well.

Of the hundreds of thousands of military retirees, many will believe that they qualify for the new payments. Consequently, we expect to receive a large number of applications. These will take some time to process and make a determination as to whether the retiree is eligible. The length of time will vary depending on the adequacy of the documentation the retiree is able to provide us or whether we have to seek additional documentation from the VA. While it will take us some time to process these thousands of claims, all retirees who qualify will be paid retroactive to the date they met all criteria for payment, but no further back than June 1st, 2003, the beginning date of the program. We anticipate the first checks will go out in July. If it takes us additional time past the start date to approve a retiree's claim, their first check will include all payments back to June 1st.

We know there will be honest disagreements regarding this program and whether or not a particular retiree qualifies. Determining whether an illness or disability that may have been incurred decades ago is service connected will continue to be the role of the VA. DoD's role will be to make the determination of whether the cause of the disability is or is not combat

related. We, like the VA, want to ensure disabled veterans receive all that they are due. If the retiree can show a proximate cause to armed conflict, hazardous duty, training exercises, or mishaps involving military equipment and they meet the other requirements, we will approve them for payments. We will also establish an appeals process so retirees who feel their claims were not correctly evaluated can have a venue for formal reconsideration and for providing more information.

We estimate that in FY 2004 we will have more than 33,000 qualified retirees with total payments of about \$327 million.

Examples of Concurrent Receipt

Because the subject of concurrent receipt can be confusing, I would like to show how the compensation of four different personnel of various pay grades and circumstances is currently computed, how it will change with the recently enacted Combat-Related Special Compensation, and what differences would occur under Congressman Bilarakis' or Senator Reid's proposals. (All examples are based on a member who qualifies for tax-exempt status of his special compensation (SCSD or CRSC) under the IRS code.)

My first example is a mid-grade NCO (E-5) with 8 years of service who is totally disabled in combat and who is retired with 100% disability. He will receive retired pay equal to 75% of his basic pay, or \$1,390 a month. He can apply for VA compensation as well. Assuming the VA awards 100% disability compensation, they will pay him \$2,193 monthly tax-free, but his retired pay will be reduced to zero. Thus, his monthly income would be \$2,193 tax-free.

The second is an E-6 with 20 years of service, who is also totally disabled in combat and retired at 100% disability. He will also receive retired pay equal to 75% of his basic pay, or \$1,855 a month. If he applies to VA for compensation and is awarded a 100% disability, he too will receive \$2,193 monthly on a tax-free basis. Like the E-5, his military retired pay will be reduced to zero because his retired pay is less than the VA's disability compensation. Since he has served 20 years, however, he is eligible for \$300 month in **SCSD** from DoD. Therefore, his total monthly income would be \$2,493 tax-free.

The third example is a senior NCO (E-7) with 20 years of service, who is also totally disabled and retires with 100% disability, but his condition is the result of injuries received in a car accident off duty. His retired pay will be 75% of his basic pay, or \$2,123 monthly. This member may also apply for VA compensation and if rated at 100% would receive disability compensation of \$2,193 monthly on a tax-free basis, just like our two previous examples. This would reduce his retired pay to zero. However, like the E-6, this member can qualify for \$300 per month in **SCSD** since he has served 20 years. Thus, his total monthly income would also be \$2,493 tax-free, the same as the E-6.

My fourth example is an E-8 with 30 years of service who retires with no disability, but who is rated by the VA as 100% disabled shortly after retirement due to a heart problem first diagnosed in service. His military retired pay is equal to 75% of this basic pay or \$2,822 monthly. His tax-free VA disability compensation of \$2,193 will reduce his military retired pay to \$629. However, because he has served more than 20 years, he will be eligible for the \$300 per month in **SCSD** from DoD. His total monthly compensation, therefore, will be \$3,122 of which \$2,493 will be tax-free and \$629 will be taxable income.

The following tables will show you how the compensation of these four individuals will be affected under the recently enacted Combat-Related Special Compensation and under the two bills currently proposed by Congressman Bilirakis and Senator Reid.

E-5 with 8 years of service, 100% Combat Disability

Pay	Current System	CRSC	S 392/ HR 303
VA Comp (Tax Free)	\$2,193	\$2,193	\$2,193
Retired Pay	\$1,390	\$1,390	\$1,390
Offset	(\$1,390)	(\$1,390)	(\$1,390)
CRSC	N/A	N/A	N/A
Offset			
Special Comp (SCSD)	<u> N/A</u>	<u> N/A</u>	<u> N/A</u>
Total (Tax Free)	\$2,193	\$2,193	\$2,193

Here our E-5 with just 8 years of service receives no extra compensation under either Combat-Related Special Compensation or the two proposed bills since he did not serve 20 years of service. His total compensation remains \$2,193 per month tax-free.

E-6 with 20 years of service, 100% Combat Disability

Pay	Current System	CRSC	S 392/ HR 303
VA Comp (Tax Free)	\$2,193	\$2,193	\$2,193
Retired Pay	\$1,855	\$1,855	\$1,855
Offset	(\$1,855)	(\$1,855)	(\$618)
CRSC	N/A	\$1,855	N/A
Offset		(\$618)	
Special Comp (SCSD)	<u> \$300</u>	<u> \$0</u>	<u> N/A</u>
Total	\$2,493	\$3,430	\$3,430

In the case of the E-6, since he completed 20 years of service, he would be eligible for the recently enacted Combat-Related Special Compensation. However, his CRSC benefit will be

reduced, or offset, because he is receiving disability retired pay that exceeds what he would receive if he retired on the basis of length of service.

E-7 with 20 years of service, 100% Non-Combat Disability

Pay	Current System	CRSC	S 392/ HR 303
VA Comp (Tax Free)	\$2,193	\$2,193	\$2,193
Retired Pay	\$2,123	\$2,123	\$2,123
Offset	(\$2,123)	(\$2,123)	(\$708)
CRSC	N/A	N/A	N/A
Offset			
Special Comp (SCSD)	\$300	\$300	N/A
Total	\$2,493	\$2,493	\$3,608

In the case of the E-7 whose disability is not combat related, he receives no additional compensation from the recently enacted Combat-Related Special Compensation. However, under the proposed bills in the House and Senate, he would receive all of his military retired pay, subject to the offset imposed for having his retired pay based on his disability rather than length of service.

E-8 with 30 years of service, 100% Non-Combat Disability

Pay	Current System	CRSC	S 392/ HR 303
VA Comp (Tax Free)	\$2,193	\$2,193	\$2,193
Retired Pay	\$2,822	\$2,822	\$2,822
Offset	(\$2,193)	(\$2,193)	\$0
CRSC	N/A	N/A	N/A
Offset			
Special Comp (SCSD)	\$300	\$300	N/A
Total	\$3,122	\$3,122	\$5,015

In the case of our E-8 member, he receives no additional compensation under CRSC since his disability is not combat-related. However, under the Bilirakis/Reid proposals, he would receive all of his military retirement, with no offset, since he had completed 30 years of service.

Survivor Benefit Plan (SBP)

SBP was intended from inception in 1972 to complement Social Security benefits and Dependency and Indemnity Compensation (DIC) from the Department of Veterans Affairs (VA). Together, these programs ensure survivors' income is at least 55 percent of the member's retired pay. SBP has a two-tier payment structure and pays the full 55% when the spouse is under the age of 62, when a survivor becomes eligible for social security payments. At age 62 and later, SBP pays 35% and social security benefits pay 20% or more. Retirees pay premiums for the SBP coverage, currently 6.5 percent of retired pay using pre-taxed dollars.

VA pays DIC if the death is service-connected and requires no premiums or program participation. Therefore, if a survivor is also eligible for SBP, DIC benefits are subtracted from SBP, and the survivor gets a full refund of any SBP premiums paid for the offset amount of the SBP annuity. In other words, if DIC pays half of what the SBP payment would be, then half of all premiums paid for the SBP would be refunded. Also, since VA payments are tax free, only the half paid by SBP would be taxable. So, this survivor would be receiving a minimum of 55 percent of the member's retired pay, half of which is tax free.

The original SBP had a dollar-for-dollar offset of Social Security payments. This offset is still available to those who retired (or were eligible to retire) as of October 1, 1985. The offset method is used if it pays the survivor more than the 35% benefit under the two-tier system. For

example, it is possible that the social security payment derived from only the member's military earnings was about 10 percent of current retired pay. Then using the offset would set the post-62 SBP payment at 45 percent instead of the two-tiered 35 percent. And the survivor may in fact receive social security in his or her own right at 20 percent. So this survivor would actually receive a total of 65 percent. Again, SBP has been designed from the beginning to work together with social security and DIC to ensure the survivor gets at least a total of 55 percent of the member's retired pay.

It is important for military members to understand how the system works, and there are several sources of information available to help them understand this benefit, including mandatory retirement briefings, DoD and Service web sites, Service retiree newsletters, military association magazines and press articles. Also, every retiree receives an account statement at least once each year that lists his SBP coverage, the cost, base amount, 55 percent annuity amount, and 35 percent annuity amount. Nonetheless, many retirees don't understand the program until later in life when they become more aware of and focus on their survivor's needs.

SBP Subsidy

SBP is a subsidized program; while participants pay premiums, a portion of the program benefits are paid directly by the government. There is a concern whether the subsidy today is less than it should be, and even a question as to what it should be. Evidence suggests that the intended subsidy was about 40 percent, but exactly who was to be included or how it was to be computed were never specified.

The idea of a 40 percent subsidy first surfaced when SBP was being developed in the early 1970s. We do know SBP was intended to have a subsidy similar to that of the Civil Service

survivor program, thought to be about 40 percent at that time. Much has changed in the program in the last 30 years, and it is not clear whether this objective is still appropriate.

One problem is that various groups have different expected subsidies as provided by the DoD Actuary and shown below:

Overall	31.5%
Non-disabled	16.4%
Disabled	54.3%
Reserve SBP	58.3%
RC – SBP*	0.0%
Active duty	100.0%

*RC-SBP program (pre-age 60) is by law not subsidized.

We are currently reviewing options that could improve the subsidy and make it more equitable among these groups.

CONCLUSION

Mr. Chairman, this concludes my statement. I thank you and the members of this Subcommittee for your outstanding and continuing support for the men and women of the Department of Defense.

I would like to take this opportunity to note that the joint efforts of Congress and the Department are beginning to pay off. Service members who completed the web-based 2002 Status of Forces Survey opinion survey expressed greater satisfaction with almost all aspects of service life than they had three years earlier. For instance, results show a significant gain in

satisfaction over compensation. This is directly attributable to the annual pay raises that exceeded wage growth in the private sector and housing allowance hikes set higher than the yearly rise in local rents. The Congress was instrumental in making this happen.

Even better news is that more than 80 percent feel they are ready to perform wartime duties. This is certainly a positive endorsement for the programs that you have helped us enact. I am hopeful that I can count on your support in the future. I look forward to working with you closely during the coming year.