Army Times/Oct. 28, 2002

Bonus not the best deal

Taking $30,000 Redux means quick cash now but much less in retirement later

By Vince Crawley

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Military people are signing up for the $30,000 Redux retirement bonus in ever greater numbers, apparently paying little heed to experts who warn that taking the money results in a net financial loss for almost everyone in uniform.

"As I teach my cadets at West Point, any retirement plan that saves the government money must cost the retiree money," Army Maj. Joe Clark said.

Clark, who teaches economics, accounting and personal finance at the U.S. Military Academy, said he knows that "it's very hard for a soldier to look $30,000 in the eye and say no."
But when he and a fellow instructor, Maj. Todd Wasmund, asked their classes to run the numbers, they were hard pressed to come up with any common scenario in which taking the $30,000 is a better deal for the service member.

They calculate that military people who fully invest the $30,000 bonus, plus all their retirement pay, would have to beat historical stock-market averages by 3 to 11 percentage points every year for the rest of their lives to match the benefits they would receive under traditional military retirement.

The traditional military retirement plan is known as "High-3." Members reaching 20 years of active service may retire at 50 percent of the average of their highest three years of income while in uniform, usually their last three. That figure is 40 percent under Redux, plus the bonus. Redux also has lower annual inflation adjustments.

The Defense Finance and Accounting Service says it paid bonuses to 8,842 service members through Sept. 30, and thousands more are on a waiting list to receive their money.

Defense Department officials have defended the Redux bonus — which actually was created by Congress — by saying it offers an instant nest egg for military members to invest. But informal evidence suggests few are investing the windfall. When the Army contacted 85 soldiers who had been paid the bonus mistakenly, none had the cash on hand to repay the government.

Clark and Wasmund stress that their findings represent their personal views, not an official study by West Point.

To do their analysis, Clark and Wasmund used a financial calculation known as "net present value," which measures what many people instinctively know — money is worth more today than it will be tomorrow.

Calculating net present value includes assumptions and variables about the future, so the answers aren’t always ironclad. But the concept has been used in court cases to determine the lump-sum value of a series of future payments — such as the value of pensions in divorces.

For example, assuming the stock market continues to grow at its long-term historical average of 10 percent a year and assuming a retiree lives to be 70, an E-6 taking the $30,000 bonus has a pension with a lump-sum value of $108,020 in today’s dollars. That includes the $30,000 bonus and assumes the service member is investing it, not buying a new car.

By contrast, if the same E-6 sticks with High-3 and the same assumptions hold true, today’s lump-sum value of his or her retirement would be $116,465, a difference of $8,436.

Clark, Wasmund and their cadets further calculated that the service member taking the $30,000 bonus and investing all of it, plus his or her retirement pay, would have to earn an average annual return of 13 percent through age 70 to beat traditional retirement.

The higher the paygrade at retirement, the harder it would be to beat traditional retirement. An O-5 would have to earn a sizzling 21 percent annual return. Those numbers might have seemed realistic in the late 1990s, but not any more.

“Overall, the High-3 retirement plan is better for the vast majority” of service members, Clark and Wasmund wrote.

Others have reached similar conclusions. Lt. Cmdr. John Burnham, a Navy SEAL Team executive officer, studied the bonus 18 months ago.

“For almost all eligible service members, it makes no sense,” Burnham said. “I fear that many troops will see the ‘bonus,’ not get the true numbers on the repercussions down the line, and wind up giving up huge amounts of their retirement money as a result.”

In 2001, the independent Center for Naval Analyses calculated that those accepting the $30,000 bonus were, in effect, taking out a lifetime loan with an interest rate ranging from 6 percent to 16 percent, depending on paygrade.