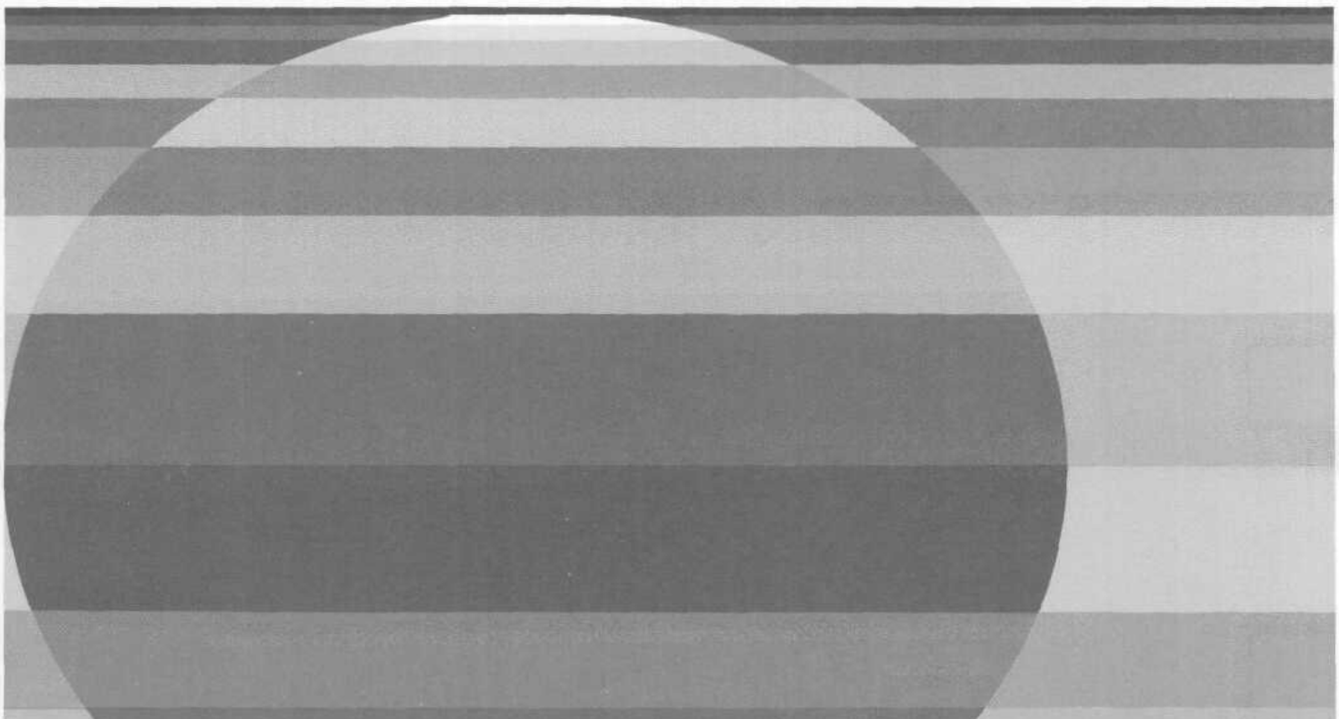
BACKGROUND PAPER

Retirement Accounting Changes: Budget and Policy Impacts

April 1977



Congress of the United States
Congressional Budget Office
Washington, D.C.

RETIREMENT ACCOUNTING CHANGES:
BUDGET AND POLICY IMPACTS

The Congress of the United States
Congressional Budget Office

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PREFACE

Some major changes in how the federal budget accounts for the costs of military and civil service retirement are likely to come before this Congress. To assist the Members in evaluating these accounting shifts, this paper discusses the changes' effects on the budget authority and outlays in the various budget functions; it also enumerates the advantages and disadvantages of the proposed changes. The report was prepared at the request of the House Budget Committee.

The Congressional Budget Office (CBO) is also preparing two papers on related topics. A proposal to create a new federal budget statement--to be called a consolidated financial statement--is examined in Federal Financial Reporting, a forthcoming technical analysis. Some of the retirement accounting changes discussed in this paper may be incorporated in the consolidated financial statement, though in a fundamentally different way than is discussed in this paper. In addition, CBO is preparing a companion background paper entitled Federal Civil Service Retirement: A Look Ahead, which includes a discussion of other aspects of civil service retirement accounting.

This paper was prepared by Robert F. Hale of the National Security and International Affairs Division of the Congressional Budget Office, under the supervision of Gary R. Nelson and John E. Koehler. The author wishes to acknowledge the helpful comments of Earl A. Armbrust of the CBO Management Programs Division and Richard P. Emery, Jr., of the CBO Budget Analysis Division, as well as Johanna Zacharias, who edited the manuscript and Patricia J. Minton, who typed it for publication.

In keeping with CBO's mandate to provide nonpartisan analysis of issues before the Congress, the report contains no recommendations.

Alice M. Rivlin
Director

April 1977

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SUMMARY

The Administration is currently considering some changes in the way the federal budget accounts for the retirement costs of military and civil service personnel. The changes are simply adjustments in accounting procedures; they will not affect the amount any employee gets when he retires, nor the cost to the federal government. Their purpose is to make the size of the budget functions, particularly the national defense function, reflect more precisely the costs of current activity; another of their aims is to improve management by making the full costs of manpower more visible. If proposed and accepted, these changes will take effect in the fiscal year 1979 budget.

The Administration is still developing specific proposals. What is likely to emerge from these deliberations is a package that includes one or more of the following:

- o The Defense Retired Pay appropriation may be transferred out of the defense function of the budget, probably into the income security function. (The Defense Retired Pay appropriation pays benefits to former military personnel now on the retired rolls and to their survivors.)

- o A charge for retirement costs of today's military personnel may be added to the defense function. The charge will equal the amount actuaries estimate would fully fund the retirement liabilities that today's military personnel earn each year. This charge will reflect expected future growth in prices and wages and future interest rates.

- o The charge that funds costs of future civil service retirees may be increased to reflect expected future increases in prices and wages. (The current civil service charge does not take into account growth in prices or wages.)

- The Administration may propose creation of a military trust fund, similar to the civil service fund, that will hold contributions and pay benefits.

These accounting modifications will probably not affect total outlays in the federal budget, though this depends on how such "off-budget" agencies as the Postal Service are handled. Outlays in some functions will change however. For example, if all four accounting changes are implemented, outlays in the defense function could increase by $0.5 billion in fiscal year 1979. While outlays in the budget as a whole may not change, budget authority will increase as the budget begins fully recognizing rights to future retirement benefits. In fiscal year 1979, if all four changes are implemented together, the increase could amount to $13.8 billion in the budget as a whole and $0.5 billion in the defense function.

Of course, estimates change considerably if only some of the four changes are implemented. For example, if the only change is to transfer the Defense Retired Pay appropriation out of the defense function, then defense outlays and budget authority will fall by $9.7 billion in fiscal year 1979. This single change was proposed in a bill recently introduced in the House of Representatives (H.R. 4894).

Estimates of budget authority and outlays are also very sensitive to economic assumptions, particularly assumptions about future interest rates. The numbers above assume a future interest rate of 6 percent. Assuming a higher interest rate could cause defense outlays to fall rather than increase, while assuming a lower interest rate could cause increases larger than $0.5 billion. Interest rate and other technical assumptions are discussed more fully in the text.

Implementing all four accounting changes together offers several advantages. The sizes of the budget functions, particularly the defense function, are sometimes used to evaluate or compare levels of current activity. The proposed accounting changes will make numbers in the budget functions better measures for such comparisons. Also, institution of a charge for military retirement, along with an increase in the civil service charge, will make retirement costs of current employees more visible. This may make planners in the Department of Defense and other agencies more frugal in their use of manpower, and could prompt a clarification of the debate over changing military retirement benefits by making savings more obvious. Finally, the changes will mean that accounting for military and civil service retirement is consistent.

Probably the major disadvantage of these accounting modifications is the sensitivity of any retirement charge to technical assumptions, such as those about future prices, wages, and interest rates. This renders the charge subject to accounting tricks. However, assumptions could be made by independent actuaries, as is done for the civil service system. Though these independent actuaries may disagree, their disagreement will presumably be on technical rather than political grounds. Another disadvantage is confusion during transition to the new system. During the transition, the defense function and other functions may appear larger or smaller even if there are no changes in real activity, thus confusing comparisons between spending for defense versus non-defense. There could also be disadvantages if only some of the four changes are implemented. For example, if the only change is to transfer the Defense Retired Pay appropriation out of the defense function, then retirement accounting would remain inconsistent; and the defense function would not include any costs for military retirement, even though retirement is an important element of defense manpower costs. Other minor drawbacks are noted in the text, along with a number of issues that must be resolved by the Administration before a final plan is submitted.

CHAPTER I. THE CHANGES TO BE PROPOSED

According to this year's budget, the Administration is considering some shifts in the way the budget accounts for military and civil service retirement costs. If proposed and accepted, the changes will take effect in next year's budget. The changes will be limited to accounting modifications. They will not affect the pay and benefits of any employee; nor will they affect the cost to the government (though other, separate proposals may suggest benefit changes).

The shifts are designed to make the size of the budget functions--particularly the defense function--a better measure of the cost of today's activity and to improve management by making the full cost of manpower more visible. 1/ Under the provisions of the Congressional Budget Act of 1974, the changes will require consultation with the Budget and Appropriations Committees; some of the proposals would also require enabling legislation. 2/

The Department of Defense and the Office of Management and Budget are still developing the scope and details of the proposed changes. Ultimately, the package may include one or more of the following:

- The Defense Retired Pay appropriation, which pays for retirement benefits to former military personnel now on the retired rolls and for benefits to their survivors, may be transferred out of the defense

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1/ The Congressional Budget and Impoundment Control Act of 1974 (P.L. 93-344) divides the budget into various numbered functions (e.g., national defense (050), health (550), income security (600)). These functions are used throughout this paper in discussing the effects of the accounting changes.

2/ Section 802, Congressional Budget Act of 1974.

function (050). It probably would be transferred to the income security function (600), which now contains the appropriation that pays benefits to civil service retirees. A bill that proposes moving the Defense Retired Pay approriation out of the defense function was recently introduced in the House of Representatives (H.R. 4894).

- In place of the retirement costs of past employees, a charge for retirement costs of present employees is likely to be added to the defense function. The charge will be the amount that actuaries estimate would have to be set aside to fund fully the retirement liabilities that military personnel earn, or "accrue," each year. 3/ This accrual charge will reflect expected future prices, wages, and interest rates. Under these proposals, the charge will be paid entirely by the Department of Defense, though separate proposals may suggest that military personnel pay a part of the cost. Accounting for this charge would be similar to accounting for the charge for civil service retirement. The charge would appear in the defense function with an offsetting receipt in function 900 (interest and offsetting receipts).

- While the budget now shows a charge for accrued costs of retirement benefits for present civil service employees, the charge does not take into account future increases in prices or wages. The

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3/ For the more technically inclined reader, the annual accrual charge is the amount that must be set aside each year so that the discounted present value of the charges, set aside over the entire career of a group of military or civilian employees, is equal to the discounted present value of retirement benefits that must be paid to those employees who remain in the service long enough to retire. Thus the calculation considers all employees, not just those who retire, and depends on how long people stay in the service. The charge also depends on future inflation, wage growth, and interest rates. The accrual charge is usually expressed as a percent of the annual military basic payroll (or of the civilian payroll).

Administration may propose increasing the charge to reflect expected future price and wage growth, with the increase being paid by the government. This increase will affect all budget functions that contain civil service payrolls. Increasing the charge was recommended by the most recent report of the Civil Service Board of Actuaries. 4/

- The Administration may propose creation of a military trust fund. The fund, like the existing civil service fund, would hold contributions and pay benefits. Such a fund would require enabling legislation. There are many questions as to exactly how such a fund would be structured and how it would be reimbursed for benefits earned before the fund existed. These issues are discussed more fully in subsequent chapters of this paper.

4/ Fifty-fourth Annual Report, Board of Actuaries of the Civil Service Retirement System, quoted in Communication from the Chairman of the U.S. Civil Service Commission, House Committee on Post Office and Civil Service, U.S. House of Representatives, Committee Print 94-18, 94-2, September 20, 1976, p. 26.

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CHAPTER II. EFFECTS ON OUTLAYS AND BUDGET AUTHORITY

The exact effect of the retirement accounting changes on outlays and budget authority depends on assumptions about future growth in prices and wages and on interest rates, as well as on other technical assumptions. Numbers are particularly sensitive to future interest rates. The numbers below illustrate general trends using two sets of assumptions. The first assumes annual growth of 4 percent in the Consumer Price Index (CPI) and 5 percent in wages, and an interest rate of 6 percent. The second makes the same assumptions about growth in the CPI and wages, but assumes a 5 percent interest rate. Effects of these and other assumptions are discussed more fully at the end of this chapter. Numbers are based on estimates by the Congressional Budget Office, the Department of Defense, and the Civil Service Commission. 1/

EFFECTS IN FISCAL YEAR 1979

Tables 1 and 2 show effects on outlays and budget authority in fiscal year 1979, the first year the changes are to be implemented. Table 1 assumes a future interest rate of 6 percent; Table 2 assumes 5 percent. For on-budget agencies, the proposed accounting modifications do not change outlays in the budget as a whole. This is true regardless of assumptions about future interest rates. Thus for on-budget agencies, the proposed accounting modifica-

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1/ Accrual percentages for military personnel are derived from The Third Quadrennial Review of Military Compensation Staff Studies, Department of Defense, Volume III, pp. 86, I-4, I-5. Accrual percentages for civil service personnel are based on computer runs done for the Congressional Budget Office by the Office of the Actuary, Civil Service Commission. Numbers are also based on CBO projections of civil service salaries and military basic pay. These projections assume no changes in payrolls except those caused by pay increases.

TABLE 1. FISCAL YEAR 1979 BUDGET CHANGES (ASSUMING 6 PERCENT FUTURE INTEREST RATE)

	Change from Transferring Retired Pay Defense Account	+	Change from Institution of Accrual Charge-- Military a/	+	Change from Increase in Accrual Charge-- Civil Service b/	+	Change from Creation of Military Trust Fund	=	Change in Total Budget
					OUTLAYS				
Defense function (050)	-9.7		+7.0		+3.2		0		+0.5
Other agency functions (100 - 800)	0		0		+3.6		0		+3.6
Income security (600)	+9.7		0		0		0		+9.7
Offsetting receipts (900) c/	0		-7.0		-6.8		0		-13.8
Total Budget	0		0		0		0		0
					BUDGET AUTHORITY				
Defense function	-9.7		+7.0		+3.2		0		+0.5
Other agency functions	0		0		+3.6		0		+3.6
Income security	+9.7		0		+6.8		+7.0		+23.5
Offsetting receipts c/	0		-7.0		-6.8		0		-13.8
Total Budget	0		0		+6.8		+7.0		+13.8

a/ These numbers assume an accrual charge equal to about 39 percent of basic pay; this percent assumes an annual growth of 4 percent in the CPI and 5 percent in wages, and an interest rate of 6 percent (approximately a 2 percent real interest rate). The 39 percent excludes inactive reserve retirement; estimates of inactive reserve retirement are not available.

b/ These numbers assume a total civil service charge (including employee and employer charges) equal to 34 percent of salary, based on the assumptions in footnote a. This percentage is higher than the one used in OMB Circular A-76 because A-76 makes slightly different economic assumptions (0 percent CPI growth, 1 percent wage growth, and an interest rate of 2 percent).

c/ Excludes possible effects of off-budget agencies.

TABLE 2. FISCAL YEAR 1979 BUDGET CHANGES (ASSUMING 5 PERCENT FUTURE INTEREST RATE)

	Change from Transferring Retired Pay Defense Account	+	Change from Institution of Accrual Charge-- Military a/	+	Change from Increase in Accrual Charge-- Civil Service b/	+	Change from Creation of Military Trust Fund	=	Change in Total Budget
					OUTLAYS				
Defense function (050)	-9.7		+9.3		+4.6		0		+4.2
Other agency functions (100 - 800)	0		0		+5.2		0		+5.2
Income security (600)	+9.7		0		0		0		+9.7
Offsetting receipts (900) c/	0		-9.3		-9.8		0		-19.1
Total Budget	0		0		0		0		0
					BUDGET AUTHORITY				
Defense function	-9.7		+9.3		+4.6		0		+4.2
Other agency functions	0		0		+5.2		0		+5.2
Income security	+9.7		0		+9.8		+9.3		+28.8
Offsetting receipts c/	0		-9.3		-9.8		0		-19.1
Total Budget	0		0		+9.8		+9.3		+19.1

a/ These numbers assume an accrual charge of 51 (officers) to 52 (enlisted) percent of basic pay; this percent assumes an annual growth of 4 percent in the CPI and 5 percent in wages, and an interest rate of 5 percent (approximately a 1 percent real interest rate). The 51-52 percent excludes inactive reserve retirement; estimates of inactive reserve retirement are not available.

b/ These numbers assume a total civil service charge (including employee and employer charges) of 43 percent of salary, based on the assumptions in footnote a.

c/ Excludes possible effects of off-budget agencies.

tions do not affect the macroeconomic information in the budget (e.g., deficits, total outlays). 2/

Outlays in the budget as a whole, however, could be affected by a higher civil service accrual charge, depending on the treatment of some off-budget agencies such as the Postal Service. Most employees of these off-budget agencies are covered by the civil service retirement system. If the civil service accrual charge is increased, higher contributions of off-budget agencies would show up in the budget only once, as offsetting receipts, and thus would lower outlays in the budget as a whole. In contrast, higher contributions from on-budget agencies show up twice, once as agency outlays and once as offsetting receipts, and so cancel out. Higher contributions from the Postal Service alone could lower outlays by $2.5 billion (assuming 6 percent interest). But these reduced outlays could be offset by a restructuring of the budget that brings the Postal Service on-budget, increases in the Postal Service subsidy, or other changes. Because no decisions on handling off-budget agencies have yet been reached, the effects are noted here but are excluded from further discussion and from the numbers in Tables 1 and 2.

While outlays in the budget as a whole do not change, at least for on-budget agencies, outlays within functions do change. Table 1 shows that, if all four of the possible modifications are implemented, the defense function increases by $0.5 billion. The increase occurs because, in fiscal year 1979, the added accrual charges more than make up for transferring the Defense Retired Pay appropriation out of the defense function. Other functions containing civil service payrolls also increase because of higher

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2/ In contrast, recent proposals for a consolidated financial statement would affect macroeconomic information. Consolidated financial statements would include in the budget as a current expense charges for depreciation of federal assets plus charges for accrued costs for civil service and military retirement and Social Security. Problems with the consolidated financial statements are discussed in detail in Federal Financial Reporting, Congressional Budget Office, Technical Analysis Paper, April 1977.

accrual charges for civil service retirement. And there are changes in the income security and offsetting receipts functions.

The size of all these changes is quite sensitive to assumptions about interest rates. Lower future interest rates require higher contributions to the fund because less is earned on money already in the fund. Thus, as Table 2 shows, assuming a 5 percent rather than a 6 percent interest rate requires higher contributions and causes the defense function to increase by $4.2 billion rather than $0.5 billion. On the other hand, higher interest rates have the opposite effect and require lower contributions. Assuming an interest rate above 6 percent could thus cause the defense function to decrease rather than increase.

The size of changes in the functions also depends on which of the four accounting modifications are implemented. The numbers above assume all four are implemented. If, for example, the only action is to transfer the Defense Retired Pay appropriation out of the defense function, then defense outlays will fall by $9.7 billion in fiscal year 1979.

In contrast to outlays, budget authority increases in the budget as a whole. If all four of the accounting modifications are made, the increase equals the accrual charge of $13.8 billion ($7.0 billion for the military plus $6.8 billion for civilians). Increased budget authority occurs because of the trust funds. Accrual contributions to the trust funds create budget authority in recognition of the right to future retirement payments. But contributions to the trust funds do not affect outlays; outlays occur only when employees actually retire. This effect is illustrated in Tables 1 and 2, where the only function whose budget authority differs from its outlays is the income security function. It is this function--which houses the trust funds--where budget authority is created in recognition of the right to future retirement payments.

EFFECTS BEYOND 1979

The numbers above suggest that, taken together, the four accounting changes could increase the defense function in fiscal year 1979. But in years beyond 1979, any increase will gradually be offset. And eventually, assuming no increases in numbers of military personnel, the defense function would appear smaller under the new accounting scheme. This shift will occur because the Defense Retired Pay appropriation, which will be transferred out of the defense function, will grow faster over the next 10 to 20 years than the accrual charge.

In the agency functions other than defense, numbers will grow as a result of wage and price growth, but they should follow the same pattern as the numbers in Tables 1 and 2. Patterns in the income security and offsetting receipts functions depend on the funding schemes adopted for the military and civil service trust funds.

ASSUMPTIONS

Comparison of Tables 1 and 2 makes clear that accrual charges are sensitive to interest rates. They are also sensitive to assumptions about future changes in prices and wages. There is currently some controversy over which price, wage, and interest rate assumptions should be used. 3/ Resolution of this controversy is one of the major tasks that must precede the introduction of a detailed proposal.

3/ In estimating the cost of retirement for management purposes, an appropriate rate of interest might be the cost of government debt, perhaps measured by three- to five-year government bonds. Even given this definition, history is of little help in choosing the appropriate rate. Since 1947, various groups of years have average "real" rates of interest on three- to five-year government bonds that vary between 2.2 percent (1959-1974) and 1.0 percent (1947-1974). (The real rate of interest is the actual rate divided by the rate of inflation.) Table 1 assumes a real interest rate of approximately 2 percent, whereas Table 2 assumes a real interest rate of approximately 1 percent. The recent change to OMB Circular A-76 assumes a 2 percent real interest rate. Interest rates have a considerable effect on accrual charges. The military charge varies from 51-52 percent (1 percent real interest) to 39 percent (2 percent real interest) to 30 percent (3 percent real interest).

Numbers for the income security function are also sensitive to assumptions about the military trust fund. This paper assumes that the fund would appear in the income security function, where the civil service fund now appears. The paper also makes assumptions about how the fund is reimbursed for unfunded liabilities. A military trust fund would take in contributions and pay out benefits to military retirees. If the fund is to remain solvent, it must be reimbursed for costs of retirement liabilities incurred before contributions began. In deriving the numbers above, CBO assumed that the fund receives an annual appropriation equal to a year's cost of retirement benefits built up before contributions began. 4/ Thus liabilities built up before creation of the trust fund would continue to be funded on a pay-as-you-go basis. Under this scheme the unfunded liability would be paid over a very long period; payments would be required for 50 years or more. If the unfunded liability paid off more quickly, numbers for the income security function would be higher.

Income security numbers also depend on payments to the civil service trust fund. The law that created the civil service trust fund established a complicated method for paying off its unfunded liability. The Civil Service Commission is currently considering whether to propose alternative methods. Since no choice has yet been made, the numbers in Tables 1 and 2 do not reflect any changes in the method of paying off the unfunded liability in the civil service retirement system. 5/

4/ This appropriation is assumed to be made in function 050 with an equal and offsetting receipt in the same function, which is similar to the accounting method for the civil service trust fund.

5/ The forthcoming CBO background paper on the civil service retirement system will discuss this point in greater detail.

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CHAPTER III. ADVANTAGES, DISADVANTAGES, AND UNRESOLVED ISSUES

Budget numbers are sometimes used to measure or compare levels of current activities. The four proposed changes, if implemented together, will make the budget numbers--particularly those in the defense function--a better measure for such comparisons. Under the present accounting system, the defense function includes retirement costs of former military employees who do not contribute to today's defense, but it includes no charges at all for current military employees who are participating in today's defense. For civil service employees, there is a charge representing retirement costs of present employees, but the charge is unrealistically low because it does not take into account future increases in prices and wages. The proposed accounting changes will reflect the full retirement costs of military and civil service employees but will exclude costs of former employees. While the proposed modifications will improve the budget as a measure of current activities, further improvements might still be possible. Some costs attributable to national defense--such as veterans' benefits--will still not be in the defense function.

These accounting changes should also increase incentives to economize on manpower. Retirement costs are an important part of the total cost of compensation, representing 30 percent or more of military basic pay and similar proportions of civilian salaries. But if these costs do not appear in the budget, or appear at unrealistically low levels, it is less likely that the costs will be considered in determining the total number of employees and other resource allocation issues. 1/ At a time when the Defense Department and other agencies are attempting to

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1/ This advantage would not be realized by including in the budget an accrual charge for Social Security, since the federal government does not employ most persons who benefit from Social Security. Nonetheless, including an accrual charge for Social Security has been proposed as part of the new consolidated financial statements (see footnote 2 in the preceding chapter).

economize, improving the visibility of retirement costs should be desirable.

While the proposed accounting changes do not affect retirement benefits, they may help clarify the long-run effects of changes in military retirement benefits. Most military retirement changes do not reduce outlays during the first five years or so because of "save-pay" clauses, which protect individuals already in the military. In fact, most military retirement changes actually increase outlays in the first few years because some benefits are given after fewer years of service. But if the accounting changes are implemented, and retirement changes are considered in terms of their effects on accrual charges, then savings are immediately apparent. For example, informal Department of Defense estimates suggest that the Retirement Modernization Act (a proposal made last year by the Ford Administration) would reduce the accrual charges in the defense function by about $1 billion per year within the first few years. 2/

The accounting changes would also make budgeting for military retirement costs consistent with budgeting for civil service retirement. At present, a retirement charge for today's civil servants appears in each function with a civil service payroll, but there is no charge anywhere for today's military employees. Furthermore, retirement costs of past military employees appear in the defense function, while retirement costs of past civil service employees are excluded from the agency functions. The proposed accounting changes would rectify these inconsistencies.

The proposed accounting changes are consistent with the recommendations of several study groups. As noted earlier, the Board of Actuaries of the Civil Service Retirement and Disability Fund has recommended increasing the civil service charge to reflect expected price and wage growth. In addition, the Defense Manpower Commission endorsed a charge for retirement costs of today's employees,

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2/ For a fuller discussion of military retirement changes, see The Costs of Defense Manpower: Issues for 1977, Budget Issue Paper, Congressional Budget Office, January 1977, pp. 78-84.

though they specifically recommended against creating a military trust fund. 3/

Perhaps the major disadvantage of the proposed accounting changes is the sensitivity of the accrual charge to technical assumptions. As Chapter II made clear, an increase of just one percentage point in assumed future interest rates could raise the charge to the Defense Department by almost $4 billion. There are many other detailed assumptions that also affect the charge. This sensitivity to technical assumptions raises the possibility of changing the defense function totals by changing technical assumptions. While accounting manipulations are possible, they would not be unique to retirement; assumptions about future inflation rates play an important part in procurement and other costs. But the possibility of manipulation could be minimized by appointing a board of independent actuaries, such as the one now used by the civil service system, to review data and propose reasonable assumptions. These actuaries may still disagree on assumptions, but presumably the disagreement would be for technical rather than political reasons.

The accounting changes could also lead to some confusion during the transition from the old system to the new one. The size of the defense function and others may appear to change even if there is no change in real activity. This may confuse the comparison between spending for defense versus non-defense activities. But this confusion should subside after the first year or two.

If just some of the accounting changes are implemented, there may be other important disadvantages. For example, if the only change is to transfer the Defense Retired Pay appropriation out of the defense function, then accounting for military and civil service retirement will remain inconsistent. Moreover, this single change would leave the defense function without any costs for military retirement, even though retirement is an important element of defense manpower costs.

3/ Defense Manpower: The Keystone of National Security, Report to the President and the Congress, Defense Manpower Commission, April 1976, pp. 379-382.

A military trust fund also presents some potential disadvantages. The fund could create the feeling among military personnel who leave before retiring that the contribution toward their retirement should be refunded, even if the contribution is made exclusively by the Department of Defense. To the extent that this occurs, an accounting change could cause members to feel they are underpaid and cause pressure for higher pay. Also, the very existence of a large fund could make reform of benefits more difficult (though most proposed reforms would contain transition provisions so that benefits already earned would not be affected). Furthermore, a military trust fund would require some increased administrative costs.

A final disadvantage to the first of the accounting changes is possible opposition on the part of military retirees. They may oppose transferring the Defense Retired Pay appropriation from defense to income security because the switch makes military retirement appear to some as a form of welfare to which a social stigma may seem to be attached.

There are a number of significant problems that the Administration must resolve before presenting a final version of the accounting changes. They are discussed briefly here to provide a checklist for judging the completeness of the final proposal:

- Earlier discussion noted the sensitivity of accrual charges to assumptions about future interest rates and growth in wages and the CPI. The Administration must settle on a reasonable set of assumptions. Several sets have been explored by the Office of Management and Budget, the Civil Service Board of Actuaries, the General Accounting Office, and other actuaries and economists studying the Social Security system.

- The actuarial method for determining the accrual charge for military retirement has to be established. One method, called the "age-entry-normal" method, determines the accrual charge by applying the same percentage to the basic pay of all personnel, regardless of seniority. The age-entry-normal method is simple, and the law requires that it be used by the civil service system. (It has been used to estimate costs in this paper.) But the age-entry-normal method does not reflect the greater probability that more senior personnel will remain in the military long enough to receive retirement benefits, and thus it understates the charge for these senior personnel. Other actuarial methods would show higher costs for these more senior personnel who are close to retirement.

- Since no estimates of accrual charges for inactive reserve retirees are now available, the Administration must determine an accrual charge for inactive reserves (or leave accounting for inactive reserves unchanged).

- Exactly where the military charge should be shown in the budget has to be determined. The charge could be placed in the Armed Services' military and reserve personnel appropriations, which would enhance the chances the charge would be considered by the Services in determining numbers of employees. Otherwise, the charge could be placed in a separate appropriation.

- The legal changes necessary to implement the accounting changes have to be identified. New laws would clearly be required to create a military trust fund. The Civil Service Commission contends that new laws would also be required to allow an increase in the civil service accrual charge.

In sum, there are problems to be resolved before the accounting changes can be implemented. If implemented, the four changes would improve the consistency and management information in the budget, though not without running into some disadvantages, particularly if they are not all implemented together.

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