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BY THE COMPTROLLER GENERAL



Report To The Congress

OF THE UNITED STATES

Noncontributory Social Security Wage Credits For Military Service Should Be Eliminated

X Military service is covered under the social security system. Both military members and the Department of Defense, as their employer, pay social security taxes on military basic pay. However, members whose basic pay is less than the social security taxable earnings ceiling are credited with additional covered earnings of up to \$1,200 a year in excess of basic pay. Neither the member nor the Department of Defense pays taxes on these credits. GAO recommends that the Congress eliminate the credits for future military service.



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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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To the President of the Senate and the
Speaker of the House of Representatives

This report discusses the provision of noncontributory social security wage credits for military service performed after 1956. We initiated this review in light of current widespread interest in, and controversy surrounding, the level of benefits attributable to military service. We have reviewed the rationale for providing the credits, estimated their effects on current benefit levels, and estimated unintended costs that will result. On the basis of this review, we are recommending that the noncontributory credits be eliminated for future military service.

We requested comments on the report from the Departments of Defense and Health, Education, and Welfare; the Office of Management and Budget; and the Veterans Administration. Comments from the Department of Defense and the Office of Management and Budget were not received in time to be considered in preparing this final report. However, we have obtained oral comments from officials of these two agencies and have made revisions to the report as appropriate.

We are sending copies of this report to the Director, Office of Management and Budget; the Administrator of Veterans Affairs; and the Secretaries of Defense and Health, Education, and Welfare.

A handwritten signature in black ink, reading "Luther A. Stacks".

Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

NONCONTRIBUTORY SOCIAL
SECURITY WAGE CREDITS FOR
MILITARY SERVICE SHOULD BE
ELIMINATED

D I G E S T

Military service was brought under contributory social security coverage in 1957. Both military members and the Department of Defense (DOD) as their employer, pay social security taxes on basic pay. However, members whose basic pay is less than the social security taxable earnings ceiling (\$22,900 in 1979) are credited with additional covered earnings of up to \$1,200 a year in excess of basic pay. Neither the member nor DOD pays taxes on these credits. The social security trust funds are reimbursed annually from the general fund of the Treasury for additional costs attributable to the noncontributory credits.

GAO reviewed the rationale for providing noncontributory credits (for service performed after 1956), examined their effects on current benefits, and estimated unforeseen costs that will result. Based on this review, GAO recommends that the Congress terminate the credits for future military service.

RATIONALE FOR PROVIDING
NONCONTRIBUTORY WAGE CREDITS

The Congress authorized gratuitous social security wage credits in a draft era when military pay for first-term members was extremely low in relation to civilian wages. The circumstances under which the credits were initially enacted strongly suggest that the intent was to provide adequate disability and survivor protection to these members. The credits were not expected to accrue in the case of career members because, at that time, basic pay levels for these members were expected to exceed the social security taxable earnings ceiling. (See pp. 6 to 8.)

RECOMMENDATIONS TO THE CONGRESS

The Congress should terminate noncontributory social security wage credits for future military service. This result may be achieved by amending section 429 of title 42, United States Code, to limit non-contributory credits to service performed before 1980.

We recognize that members may view termination of the credits as an erosion of benefits. However, it should be recognized that the recommended action does not revoke credits granted before 1980. Thus, members would still be entitled to any benefits arising from those credits.

AGENCY COMMENTS

Formal comments were requested from DOD, the Department of Health, Education, and Welfare (HEW), Office of Management and Budget, and Veterans Administration (VA). Comments from DOD and the Office of Management and Budget were not received in time to be included in this report, but officials of these two agencies have provided us with oral comments.

HEW favors termination of the noncontributory credits but believes that they should be phased out rather than terminated all at once. They are currently working on a legislative proposal to accomplish that result. (See pp. 33 to 34.) Officials of the Office of Management and Budget indicated agreement with the need for terminating the credits and are currently working with HEW on its legislative proposal. (See p. 34.) VA agreed with the descriptions and estimates of disability and survivor benefits provided by VA. (See p. 33.) DOD officials initially told us that DOD would probably disagree with terminating the credits. Just prior to release of this report, we were informed that DOD may now support the HEW proposal. (See pp. 30 to 33.)

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ABBREVIATIONS

DIC	Dependency and Indemnity Compensation
DOD	Department of Defense
GAO	General Accounting Office
HEW	Department of Health, Education, and Welfare
LTD	Long-Term Disability
OMB	Office of Management and Budget
SBP	Survivor Benefit Plan
VA	Veterans Administration
WC	Workers' Compensation
YOS	years of service

CHAPTER 1

INTRODUCTION

Over the past decade the military compensation system, and particularly the retirement system, has been the subject of considerable controversy and criticism. Numerous studies of the system have been conducted by the Department of Defense (DOD), other Government agencies, and private organizations. A major criticism of the system found in most of these studies is that it is too generous to military retirees and too costly to the taxpayers.

One cost-reducing feature included in most recent proposals for restructuring the system is a social security offset feature, which would reduce military retired pay when members receive social security old-age benefits. The primary rationale for this feature is the additive nature of military retired pay and social security benefits: the retiree receives benefits from two systems based on the same period of Federal service.

Military members, however, strongly oppose social security offsets. They argue that their social security contributions entitle them to full social security benefits and their dedicated military service entitles them to full military retired pay.

In reviewing legislation relating to social security coverage of military members, we focused our attention on one particular provision which authorizes noncontributory social security wage credits for service on active duty performed after 1956. These noncontributory credits are the subject of this report.

NONCONTRIBUTORY CREDITS FOR MILITARY MEMBERS

Military members were brought under contributory social security coverage in 1957. Both military members and DOD, as their employer, pay social security taxes as do employees and employers in civilian covered employment.

However, the treatment of military members and the majority of civilian covered employees differs in that taxes are levied on military basic pay only. The value of items such as housing and meals provided to military personnel (or cash allowances provided instead of the items) and special and incentive pays are not subject to social security taxes. The value of such items and pays provided to civilian covered employees is generally subject to the taxes.

In addition, military members whose basic pay is below social security maximum covered earnings may receive up to \$1,200 each year in additional earnings credit under the social security system. Neither the member nor DOD pays taxes on this \$1,200 credit. For example, the annual rate of basic pay for an Army Captain (pay grade 0-3) with more than 6 years of service is \$16,985. Social security maximum covered earnings for 1979 are \$22,900. Both DOD and the member will pay social security taxes on the member's basic pay of \$16,985. Since his basic pay is less than \$22,900, the member will be credited with an additional \$1,200 of covered earnings for 1979, on which neither the member nor DOD has paid taxes. For purposes of computing social security benefits, the member's covered earnings for 1979 will be \$18,185.

SCOPE OF REVIEW

This report focuses on two issues concerning noncontributory credits, the need for continuing to provide the credits and the potential costs.

To address these issues we

- discussed the credits and their effects with DOD officials;
- examined legislative background relating to social security coverage of military personnel;
- interviewed officials of the Internal Revenue Service and the Social Security Administration regarding the taxability of wages provided in the form of items rather than cash;
- identified other programs providing disability and survivor protection, examined their interrelationship with the social security system, and discussed these matters with officials of the Department of Labor and the Social Security Administration;
- developed military career profiles and estimated the costs of the noncontributory credits in terms of the additional old-age benefits they provide for military retirees; and
- developed illustrative examples of the total disability and survivor benefits payable when members are disabled or die in active military service.

CHAPTER 2

LEGISLATIVE BACKGROUND RELATING TO SOCIAL SECURITY COVERAGE FOR MILITARY SERVICE

OVERVIEW OF THE SOCIAL SECURITY SYSTEM

The social security system was designed to assure that a basic level of family income would continue when earnings are impaired by a worker's death, disability, or old age. The system's objective is to provide a "floor" of income protection. Currently, approximately 9 out of 10 jobs are covered under the social security system, 1/ and coverage generally continues when workers change jobs.

The system is financed by a payroll tax levied equally on covered workers and their employers on wages up to a specified maximum covered earnings limit. For example, in 1979 covered workers and their employers will each contribute 6.13 percent of their wages up to \$22,900. The concept of a maximum covered earnings limit is an integral part of the system. It clearly recognizes the fact that social security's floor of protection is only one of three elements in the Nation's income maintenance system--the other two being: private pensions, savings, etc., and public assistance programs.

A worker's eligibility for benefits is based on two criteria: a minimum period in covered employment and age or disability status. Dependents and survivors of eligible workers may also be eligible for benefits.

Benefits are based on average covered earnings over the length of time a worker could reasonably have been expected to work in covered employment. Specifically, the number of years is generally five less than the number of years elapsing beginning with 1937 (when the program began) or with 1951 (when the program was extended to cover the jobs of millions of workers) or, if later, with age 22 and up to the year in which the individual reaches age 62, becomes disabled, or dies. The averaging period will eventually expand to a maximum of 35 years for all workers

1/The largest group of jobs not covered under the social security system is about 5.8 million jobs in public employment, including Federal civilian, State, and local employment. Most of these jobs are covered under public retirement systems.

reaching age 62 in 1991 and later. Under this computation method, benefits can be based on as few as 2 years of earnings for a worker who has become disabled or dies at age 29 or younger. Benefits are automatically adjusted based on increases in the cost of living.

EXTENSION OF SOCIAL SECURITY
COVERAGE TO MILITARY MEMBERS

Social security coverage was first extended to military members in the form of noncontributory wage credits of \$160 a month for those who served between September 16, 1940, and July 25, 1947. These credits were enacted to bridge the gap in survivor protection caused by a lapse in social security coverage for individuals who were called into military service during World War II. The noncontributory credits were subsequently extended to cover service through December 1953, the Korean conflict period. Pending the development of a permanent solution to the problem of adequate survivor protection for military members, the credits were again extended to cover service up to 1957. Benefits arising from these credits are not payable if the member receives benefits payable by another Federal agency (other than the Veterans Administration (VA)) based on the same period of service (42 U.S.C. 417).

In May 1954 the Committee on Retirement Policy for Federal Personnel (Kaplan Committee), which had been created pursuant to Public Law 555 (82nd Congress) to conduct a full appraisal of all Government retirement systems, issued a report on the uniformed services retirement system. A major recommendation of that report was that members of the uniformed services be brought under the social security program on the same contributory basis that applied to civilian covered employment, with coverage based on approximate measures of average gross pay ¹/ by pay grade. The report stated that such a change would

- provide a measure of retirement protection for non-career members,
- improve the retirement protection of career members,
and

¹/Estimates of gross pay included the value of items such as housing and food provided to military members, allowances, and special pays as well as basic pay.

--aid in establishing a sound and equitable program of survivor protection for all members.

In August 1954 the House of Representatives created a Select Committee on Survivors Benefits to develop legislative recommendations for an equitable and coordinated program of survivor benefits for military members. The select committee, reporting to the House in December 1954, declined to make comprehensive recommendations at that time. Although the select committee had studied the Kaplan Committee report, it reported that time limitations and the complexity of existing programs rendered it unable to fully evaluate the matter. The report recommended that the select committee be continued by the next Congress and that serious consideration be given to placing Armed Forces members under contributory social security coverage instead of certain survivor benefits which were then provided gratuitously.

The select committee was continued by the 84th Congress and reported proposed legislation in June 1955. The committee proposed extending contributory coverage to military members, with coverage based on basic pay only.

The decision to include only basic pay appears to have been the result of three considerations.

--Military members in the lower grades received only about \$100 a month in cash pay. Gross pay for these members was estimated to be about \$200 a month. The committee felt that the members affected would not understand why they should contribute 4 percent of their cash pay while covered civilians contributed only 2 percent. ^{1/} The committee felt that these members would object to the perceived inequity.

^{1/}The social security contribution rate at the time was 2 percent of covered wages. Since civilian covered earnings generally equaled cash pay (gross salary or wages), the civilian would contribute 2 percent of his salary. However, military members in the lower grades received a substantial portion of "gross pay" in items rather than in cash. Thus, these members would contribute 2 percent of the estimated gross pay of \$200, but the resulting contribution of \$4 would be 4 percent of the member's cash pay.

--Military members paid income taxes on basic pay only. If social security taxes (contributions) were based on the much higher gross pay estimates, it was considered inevitable that members would also be called on to pay income taxes on the higher gross pay estimates.

--The legislation contained additional survivor benefits in the form of Dependency and Indemnity Compensation (DIC) to be paid by VA. The committee considered the combination of benefits that would be provided by both programs to be adequate. Therefore, social security coverage in excess of basic pay would be unnecessary.

The select committee recognized that, in addition to improving survivor protection, contributory social security coverage would provide additional old-age (retirement) benefits for military retirees. It proposed that old-age benefits from contributory social security coverage be additive to military retirement benefits.

The committee's proposals were incorporated in the Servicemen's and Veterans' Survivor Benefits Act of August 1, 1956 (Public Law 881, 84th Congress, 70 Stat. 862-867, 869-870).

THE RATIONALE FOR PROVIDING NONCONTRIBUTORY
WAGE CREDITS FOR SERVICE PERFORMED AFTER 1956

In 1967 the House Ways and Means Committee proposed legislation containing a provision granting noncontributory social security wage credits for military service on active duty performed after 1967. The rationale for the provision was that because military coverage was limited to basic pay, social security protection was impaired during military service due to the relatively low covered earnings on which benefits were based. The committee noted that other cash payments, or the cash value of items provided (for example, food and housing), was generally counted as covered wages in the case of civilian employment. It reasoned that military members should therefore receive coverage in excess of basic pay in recognition of remuneration provided them in forms other than cash.

The committee proposed including an additional \$100 in military covered earnings for each \$100 of basic pay received in a calendar quarter, up to a maximum credit of \$300 for each calendar quarter (or \$1,200 a year). While

recognizing that civilian employees were generally required to pay social security taxes on the value of items included in covered earnings as well as cash payments, the committee believed it would be unfair to many members, particularly those whose basic pay was relatively small, to require that they pay taxes on the proposed credits. 1/

The committee proposal provided for reimbursing the social security trust funds for the additional benefits that would result from the noncontributory credits. However, the committee stated that the credits would not result in additional benefits in most cases for two reasons

--the individual's earnings would exceed maximum covered earnings without them 2/ or

--these would be dropout years when social security benefits were calculated. 3/

1/This reasoning may appear quite unfair to civilian employees. However, we note that at the time, large numbers of young men were drafted into military service as a result of the Vietnam buildup, and military pay for first-term members was extremely low compared to civilian wages.

2/At that time, social security maximum covered earnings generally remained at the same level for several years. For example, maximum covered earnings were \$7,800 for calendar years 1968 through 1971. Also at this time, the Congress was considering a procedure providing for automatic annual increases in military basic pay based on increases in Federal civilian salaries. Thus, it was likely that career members would have maximum covered earnings based on basic pay alone.

3/Individuals generally enter the force between the ages of 18 and 25. The earliest age at which social security old-age benefits are payable is 62. Since most employment is covered under social security, most individuals would have about 40 years of covered earnings by age 62. And since social security old-age benefits would be based on the average of covered earnings for the 35 years in which those earnings were highest, the dropout years would generally be the first few years of military service.

The committee believed that the use of the credits would generally be confined to cases of death and disability, with the additional costs being relatively small, perhaps a few million a year. The committee proposal was incorporated in Public Law 90-248 (January 2, 1968, 81 Stat. 833-834).

In 1970 the House Ways and Means Committee proposed extending the noncontributory credits retroactively to cover the period 1957 to 1967, stating that the extension would assure realistic social security credit for military service on active duty for all years of contributory coverage. The Senate Finance Committee amended the proposal, providing a flat \$300 credit for each calendar quarter of active service (after 1956) in which a service member received basic pay. The Finance Committee stated that for most military members, the credits provided under the earlier legislation were \$300. The Finance Committee proposal was incorporated in Public Law 92-603 (October 30, 1972, 86 Stat. 1352).

The Social Security Amendments of 1977 (Public Law 95-216, December 20, 1977, 91 Stat. 1555) revised the method of calculating noncontributory credits for military service after 1977. This revision was made to conform to annual, rather than quarterly, reporting of social security earnings. Currently, for every \$300 of basic pay for active duty or active duty for training, the member receives a noncontributory credit of \$100, to a maximum credit of \$1,200 each year.

The social security trust funds are reimbursed annually from the general fund of the Treasury for additional costs attributable to noncontributory credits. The Secretary of Health, Education, and Welfare determines the amounts to be reimbursed. In fiscal year 1977, the old-age and survivors fund received reimbursements of \$24 million, and the disability fund, \$11 million, for additional costs attributable to noncontributory credits granted for service after 1956. 1/

The circumstances under which noncontributory credits were initially enacted strongly suggests that the primary purpose of providing credits (for military service after 1956) was to secure adequate disability and survivor protection for first-term military members. The credits were

1/1978 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds.

not expected to accrue in the case of career members because basic pay for these members was expected to exceed social security maximum covered earnings. In recent years, however, social security maximum covered earnings have increased dramatically. Chapter 3 discusses the resulting relationship between maximum covered earnings and basic pay, and some of the effects this relationship will have on social security expenditures. Chapters 4 and 5 discuss the disability and survivor protection currently provided to members and former members in relation to the need for providing social security coverage in excess of basic pay.

CHAPTER 3

NONCONTRIBUTORY WAGE CREDITS WILL RESULT IN

ADDITIONAL OLD-AGE BENEFITS FOR MOST MILITARY RETIREES

Social security maximum covered earnings have increased dramatically in recent years. As a result, almost 97 percent of the active duty force, including all enlisted members (both noncareer and career) and officers up to grade 0-4 (with more than 14 years' service), will receive noncontributory social security wage credits of \$1,200 in 1979. Furthermore, the noncontributory credits will result in additional social security old-age benefits for military retirees. This result was neither intended nor foreseen by the Congress when it authorized noncontributory credits. We estimate that the cost to the Government (in terms of social security outlays) of the additional benefits will eventually exceed \$100 million annually as military retirees who entered the force after 1956 become eligible for social security old-age benefits.

MILITARY BASIC PAY HAS NOT INCREASED AS DRAMATICALLY AS MAXIMUM COVERED EARNINGS

As was pointed out earlier, maximum covered earnings had remained at \$7,800 for calendar years 1968 through 1971. In 1972 maximum covered earnings increased by 15.4 percent to \$9,000. Over the same period, 1968 through 1972, military basic pay for career members increased by about 50.5 percent. The result was a decrease in the percent of the active duty force which would receive noncontributory credits from almost 91 percent in 1968 to about 87 percent in 1972. Most senior enlisted members in grades E-8 and E-9 and officers in grade 0-3 and above were not receiving credits by 1972.

The Social Security Amendments of 1972 (Public Law 92-336, July 1, 1972) established a procedure for automatically increasing maximum covered earnings. As a result of this legislation, maximum covered earnings increased substantially after 1972. By 1977, the covered earnings limit was \$16,500, an increase of 83.3 percent since 1972. The Social Security Amendments of 1977 (Public Law 95-216, December 20, 1977, 91 Stat. 1513) further accelerated the growth in the earnings limit. For 1979, maximum covered earnings are \$22,900, an increase of about 154 percent over the 1972 level. Military basic pay for career members increased by about 46 percent over the same period. The result is that almost 97 percent of the active duty force

will receive noncontributory credits of \$1,200 in 1979, including all enlisted members and most officers up to grade 0-4 (with more than 14 years' service). Furthermore, the covered earnings limit is scheduled to increase to \$25,900 in 1980 and to \$29,700 in 1981, an increase of almost 30 percent over the next 2 years. Thus, it is likely that the percentage of members receiving credits will not decrease in the near future.

INCREASES IN SOCIAL SECURITY
OLD-AGE BENEFITS ATTRIBUTABLE
TO NONCONTRIBUTORY CREDITS

To estimate the additional old-age benefits resulting from noncontributory credits, we developed lifetime covered earnings profiles for officer and enlisted members and estimated social security old-age benefits based on those earnings. Our first step was to develop promotion profiles for officer and enlisted members based on fiscal year 1977 promotion data supplied by DOD. We then estimated military career earnings based on the promotion profiles. Because most military retirees are employed in civilian jobs after retiring from active duty, we also estimated civilian covered earnings after military retirement. Members' military and civilian covered earnings constitute their lifetime covered earnings profile.

We assumed four patterns of civilian covered earnings after military retirement.

- The first was no civilian covered earnings. The member would have no civilian covered earnings if not employed after military retirement or if employed in a noncovered job (e.g., as a Federal civilian employee subject to the Civil Service Retirement System).
- The second pattern was maximum covered earnings for each year after military retirement until age 62.
- The third pattern was earnings equal to average social security covered earnings for each year over the same period.
- The fourth pattern was low covered earnings over the period.

Enlisted profiles

We first considered the earnings of an enlisted member who entered active duty in 1957 and served for 20 years. We estimated military covered earnings based on basic pay alone and on basic pay plus noncontributory credits. In the latter case, the member would have received credits of \$1,200 for each year of military service. Incorporating the four patterns of subsequent civilian earnings, we developed lifetime earnings profiles and estimated social security old-age benefits. 1/ The difference in benefits resulting from including and excluding the credits is the additional cost (to the Government) of the credits.

Our analysis shows that the estimated cost (in terms of social security outlays) ranges from \$216 a year to \$1,056 a year depending on the level of the retiree's subsequent civilian covered earnings. (See table 1 on p. 14.) Generally, the lower the retiree's civilian covered earnings, the greater the cost attributable to the credits. 2/

We also developed lifetime covered earnings and estimated old-age benefits for enlisted members who (1) entered service in 1957 and served for 30 years, (2) entered service in 1977 and served for 20 years, and (3) entered

1/Estimating civilian covered earnings and social security benefits requires assumptions regarding future increases in social security average covered earnings. We began with the Social Security Administration's preliminary estimate of average covered earnings in 1977 and assumed that the rate of increase would be 5.5 percent in 1978, 6 percent in 1979, 1980, and 1981, 5.7 percent in 1982, and 5.4 percent thereafter. (See footnote 1 on p. 13.)

2/This results because of (1) the "social weighting" in the social security benefit formula, e.g., benefits are a larger percentage of average covered earnings for lower income workers and (2) civilian years of earnings, rather than military years, may be dropped from the benefit computation. The second point results in more military years, and consequently more noncontributory credits entering the benefit computation.

service in 1977 and served for 30 years. 1/ In all cases, the member receives credits of \$1,200 for each year of military service. Table 1 shows the estimated costs associated with our enlisted profiles.

1/For these cases, we assumed that the rate of increase in basic pay would be 6 percent in 1979, 1980, and 1981, 5.7 percent in 1982, and 5.4 percent thereafter. These assumptions are consistent with fiscal year 1979 budget assumptions.

TABLE 1

COST OF NONCONTRIBUTORY CREDITS

(ADDITIONAL BENEFITS FOR ENLISTED RETIREES)

	Level of subsequent civilian covered earnings							
	None (note a)(note b)		Low (note c)		Average		Maximum	
20-year military careers:								
Service on active duty, 1957-76 (note d)								
Monthly cost (note e)	\$ 88	\$ (27)	\$ 56	\$ (17)	\$ 38	\$ (12)	\$ 18	\$ (6)
Annual cost (note e)	1,056	(324)	672	(204)	456	(144)	216	(72)
Service on active duty, 1977-96 (note f)								
Monthly cost (note e)	82	(9)	60	(6)	36	(4)	17	(2)
Annual cost (note e)	984	(108)	720	(72)	432	(48)	204	(24)
30-year military careers:								
Service on active duty, 1957-86 (note d)								
Monthly cost (note e)	106	(33)	74	(23)	58	(18)	27	(8)
Annual cost (note e)	1,272	(396)	886	(276)	696	(216)	324	(96)
Service on active duty, 1977-2006 (note f)								
Monthly cost (note e)	104	(11)	79	(9)	53	(6)	25	(3)
Annual cost (note e)	1,248	(132)	948	(108)	636	(72)	300	(36)

a/The amounts in columns 1, 3, 5, and 7 represent additional dollars that will be received by the retiree.

b/Inflation causes the purchasing power of a dollar to decline over time. Amounts in parentheses (columns 2, 4, 6, and 8) indicate the estimated purchasing power of dollars received in terms of the purchasing power of today's dollars, assuming the rate of inflation is 5.4 percent a year.

c/Low covered earnings were assumed to equal 70 percent of average covered earnings.

d/We have assumed that the member entered service on January 1, 1957, at the age of 18, and retired from active duty on December 31 of the year indicated. We have assumed that retirees will begin receiving social security old-age benefits at age 62, the earliest age at which old-age benefits may commence. In these cases, the retiree would attain age 62 in the year 2001.

e/The cost of the credits (to the Government) is the difference in benefits computed with and without the noncontributory credits.

f/We have assumed that the member entered service on January 1, 1977, and retired from active duty on December 31 of the year indicated. In these cases, the retiree would attain age 62 in the year 2021.

Officer profiles

We developed officer covered earnings profiles over the same time periods. The results for the officer who entered service in 1957 and served for 20 years are quite different from the results for the enlisted member. While the enlisted member received credits of \$1,200 for each year of service, the officer will have received credits for only the first few years of service. When the officer attained the grade of O-3, basic pay exceeded maximum covered earnings and continued to exceed the earnings limits in effect through the rest of the officer's military career. The cost to the Government (in terms of social security outlays) attributable to the credits is therefore much lower than the cost in the case of the enlisted member, ranging from \$36 a year to \$204 a year, depending on the officer's subsequent civilian covered earnings.

However, in the future, because of the substantial increase in maximum covered earnings, officers will receive noncontributory credits through most of their military careers. For example, officers who entered service in 1977 will receive noncontributory credits for about 20 years. The cost to the Government (in terms of social security outlays) will range from \$228 a year to \$804 a year for each officer retiree. Table 2 shows the estimated costs attributable to the credits for our officer profiles.

TABLE 2

COST OF NONCONTRIBUTORY CREDITS

(ADDITIONAL BENEFITS FOR OFFICER RETIREES)

	Level of subsequent civilian covered earnings							
	None		Low		Average		Maximum	
	(note a)	(note b)	(note c)					
20-year military careers:								
Service on active duty, 1957-76 (note d)								
Monthly cost (note e)	\$ 17	\$ (7)	\$ 16	\$ (6)	\$ 6	\$ (2)	\$ 3	\$ (1)
Annual cost (note e)	204	(84)	192	(72)	72	(24)	36	(12)
Service on active duty, 1977-96 (note f)								
Monthly cost (note e)	67	(9)	66	(9)	26	(4)	19	(3)
Annual cost (note e)	804	(108)	792	(108)	312	(48)	228	(36)
30-year military careers:								
Service on active duty, 1957-86 (note d)								
Monthly cost (note e)	9	(3)	8	(3)	3	(1)	3	(1)
Annual cost (note e)	108	(36)	96	(36)	36	(12)	36	(12)
Service on active duty, 1977-2006 (note f)								
Monthly cost (note e)	31	(4)	32	(4)	26	(4)	19	(3)
Annual cost (note e)	372	(48)	384	(48)	312	(48)	228	(36)

a/The amounts in columns 1, 3, 5, and 7 represent additional dollars that will be received by the retiree.

b/Inflation causes the purchasing power of a dollar to decline over time. Amounts in parentheses (columns 2, 4, 6, and 8) indicate the estimated purchasing power of dollars received in terms of the purchasing power of today's dollars, assuming the rate of inflation is 5.4 percent a year.

c/Low covered earnings were assumed to equal 70 percent of average covered earnings.

d/We assumed that the member entered service on January 1, 1957, at age 22, and retired from active duty on December 31 of the year indicated. In these cases, the retiree would attain age 62 in the year 1997.

e/The cost of the credits (to the Government) is the difference in benefits computed with and without the noncontributory credits.

f/We assumed that the member entered service on January 1, 1977, and retired from active duty on December 31 of the year indicated. In these cases, the retiree would attain age 62 in the year 2017.

Annual outlays attributable to
noncontributory wage credits

Over 50,000 military personnel retire from active duty annually. Thus, while the cost of the noncontributory credits per retiree may not appear significant, the total annual costs may be substantial because of the number of retirees who will receive additional social security old-age benefits attributable to the credits. We estimate that the noncontributory credits will result in social security outlays eventually exceeding \$100 million annually as members who entered service after 1956 become eligible for social security old-age benefits. Table 3 shows our estimated costs for the years 2001 through 2030.

Our estimates are conservative for two major reasons. First, we assumed that all military retirees who survive to age 62 1/ earned maximum covered earnings in civilian employment from the time of retirement from active duty until age 62. As can be seen from tables 1 and 2, this assumption results in the lowest estimate of additional cost per retiree. Second, we did not estimate costs associated with benefits payable to eligible dependents of retirees.

1/Estimates of the numbers of retirees who will survive to age 62 were based on mortality data supplied by DOD.

TABLE 3

ANNUAL COST (note a) OF NONCONTRIBUTORY CREDITS

	Assuming 5.4-percent inflation a year		Assuming 4-percent inflation a year	
	Budget dollars (note b)	1979 dollars (note c)	Budget dollars (note b)	1979 dollar (note c)
	----- (millions) -----			
2001	\$ 9	\$ 3	\$ 9	\$ 4
2002	16	5	16	7
2003	24	7	24	10
2004	32	8	31	12
2005	40	10	39	15
2006	48	11	46	17
2007	56	13	54	19
2008	65	14	61	21
2009	73	15	69	22
2010	81	16	76	23
2011	89	16	83	25
2012	97	17	90	26
2013	105	17	97	27
2014	113	18	103	27
2015	120	18	109	28
2016	127	18	115	28
2017	136	18	122	29
2018	144	18	129	29
2019	152	18	136	29
2020	159	18	142	30
2021	166	18	147	30
2022	172	18	153	29
2023	178	17	157	29
2024	184	17	162	29
2025	186	16	164	28
2026	189	16	166	27
2027	191	15	167	27
2028	193	15	170	26
2029	195	14	172	25
2030	<u>197</u>	<u>13</u>	<u>173</u>	<u>24</u>
Total	<u>\$3,537</u>	<u>\$437</u>	<u>\$3,182</u>	<u>\$702</u>

a/These estimates are conservative. (See p. 17.)

b/Budget dollars mean the social security outlays that would be attributable to the credits in the years indicated.

c/Inflation causes the purchasing power of the dollar to decline over time. By 1979 dollars we mean dollars of purchasing power equivalent to the purchasing power of today's dollar. Thus, we have deflated budget dollars to ascertain the cost of the credits (and the additional purchasing power that will accrue to military retirees) in terms of today's dollars.

CHAPTER 4

BENEFITS FOR MEMBERS WHO ARE DISABLED

OR DIE IN SERVICE

As we pointed out earlier, the primary purpose of providing noncontributory credits for military service (after 1956) was to secure adequate disability and survivor protection for military members, particularly first-term members. However, the social security system is not, and was not intended to be, the sole source of such protection. Additional protection is provided through the military retirement system and through benefits payable by VA.

In examining the need for providing social security coverage in excess of basic pay, we considered the total benefits provided by these sources in relation to active duty pay and allowances. Our examples show that disability benefits often equal or exceed pay and allowances received while on active duty, even if social security benefits are based on basic pay coverage only. For this reason, we believe that additional benefits resulting from the noncontributory credits are not justified. In the case of survivor benefits, the additional protection provided by the credits is negligible.

DISABILITY PROTECTION FOR MILITARY MEMBERS

Military members may be retired from active duty with disability retired pay payable by DOD if the service concerned determines that, as a result of a disability incurred in the line of duty, the members are unable to perform duties commensurate with their grade or rank. Disability retirement benefits consist of monthly payments equal to the larger of the benefits resulting from

--multiplying basic pay by the percent of disability
or

--multiplying basic pay by 2-1/2 percent for each year
of military service.

The maximum benefit payable is 75 percent of basic pay. Benefits are automatically adjusted based on increases in the cost of living.

The disabled member may be eligible for service-connected disability compensation payable by VA. These benefits consist of tax-free monthly payments based on a

schedule of rates ranging from \$44 for a 10-percent disability rating up to \$809 for a 100-percent disability rating. Additional amounts are payable for specific conditions, such as loss of hand, foot, or blindness. The member rated at least 30-percent disabled is entitled to additional compensation for dependents. VA compensation is not additive to DOD retired pay; it may be elected instead of or in combination with DOD benefits. In recent years, the Congress has adjusted benefits annually in recognition of increases in the cost of living.

Social security disability benefits are tax-free and additive to the other disability benefits. However, members retired from active service because of disability are not always eligible for social security disability benefits because of the more stringent definition of disability applicable under the social security system. To be eligible for social security disability benefits, a covered individual must be so severely disabled as to be incapable of engaging in any substantial gainful activity. The disability must be expected to continue for at least 12 months or to result in death.

Because our concern is the additional disability protection provided by the social security wage credits, the examples below illustrate benefits payable in cases of severe disability qualifying the member for social security benefits. Military members qualifying for social security disability benefits will likely be eligible for disability benefits (based on 100-percent disability) from DOD and/or VA.

Examples of disability benefits for selected pay grades

Table 4 presents examples of the disability benefits which would be payable to members of various pay grades who are totally disabled in the line of duty. It also shows the relationship between disability benefits and active duty pay and allowances by expressing the benefit as a percent of active duty pay and allowances.

As can be seen from columns 8 and 9 of table 4, disability benefits approach, and often exceed, pay and allowances received while on active duty, even without considering the additional social security benefit resulting from the wage credits. In addition, benefits from VA and social security are tax-free. The percentages shown, therefore, understate the percentage of after-tax pay replaced, particularly in the case of higher income members. In view of these results, we believe that additional benefits resulting from wage credits are not justified.

TABLE 4
ANNUAL DISABILITY BENEFITS

Pay grade, years of service (YOS), and dependency status (note a)	Social security benefit based on basic pay only	Social security benefit based on basic pay plus noncontributory credit	Benefits from DOD and/or VA (note b)	Total benefits		Current basic pay plus allowances (note c)	Total benefits as percent of current basic pay plus allowances (note d)	
				Column 2 plus 4	Column 3 plus 4		Total benefits based on base pay only	Total benefits based on base pay plus credits
E-4, over 2 YOS with spouse and two children	\$4,374	\$4,950	\$11,028	\$15,402	\$15,978	\$ 9,547	161	167
E-4, over 2 YOS with spouse only	2,916	3,300	10,296	13,212	13,596	9,547	138	142
O-2, over 2 YOS with spouse and two children	6,030	6,606	11,028	17,058	17,634	15,485	110	114
O-2, over 2 YOS with spouse only	4,020	4,404	10,296	14,316	14,700	15,485	92	95
E-6, over 12 YOS with spouse and two children	6,048	6,642	11,028	17,076	17,670	13,601	126	130
E-6, over 12 YOS with spouse only	4,032	4,428	10,296	14,328	14,724	13,601	105	108
O-4, over 12 YOS with spouse and two children	8,622	e/8,622	15,422	24,044	24,044	25,136	96	96
O-4, over 12 YOS with spouse only	5,748	e/5,748	15,422	21,170	21,170	25,136	84	84

a/All examples assume that the member became disabled in January 1979. Thus, the member with more than 2 years of service at that time would have entered service in 1977. The member with more than 12 years of service would have entered in 1967.

b/In all cases except for the O-4, VA compensation exceeds the disability retired pay that would be received from DOD. Thus, the amounts shown are from VA. In the case of the O-4, the amount shown is disability retired pay based on percentage of disability (in this case, the maximum 75 percent of basic pay). The O-4 may elect to receive part of the compensation from VA and the remainder from DOD. VA benefits have been calculated at the minimum total disability benefit of \$809 a month with additional amounts payable for dependents. Additional VA payments may be available to the member for specific conditions such as loss of a hand or foot, blindness, etc.

c/This column represents the rate of compensation received immediately before becoming disabled. The figures shown are the total of basic pay, quarters allowances at the with dependents rate and cash subsistence allowances. Pay net of taxes would actually be less than the amounts shown since basic pay is taxable.

d/The percentages shown would be higher if we had considered the effects of taxes, particularly for higher paid members. Virtually all of the total disability benefit is tax-free. While on active duty, the member would have been taxed on basic pay. (Also see notes b and c.)

e/In these cases the credits provided no additional protection. As we pointed out in chapter 3, however, for officers currently entering the force, the credits will provide additional protection.

SURVIVOR PROTECTION FOR MILITARY MEMBERS 1/

Survivors of military members who die in the line of duty while on active duty, active duty for training, or inactive duty training are eligible for Dependency and Indemnity Compensation payable by VA. This compensation is also payable in cases of death due to service-connected disabilities. Benefits for the widows(ers) of deceased members consist of tax-free monthly payments based on a schedule of rates ranging from \$297 a month to \$760 2/ a month depending on deceased members' pay grades. An additional amount of \$35 monthly is payable for each child. The widows'(ers') benefits continue for life (except in the event of remarriage) and are not affected by income from other sources. In recent years, the Congress has periodically adjusted DIC in recognition of increases in the cost of living.

Survivors of deceased members may also be eligible for monthly social security benefits based on members' covered earnings before death. The unremarried widows(ers) of deceased members are generally eligible for social security survivor benefits if caring for a child eligible for benefits or if age 60 or over. 3/ If the widows(ers) are caring for an eligible child(ren), payments are made to both widows(ers) and child(ren). Social security survivor benefits are tax-free and are additive to DIC benefits.

The widows(ers) of a member who die while on active duty after becoming eligible for retirement are entitled to monthly annuities from the military Survivor Benefit Plan (SBP). The amount of SBP annuities equals the difference between DIC and 55 percent of what deceased members' retired pay would have been based on grade and years of service at the time of death. If the widows(ers) also receive

1/This section considers only that protection which relates to income maintenance, that is, continuing monthly payments. Survivors will generally be eligible for several lump-sum payments as well, such as death gratuities and burial allowances.

2/In the case of the Chairman of the Joint Chiefs of Staff, Chief of Staff of the Army, Chief of Naval Operations, Chief of Staff of the Air Force, or Commandant of the Marine Corps, the spouse's benefit is \$814 monthly.

3/Severely disabled widows(ers) may claim a reduced benefit as early as age 50.

social security survivor benefits, the SBP annuity is further reduced by the amount of the social security benefit attributable to deceased members' military covered earnings. SBP payments are taxable and are automatically adjusted based on increases in the cost of living.

Examples of benefits for survivors
of military members

Table 5 (see p. 24) shows examples of benefits payable to survivors of deceased members, and expresses the benefits as a percent of deceased members' active duty pay and allowances.

TABLE 5
ANNUAL SURVIVOR BENEFITS

Survivors (pay grade and years of service (YOS)) of deceased members (note a)	Social security benefit based on basic pay only	Social security benefits based on basic pay plus noncontributory credit	Benefits from VA (DIC)	Total benefits		Current basic pay plus allowances (note b)	Total benefits as percent of current basic pay plus allowances (note c)	
				Column 2 plus 4	Column 3 plus 4		Total benefits based on base pay only	Total benefits based on base pay plus credits
Widow(er) and two children (E-4, 2 YOS)	\$4,374	\$4,950	\$4,848	\$ 9,222	\$ 9,798	\$ 9,547	97	103
Widow(er) only (note d) (E-4, 2 YOS)	0	0	4,008	4,008	4,008	9,547	42	42
Widow(er) and two children (O-2, 2 YOS)	6,030	6,606	5,496	11,526	12,102	15,485	74	78
Widow(er) only (note d) (O-2, 2 YOS)	0	0	4,656	4,656	4,656	15,485	30	30
Widow(er) and two children (E-6, 12 YOS)	6,048	6,642	5,052	11,100	11,694	13,601	82	86
Widow(er) only (note d) (E-6, 12 YOS)	0	0	4,212	4,212	4,212	13,601	31	31
Widow(er) and two children (O-4, 12 YOS)	8,622	e/8,622	6,108	14,730	14,730	25,136	59	59
Widow(er) only (note d) (O-4, 12 YOS)	0	0	5,268	5,268	5,268	25,136	21	21

a/All examples assume that the member died in January 1979.

b/This column represents the rate of pay received immediately before death. The figures shown are the total of basic pay, quarters allowances at the with dependent rates and cash subsistence allowances. Pay net of taxes would be less than the amounts shown since basic pay is taxable.

c/The percentages shown would be higher if we had considered the effects of taxes, particularly for higher paid members. Survivor benefits are tax-free. While on active duty, the member would have been taxed on basic pay. (Also see note b.)

d/Widows(ers) without dependent children would not generally be eligible for social security survivor benefits until age 60. In these cases, the widows(ers) would be much younger than 60 when the member died.

e/In this case the credits provided no additional protection. As we pointed out in chapter 3, however, for officers currently entering the force, the credits will provide additional protection.

In the case of widows(ers) with dependent children, benefits range from about 59 percent to about 103 percent of the deceased members' pay and allowances. However, if social security benefits were based on basic pay coverage only, total benefits would still range from about 59 percent to about 97 percent of active duty pay. In addition, the benefits are tax-free. The percentages shown therefore understate the percentage of after-tax income that the benefits replace, particularly in the case of higher income members. The additional survivor benefits attributable to the credits are negligible.

In the case of widows(ers) with no dependent children, the wage credits are of no immediate value anyway because the widows(ers) would generally not be eligible for social security survivor benefits until they reach age 60.

CHAPTER 5

DISABILITY AND SURVIVOR PROTECTION PROGRAMS

AVAILABLE TO NONCAREER PERSONNEL

We have also considered the necessity for providing social security coverage in excess of basic pay in the case of individuals who serve for a short period of time in the military and are disabled or die in subsequent civilian employment. In such cases, social security coverage on basic pay only would result in lower covered earnings and consequently lower social security benefits for these individuals. We found, however, that individuals who leave military service will generally be offered protection through other programs as well as social security. Disability benefits from Workers' Compensation (WC) programs are usually coordinated with social security benefits through offsets (benefit reductions) to insure that total benefits are not so high that they discourage rehabilitation and return to work. Benefits from private protection plans are also generally reduced in recognition of social security benefits. Because of these offset provisions, it appears that individuals in such circumstances may not benefit from coverage in excess of basic pay. Therefore, such coverage appears to be of questionable necessity.

STATE WORKERS' COMPENSATION PROGRAMS PROVIDE DISABILITY AND SURVIVOR PROTECTION

WC programs are designed to provide disability and survivor benefits in the event of work-related injuries, diseases, or death. Each of the 50 States has a WC program covering virtually all industrial work. In most States, public employees are also covered. Coverage generally commences with the first day of employment. Benefits are tax-free.

There are three types of disability benefits provided by WC programs.

- Cash benefits are available for four classifications of disability: temporary total, permanent total, temporary partial, and permanent partial. Benefits for total disability are expressed as a percentage of wages to a specified maximum percent, usually 66-2/3 percent. However, in most States limitations are placed on maximum and minimum weekly benefits. In cases of temporary disability, payments usually

continue for the period of disability; payments for permanent total disability generally extend through the employee's lifetime.

- Medical benefits are usually provided without dollar or time limits. In the case of most occupational injuries, only medical benefits are provided since substantial impairment or wage loss is not involved.
- Rehabilitation benefits include both medical rehabilitation and vocational rehabilitation for those cases involving severe disabilities.

WC survivor benefits include periodic payments and lump-sum burial allowances. These benefits are payable if the worker dies at the time of injury or if he dies during disability resulting from an occupational injury or disease. Periodic payments based on the deceased worker's wages are usually received by the widow(er) until remarriage and by the children until a specified age.

Coordination with social security benefits

Workers who become totally and permanently disabled due to occupational disease or injury usually qualify for both WC and social security disability benefits. The States may offset (reduce) WC disability benefits when social security disability benefits are also payable. Currently, only nine States provide for such an offset. However, if WC benefits are not reduced, the social security benefit may be reduced if total benefits exceed 80 percent of the worker's average current earnings. ^{1/} The purpose of offset features is to insure that total benefits are not so large that they discourage rehabilitation and return to work. The offset does not apply to disabled workers who have attained age 62, nor does it apply in the case of survivor benefits payable under the programs.

LONG-TERM DISABILITY PROGRAMS

Private Long-Term Disability (LTD) programs have been the fastest growing employee benefit in the 1970s, in terms of the number of new employees joining LTD plans each year.

^{1/}In the majority of cases, monthly average current earnings equal one-twelfth of the highest annual earnings in covered employment (without regard to the maximum earnings limit) in year of disablement and the preceding 5 years.

These plans are designed to provide a partial replacement of earnings lost because of a disability due to accident or illness. Most plans provide coverage for both nonoccupational and on-the-job accidents and illnesses.

Benefits consist of weekly or monthly payments usually based on the worker's rate of pay. The period during which benefits are payable varies, but the most common periods are 5 years, 10 years, and to age 65. The plans are normally designed to insure that monthly benefit amounts are significantly less than the individual's net earnings after taxes if he were working. In addition, LTD benefits are normally offset (reduced) when the individual receives payments from other sources, including social security and WC, to avoid making total disability payments overly attractive as compared with earnings in employment.

EMPLOYER DISABILITY RETIREMENT PLANS

Private employer disability retirement pay plans usually cover situations where the impairment is total and permanent. Typical pension provisions allow for full accrued pension (no reduction) for life, a minimum benefit level such as 25 percent of pay, a special added supplement of \$100 until social security starts, and continuing accumulation of service credits until age 65. Recently, however, there has been a leveling off in the growth of these programs, mainly due to the growing preference for LTD plans which tie to salary, not pension accrual. Benefits from these programs are also generally integrated with any public disability coverage such as social security or WC.

CHAPTER 6

CONCLUSIONS AND RECOMMENDATIONS

CONCLUSIONS

The circumstances under which noncontributory credits were initially enacted strongly suggest that the wage credits were primarily intended to provide adequate disability and survivor protection for first-term military members. Our estimates of disability benefits provided to first-term personnel show that the combination of benefits available from the social security system, VA, and DOD generally approaches or exceeds pay and allowances received while on active duty, even if social security benefits are based on current contributory coverage alone. The additional survivor protection provided by the credits is negligible. In addition, the pay and allowances replaced by the combination of benefits are considerably higher than the depressed wages of the draft era existing when the credits were authorized. In view of these considerations, we believe that the noncontributory credits are unnecessary. While it may be argued that the provision of noncontributory credits recognizes the Nation's special obligation to members who are disabled or die in the line of duty, we believe that the provision of additional ("noncontributory") benefits from VA acknowledges that obligation.

The noncontributory credits will also provide additional social security old-age benefits for military retirees, a result neither foreseen nor intended by the Congress when it authorized the credits. We estimate that the cost (in terms of social security outlays) of the additional old-age benefits attributable to the noncontributory credits will eventually exceed \$100 million annually as retirees who entered the force after 1956 become eligible for social security old-age benefits. Criticism of the generosity of retirement benefits attributable to military service already exists because of the additive nature of military retired pay and benefits arising from contributory social security coverage. We see no justification for providing additional old-age benefits resulting from the noncontributory wage credits.

Disability and survivor protection for individuals who serve in the military for relatively short periods of time, and are disabled or die in subsequent civilian employment, will not be substantially impaired because of relatively low covered earnings in military service (due to coverage

on basic pay only). Such individuals will probably be covered under at least one other disability and survivor protection program (WC) as well as social security.

RECOMMENDATIONS TO THE CONGRESS

We recommend that the Congress terminate noncontributory social security wage credits for future military service. This result may be achieved by amending section 429 of title 42, United States Code, to limit noncontributory credits to service performed before 1980.

We recognize that members may view termination of the credits as an erosion of benefits. However, it should be recognized that the recommended action does not revoke credits granted before 1980. Thus, members will be entitled to any benefits arising from those credits.

AGENCY COMMENTS AND OUR EVALUATION

Comments were requested from DOD, HEW, OMB, and VA. Comments from DOD and OMB were not received in time to be included in this report, but officials of these two agencies have provided oral comments.

DOD

DOD officials said that DOD would probably disagree with elimination of the noncontributory credits for three reasons. First, in the case of military retirees, the value of benefits attributable to the credits will diminish over time because inflation will erode the purchasing power of dollars received in the distant future. (This effect is illustrated in table 1 on p. 14, where both dollars to be received in the future and their equivalent in terms of 1979 purchasing power are shown, assuming an inflation rate of 5.4 percent a year.) Eventually, the additional benefits attributable to the credits will be worth virtually nothing to future military retirees. Second, military members would view elimination of the credits as an erosion of benefits. Third, DOD would probably disagree with a reduction in disability benefits under any circumstances.

In relation to the first point raised by DOD officials, we recognize that the value of benefits attributable to the credits will diminish for future military retirees. However, the aggregate costs of the credits (see table 3, p. 18) are, in our opinion, significant, particularly since demographic projections relative to the social security system reveal a dramatically increasing number of social

security beneficiaries relative to the working population beginning around the year 2005 and continuing until about the year 2030. Since the social security system operates on a pay-as-you-go basis (that is, social security benefits are financed through social security taxes on the covered working population), an increase in the ratio of beneficiaries to workers implies a greater burden on future taxpayers. We believe that the Government should act to preclude any unintended (and unnecessary) addition to that burden. Table 6 presents estimated savings if the noncontributory credits are eliminated for service performed after 1979.

TABLE 6

ESTIMATED SAVINGS - GAO RECOMMENDATION

<u>Year</u>	<u>Assuming 5.4-percent inflation a year</u>		<u>Assuming 4-percent inflation a year</u>	
	<u>Budget dollars (note a)</u>	<u>1979 dollars (note b)</u>	<u>Budget dollars (note a)</u>	<u>1979 dollars (note b)</u>
	------(millions)-----			
2015	\$ 7	\$ 1	\$ 7	\$ 2
2016	14	2	14	3
2017	24	3	23	5
2018	33	4	33	7
2019	43	5	42	9
2020	53	6	51	11
2021	63	7	61	12
2022	73	8	70	14
2023	84	8	79	15
2024	94	9	89	16
2025	104	9	98	17
2026	114	10	106	18
2027	124	10	115	18
2028	134	10	123	19
2029	144	10	131	19
2030	<u>153</u>	<u>10</u>	<u>139</u>	<u>20</u>
Total	<u>\$1,261</u>	<u>\$112</u>	<u>\$1,181</u>	<u>\$205</u>

a/Budget dollars mean the social security outlays that would be attributable to the credits in the years indicated.

b/Inflation causes the purchasing power of the dollar to decline over time. By 1979 dollars we mean dollars of purchasing power equivalent to the purchasing power of today's dollars. Thus, we have deflated budget dollars to ascertain the cost of the credits (and the additional purchasing power that will accrue to military retirees) in terms of today's dollars.

Note: Comparison of this table with table 3 on page 18 reveals a "residual" cost even if the credits are eliminated for service after 1979. This residual cost is a nonrecoverable (or "sunk") cost attributable to credits granted for service before 1980. Also, as we pointed out in note a of table 3, the estimated costs are conservative. The estimated savings presented here are also conservative for the same reasons.

The second point raised by DOD officials appears to contradict the first in the case of military retirees. If the credits will be worth virtually nothing to the retirees, we find it difficult to view elimination of the credits as an erosion of benefits. Also, as we pointed out earlier, we are not recommending that credits granted before 1980 be revoked. In the area of disability and survivor protection, we believe that tables 4 and 5 on pp. 21 and 24 respectively, show that protection will not be substantially impaired by eliminating the credits.

The third point raised by DOD officials concerns disability benefits. We firmly believe that members who are disabled while serving the Nation should be compensated for their losses. We are convinced that elimination of the credits does not violate the obligation to provide adequate income maintenance assistance in these circumstances. Our analysis shows that disability benefits often equal or exceed pay and allowances received while on active duty, even if social security benefits are based on basic pay coverage only. (See table 4, p. 21.) VA also provides assistance in other areas such as medical care, vocational rehabilitation, and dependents' education.

Just prior to releasing this report, we were informed that DOD may now support the HEW proposal. (See HEW comments below.)

VA

VA agreed with the descriptions of disability compensation and DIC contained in the report and with the assumptions underlying the determination of amounts payable in the examples shown in chapter 4 of the report.

HEW

HEW favors terminating the noncontributory credits, but prefers that the credits be phased out rather than terminated as of 1980. A proposal to accomplish this phaseout is currently being processed. The proposal would "freeze" the taxable wage base at the 1979 level (\$22,900) for purposes of determining the credits in future years. Thus, as military pay rises in the future, and more military members reach that wage level, their entitlement to the credits would terminate automatically.

The HEW proposal will ultimately have the same effect as our proposal--terminating the credits. However, it would

continue to provide additional disability and survivor protection for first-term members over an extended period of time. We believe that our analysis clearly demonstrates that the credits are unnecessary in terms of adequate protection for these members. The HEW proposal would also continue to provide credits to current career members, particularly enlisted members, through most of their military careers. It would therefore continue to provide unintended old-age benefits for these members, thereby reducing/deferring somewhat the potential savings.

OMB

OMB officials have indicated agreement with the need for terminating the credits. They are currently working with HEW on its legislative proposal.



VETERANS ADMINISTRATION
OFFICE OF THE ADMINISTRATOR OF VETERANS AFFAIRS
WASHINGTON, D.C. 20420
JULY 5 - 1979

Mr. Gregory J. Ahart
Director, Human Resources Division
U. S. General Accounting Office
441 G Street, NW
Washington, DC 20548

Dear Mr. Ahart:

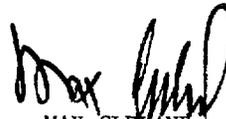
We have reviewed the May 23, 1979 draft report, "Noncontributory Social Security Wage Credits for Military Service Should be Eliminated," which states that military personnel were brought under contributory social security coverage in 1957 and both military members and the Department of Defense (DOD), as their employer, pay social security taxes on basic pay. Members whose basic pay is less than the social security taxable earnings ceiling (\$22,900 in 1979) are credited with additional covered earnings, in excess of basic pay, up to \$1,200 year, on which neither the member nor DOD pays taxes. The General Accounting Office (GAO) reviewed the rationale for providing the noncontributory wage credits for service performed after 1956, examined the need for providing the credits in light of their effects on current benefit levels, and estimated unforeseen costs that will result from the credits. Based on their review, GAO recommends that the Congress limit noncontributory wage credits to military service performed before 1980.

We agree that the descriptions of disability compensation and Dependency and Indemnity Compensation benefits contained in Chapter 4 of the report are correct. We believe the assumptions made for determining the amounts of veterans benefits payable to be appropriate. The examples cited in Chapter 4 consider cases in which eligibility for Social Security benefits is based on an inservice permanent and total disability or death occurring in line of duty. In such cases, disability compensation at the 100 percent rate (after waiver of retired pay) or Dependency and Indemnity Compensation based on the deceased member's pay grade would be payable.

[GAO note: VA officials requested that this paragraph be removed from its comments.]

Thank you for the opportunity to review this draft report.

Sincerely,


MAX CLELAND
Administrator



DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE
OFFICE OF THE SECRETARY
WASHINGTON, D. C. 20201

JUL 19 1979

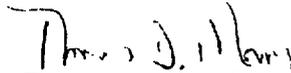
Mr. Gregory J. Ahart
Director, Human Resources
Division
United States General
Accounting Office
Washington, D.C. 20548

Dear Mr. Ahart:

The Secretary asked that I respond to your request for our comments on your draft report, "Noncontributory Social Security Wage Credits for Military Service Should be Eliminated." The enclosed comments represent the tentative position of the Department and are subject to reevaluation when the final version of this report is received.

We appreciate the opportunity to comment on this draft report before its publication.

Sincerely yours,


Thomas D. Morris
Inspector General

Enclosure

COMMENTS OF THE DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE ON THE
GENERAL ACCOUNTING OFFICE'S DRAFT REPORT "NONCONTRIBUTORY SOCIAL
SECURITY WAGE CREDITS FOR MILITARY SERVICE SHOULD BE ELIMINATED,"
FPCD-79-57, DATED MAY 17, 1979

GAO Recommendation to the Congress

That the Congress terminate noncontributory social security wage credits for future military service. This result may be achieved by amending Section 429 of Title 42, United States Code, to limit noncontributory credits to service performed prior to 1980.

Department Comment

We favor termination of noncontributory or gratuitous social security wage credits for military service; however, we think it is advisable that the credits should be phased out rather than terminated all at once as GAO recommends.

A proposal to the Congress is being processed which would accomplish this phase-out. For purposes of determining the gratuitous wage credit in future years, the proposal would in essence "freeze" the wage base, on which social security benefits are computed, at the 1979 level. As uniform services pay rises in the future and as more and more servicemen reach that wage level, the gratuitous wage credit would be terminated automatically.

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