

MODIFYING MILITARY SURVIVOR BENEFITS

Statement of

**Robert F. Hale
Assistant Director
for
National Security Division
Congressional Budget Office**

**before the
Subcommittee on Manpower and Personnel
Committee on Armed Services
United States Senate**

June 20, 1985

**This statement is not available for
public release until it is delivered at
9:00 a.m. (EDT) on Thursday, June
20, 1985.**

Mr. Chairman, I am pleased to testify today on the Military Survivor Benefit Plan. My testimony will focus on the provisions of the current plan and the changes proposed by the House Armed Services Committee (HASC) in their version of H.R. 1872.

The current plan is a voluntary one. Those retirees who join contribute through reductions in their military pensions; in return their survivors receive benefits. Today nearly 800,000 military retirees participate in a survivor benefit plan and about 94,000 survivors are receiving benefits.

Critics argue that the current plan is too complex for members to understand and that it is inequitable because, in some cases, it provides different benefits to survivors of members who make the same contributions. There is also concern that, because of the nature of the formula used to calculate contributions, future retirees will pay an increasing share of the cost of the program.

The HASC proposal makes changes designed to simplify the plan. It would also tend to stabilize the portion of costs paid by future retirees at about 62 percent, roughly the same percent as for those retiring today. These improvements would come at some cost. If the HASC proposal is enacted, the long-run or "accrual" costs that appear in the 1986 DoD budget would increase to about \$446 million compared to costs under current law that range from \$226 million to \$298 million, depending on the interpretation of changes to current law enacted last year.

Provisions of Current Law

Under current law, members must make an irrevocable decision at the time of retirement about whether to participate in the Survivor Benefit Plan. Members who participate may choose to cover under the plan any portion of their retired pay up to 100 percent. The participant must, however, cover a minimum of \$300 a month of retired pay (or 100 percent of retired pay, if that amount is less than \$300 a month).

Contribution Formula. Members pay part of the cost of the program through reductions in their retired pay. For the first \$300 per month of covered pay, monthly retired pay is reduced by 2.5 cents per dollar covered. For each dollar of coverage beyond \$300, retired pay is reduced by 10 cents. The \$300 base is not "indexed" or changed as retired pay changes along with wage increases. Thus, the percentage of retired pay that members pay for survivor benefits may be higher for future retirees.

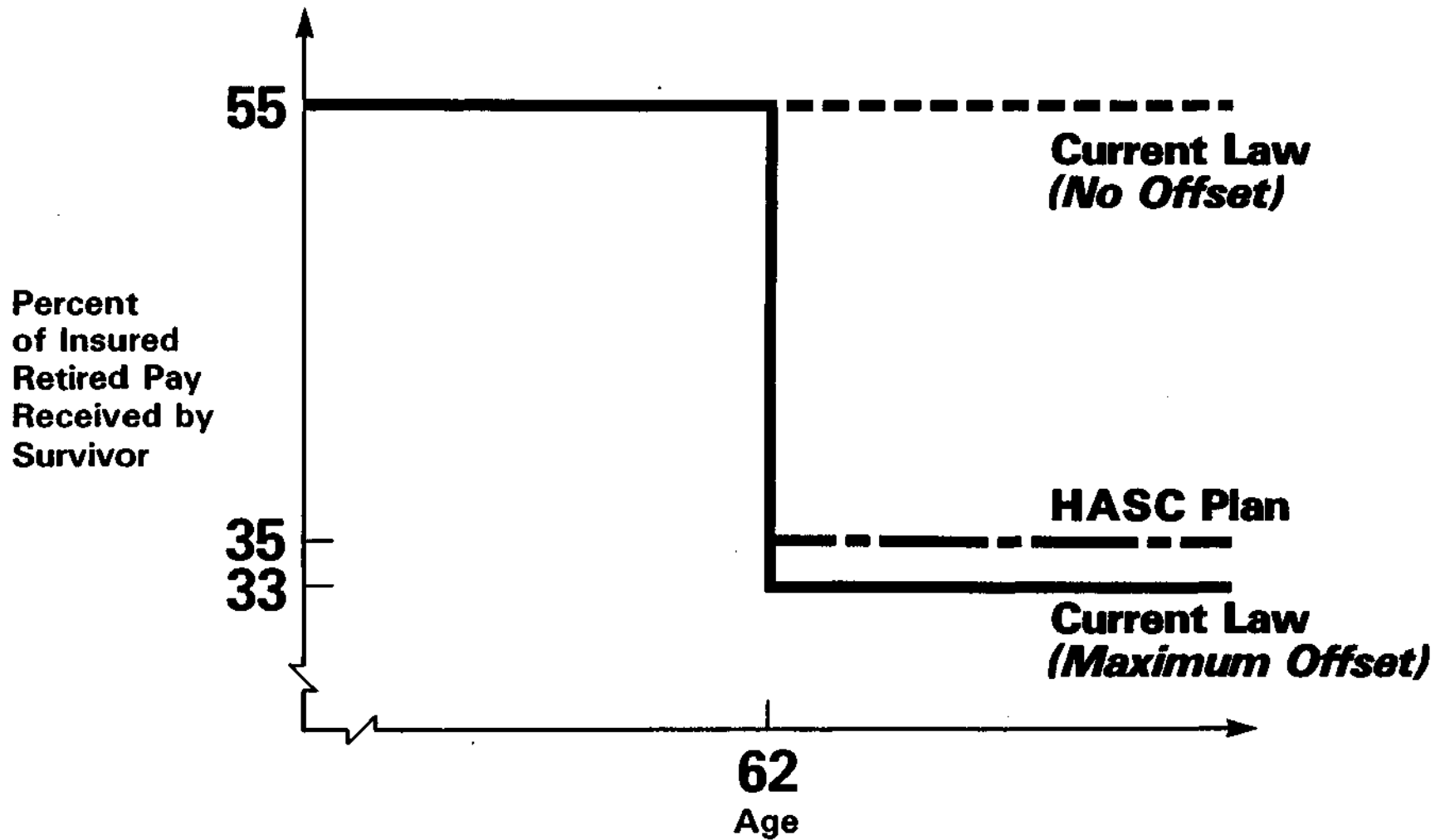
Let me illustrate the effects of these provisions and, specifically, the effects of indexing the \$300 base amount in the formula. I will assume that a current retiree decides to cover \$1,000 a month of retired pay. The retiree's pension would then be reduced by \$77.50 a month based on the current formula, or 7.75 percent of covered retired pay. Each time inflation caused a certain percentage increase in retired pay, the covered amount and the dollar level of the contribution would increase by the same percentage. Thus, in future years, if inflation pushed this covered retired pay up to

\$1,200, the contribution would still be pegged at 7.75 percent of covered retired pay, although the dollar amount would increase to \$93.00.

Now take the case of a future retiree who retires with a monthly pension of \$1,200 and covers it all. The survivor will probably get the same benefits as the survivor of the earlier retiree; both are covering \$1,200 of retired pay. But the future retiree will contribute \$97.50 a month or 8.125 percent of the retired pay. This occurs because, when the contribution is first established using the formula, more of the future retiree's pay will be subject to the 10 percent portion of the formula than was the case for the earlier retiree. (That is, the retiree's pay will be greater while the base amount will still be \$300.) This gradual increase in the contribution percentage means that those retiring in future years will pay an increasing share of the cost of the Survivor Benefit Plan. This is one of the aspects of current law addressed by the HASC proposal.

Benefits. Let me turn next to survivors' benefits. Up to age 62, survivors receive annuities equal to 55 percent of members' covered retired pay (see chart). At age 62, when the survivor becomes eligible for Social Security, this annuity is reduced for most survivors by the amount of Social Security the survivor would have received based on the member's military service. Thus, if a widow is eligible for \$200 a month in Social Security, and \$100 of that is based on her spouse's income while in the military, her

Lifetime Survivor Benefit Payments



SOURCE: Congressional Budget Office.

survivor's benefits are reduced by \$100 a month. This Social Security offset, however, cannot exceed 40 percent of the survivor's benefits.

Today, most survivors are subject to a 40 percent reduction in their benefits at age 62 and beyond. Thus most receive benefits equal to 33 percent of covered retired pay (that is, 55 percent less the 40 percent reduction).

Some survivors, however, receive more than 33 percent. Survivors of senior officers, whose Social Security is less in relation to their retired pay because of the progressive nature of the Social Security formula, have lower offsets and receive benefits greater than 33 percent of members' retired pay. So do survivors of members who had extensive service before 1957; pre-1957 service does not contribute substantially to the offset because the military first came under full Social Security coverage in 1957.

Moreover, starting in fiscal year 1986, there will be even more variation under current law. Last year, the Congress enacted the Thurmond Amendment--effective in fiscal year 1986--to change the Social Security offset for survivors whose Social Security benefits are based on their own income. There are possible practical problems and uncertainties associated with implementing the amendment, and final rulings have yet to be issued by the Comptroller General on these matters.

Therefore, our analysis discusses two possible interpretations of the language of the amendment. A "narrow" interpretation of the amendment would require elimination of the entire Social Security offset only for those

survivors who receive Social Security benefits based entirely on their own earnings. CBO estimates that, under this narrow interpretation, about 10 percent of all survivors would avoid the offset starting in the next fiscal year. For these survivors, benefits after age 62 would continue to equal 55 percent of covered retired pay.

The "broad" interpretation of the Thurmond Amendment would reduce the Social Security offset in proportion to the amount of the Social Security benefit that is earned by the survivor. Assume, for example, that a survivor receives \$200 a month in Social Security benefits based on the spouse's Social Security history but would receive \$100 based on his or her own earnings. Under the broad interpretation, this survivor would be subject to only half the full Social Security offset based on the retiree's earnings. CBO estimates that, under this broad interpretation, about 30 percent of all survivors would have reduced offsets. Their benefits would fall somewhere between 33 percent and 55 percent of covered retired pay.

This discussion suggests a second issue in current law addressed by the HASC proposal. Members contributing the same amount may have survivors who receive different benefits. The discussion also suggests that the current plan is complex. And there is uncertainty as well. The Social Security offset itself is based on a complex calculation that cannot be made until the retiree dies or reaches age 62. Hence, at the time the retiree and spouse are required to make an irrevocable decision about whether to join

the Survivor Benefit Plan, they do not know the exact benefits that the survivor could eventually receive.

Provisions of the HASC Proposal

The HASC proposal would make several changes intended to address the issues just discussed.

To simplify the program, the HASC proposal would eliminate the Social Security offset entirely, thus obviating the uncertainties associated with the offset. Instead, survivors would receive 55 percent of covered retired pay until age 62 and 35 percent thereafter as shown in the chart. This so-called "two-tier" plan would provide the same survivor benefits for all who cover the same amount of pay.

To help keep the cost of the program from rising for future retirees, the HASC proposal would "index" the \$300 basic amount in the contribution formula. That is, the \$300 base would increase every time military retired pay increased and by the same percentage. This would avoid a situation in which future retirees might contribute a higher percentage of their pay than current retirees and hence bear more of the program's cost.

The HASC also added two new provisions designed to improve equity and consistency with the survivor benefit plan for civil servants. The first would require the concurrence of a retiring member's spouse if the member wished to decline SBP coverage or to cover less than 100 percent of retired pay. In effect, the spouse may be able to require full coverage. The second

TABLE 1. PERCENT OF COSTS BORNE BY RETIREES UNDER
ALTERNATIVE SURVIVOR BENEFIT PLANS
(For the average retiree entering military service in fiscal
year 1986)

	<u>Percent</u>
Current Law	
Narrow interpretation	70
Broad interpretation	64
Without Thurmond Amendment	73
HASC Proposals	
Two-tier plan only	69
Two-tier and indexing only	58
Two-tier, indexing, and spousal concurrence only	61
Two-tier, indexing, spousal concurrence, and remarriage option (all HASC proposals)	62

provision would give participating retirees who remarry, and their new spouses, the option of declining or reducing coverage. At present, resumption of coverage and deductions are automatic when a participating member remarries.

In addition to these key changes, the HASC proposals provide a save-pay provision to prevent any reduction in payments to current beneficiaries or those retired or eligible to retire. The HASC also proposes several other more minor changes in eligibility. I will not discuss these provisions in my testimony.

Effects on Cost Sharing

Under current law, members retiring today will bear about 62 percent of the cost of survivor benefits, consistent with the HASC goals for cost sharing. Those retiring in the future, however, will pay more because of the absence of indexing in the contribution formula discussed earlier. CBO estimates that those entering military service in fiscal year 1986 will bear between 64 percent and 70 percent of the costs when they eventually retire (see Table 1). The 70 percent would prevail under the narrow interpretation of the Thurmond Amendment, while the 64 percent would prevail under the broad interpretation. (Without the Thurmond Amendment, those entering service in 1986 would have borne 73 percent of the costs.)

These estimates of costs borne by retirees are based on the entry-age normal method used by the Fifth Quadrennial Review of Military Compensation. This method looks at costs and benefits of persons from the time they enter the military through their retired lifetimes and the lifetimes of their survivors. In making the calculations, CBO used the actuarial assumptions employed by DoD to estimate retirement costs for 1986. We assumed annual inflation of about 4 percent. Consistent with the assumptions used by the Department of Defense in other retirement analyses, wage growth was assumed to exceed inflation by 0.5 percent a year and interest rates were assumed to be 1 percent above inflation.

The changes proposed by the HASC, taken together, would tend to stabilize the portion of costs borne by the average retiree--both those

retiring today and in the future--at about 62 percent. This is close to the level urged by the HASC.

The individual proposals made by the HASC would have differing effects on cost sharing, as Table 1 shows. Replacement of the Social Security offset with the two-tier plan would, in the absence of any other changes, lead the average member to pay 69 percent of the costs. This compares to costs of 64 to 70 percent for members retiring in 1986 when the Thurmond Amendment will be in effect and about 73 percent in the absence of the Thurmond Amendment. Adding indexing of the \$300 base to the two-tier plan would mean that members would pay only 58 percent, as contributions would be held down because of the indexing. If the two-tier plan and indexing were further amended to include spousal concurrence, then the members' share would rise to 61 percent. Spousal concurrence would add to the share because persons are assumed to cover more of their pay when this provision is in effect. The addition of optional remarriage coverage would raise the ratio further to 62 percent, as retirees who had previously contributed opted out of the system.

These estimates are subject to uncertainty primarily because changes in behavior--including the willingness to participate in the survivor plan--could affect the numbers. These uncertainties are particularly important in the cases of optional coverage upon remarriage and spousal concurrence, since it is difficult to estimate the extent to which these options would change behavior.

TABLE 2. 1986 ACCRUAL COSTS UNDER ALTERNATIVE SURVIVOR
BENEFIT PLANS
(In millions of dollars)

Current Law	
Narrow interpretation	\$ 226
Broad interpretation	\$ 298
HASC Proposals	\$ 446

Change Relative to Current Law (Narrow Interpretation) Resulting From:	
Two-tier plan eliminating Social Security offset	+7
Indexing \$300 to retired pay changes	+86
Optional coverage upon remarriage	-18
Spousal concurrence	+146

Costs of the Changes

The Survivor Benefit Plan is one component of the overall military retirement system, and accordingly is subject to the accrual accounting procedures used to budget for military retirement. Under this accrual approach, funds are set aside in current budgets to build a trust fund sufficiently large to pay benefits to future retirees and their survivors.

CBO estimates the 1986 accrual cost of the current Survivor Benefit Plan at between \$226 million and \$298 million (see Table 2). The lower figure represents costs under the narrow interpretation of the Thurmond Amendment, which minimizes reductions in the offset, while the higher

figure represents costs under the broad interpretation. Without the Thurmond Amendment, the cost in 1986 would equal \$190 million.

Under the proposals made by the HASC, the accrual charge in 1986 would be about \$446 million. Thus the accrual charge would be about \$220 million higher than under current law, assuming a narrow interpretation of the Thurmond Amendment. Looked at another way, the HASC plan would raise the accrual charge for the Survivor Benefit Plan to 2.4 percent of the total accrual cost of the military retirement system, compared to 1.2 percent to 1.6 percent under current law and the alternative interpretations of the Thurmond Amendment.

The specific HASC proposals vary widely in the amount they would add to the accrual charge (see Table 2). The major provisions would add relatively little. Elimination of the Social Security offset, coupled with the two-tier plan, would account for only about \$7 million of the \$220 million increase. The addition would be small because, as the chart shows, most survivors would get about the same benefits under the HASC plan and under current law. Indexing the \$300 base in the contribution formula, which would stabilize the portion of costs borne by the retiree, would add \$86 million to the accrual charge.

The provision allowing those who remarry to drop or reduce their coverage would actually decrease the accrual charge by \$18 million in 1986. The government would avoid paying its share for those who drop coverage.

By far the largest change in accrual cost would come from the provision allowing spouses to insist on full coverage. CBO assumes that, with spouse concurrence, about half of those who are eligible and now decline or limit coverage would take it or increase the amount of pay that is covered. This provision would increase the accrual charge in 1986 by \$146 million. As noted earlier, there is little evidence to determine exactly how this provision or the remarriage option would affect behavior; thus, both estimates should be viewed as rough approximations.

These accrual costs approximate long-run costs and thus are the best measure for judging the HASC proposal, since present commitments made to retirees are difficult to change later. Accrual costs are also the ones that appear in the defense budget. They are the amounts that must be set aside to cover future payments to beneficiaries, however, rather than actual outlays for today's payments. As Table 3 shows, the estimated effects of the HASC proposals on government outlays over the next few years, and hence on the near-term federal deficit, are sometimes quite different from the estimated effects on accrual costs. Indeed, the HASC proposals taken together would actually reduce outlays in the near term, largely because more retirees would participate and thus total contributions would rise. Eventually, outlays would increase as these additional participants' survivors began to receive benefits.

TABLE 3. CHANGES IN OUTLAYS RELATIVE TO CURRENT LAW
 UNDER ALTERNATIVE SURVIVOR BENEFIT PROVISIONS
 (In millions of dollars) a/

	1986	1986-1990
Two-tier Plan Eliminating Social Security Offsets	+14	+104
Indexing \$300 to Changes in Retired Pay	--	+5
Optional Coverage upon Remarriage	--	-2
Spousal Concurrence	<u>-19</u>	<u>-237</u>
HASC Proposals	-5	-130

a. Estimates of current law assume narrow interpretation of Thurmond Amendment.

In sum, Mr. Chairman, the current Survivor Benefit Plan is quite complex, largely because of the Social Security offset, and would result in future retirees bearing an increasing share of program costs. The HASC proposal would simplify the system and would tend to stabilize the portion of costs borne by the retiree. The proposals also have other features--spousal concurrence and optional coverage after remarriage--which the HASC argues would make the military plan more equitable and consistent with the civil service plan.

This simplification and stabilization would cause accrual costs for survivor benefits in 1986 to rise to \$446 million, about twice those under current law with the narrow interpretation. In relation to the total accrual charge for military retirement, costs would be 2.4 percent under the HASC proposal instead of 1.2 percent to 1.6 percent under current law, depending on the varying interpretations of the Thurmond Amendment.