CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

May 11, 2015

H.R. 1735
National Defense Authorization Act for Fiscal Year 2016

As reported by the House Committee on Armed Services on May 5, 2015

SUMMARY

H.R. 1735 would authorize appropriations totaling an estimated $605.3 billion for fiscal year 2016 for the military functions of the Department of Defense (DoD), for certain activities of the Department of Energy (DOE), and for other purposes. In addition, H.R. 1735 would prescribe personnel strengths for each active-duty and selected-reserve component of the U.S. armed forces.

If appropriated, $515.6 billion of the authorized amounts would count against the defense caps set in the Budget Control Act (BCA), as amended. Another $0.4 billion would count against the nondefense caps. An additional $89.2 billion would be authorized for overseas contingency operations (OCO), and if appropriated would not count against the caps; of that amount, $50.9 billion would be for war-related activities, while the remaining $38.3 billion would be used for "Overseas Contingency Operations for Base Budget Requirements" that in recent years have counted against the defense caps. CBO estimates that appropriation of the authorized amounts would result in outlays of $590.3 billion over the 2016-2020 period.

The bill also contains provisions that would affect the costs of defense programs funded through discretionary appropriations in 2017 and future years. Those provisions would affect force structure, DoD compensation and health care benefits, the uniformed services retirement system, and other programs and activities. CBO has analyzed the costs of a select number of those provisions and estimates that they would, on a net basis, lower the amount of appropriations needed to implement defense programs relative to current law by about $3.4 billion over the 2017-2020 period. The effects of those reductions are not included in the total amount of outlays mentioned above because funding for those activities would be covered by specific authorizations in future years.

In addition, H.R. 1735 contains provisions that would affect revenues and direct spending. Changes to the uniformed services retirement system would require DoD—beginning in 2018—to make matching contributions (using appropriated funds) to the Thrift Savings Plan (TSP) on behalf of military personnel. Those matching contributions would encourage members to contribute a larger portion of their pay to the TSP, thereby reducing their taxable income. CBO and the staff of the Joint Committee on Taxation (JCT) estimate that enacting the bill would reduce revenues by about $1.3 billion over the 2016-2025 period. Several other provisions would change direct spending by less than $500,000 over the 2016-2025 period. Because enacting the bill would affect revenues and direct spending, pay-as-you-go procedures apply.

In the decade after 2025 and in subsequent decades, CBO expects that other changes to the uniformed services retirement system made by the bill would reduce mandatory spending by more than the revenue losses from expanded participation in the TSP in those years.

H.R. 1735 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would impose no costs on state, local, or tribal governments.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary effects of H.R. 1735 are shown in Table 1. Almost all of the $605.3 billion authorized by the bill would be for activities within budget function 050 (national defense). Some authorizations, however, fall within other budget functions, including, in 2016: $196 million for the Maritime Administration in function 400 (transportation); $145 million for function 700 (veterans benefits and services); $64 million for the Armed Forces Retirement Home in function 600 (income security); and $18 million for the Naval Petroleum Reserves in function 270 (energy).

TABLE 1. BUDGETARY EFFECTS OF H.R. 1735, THE NATIONAL DEFENSE AUTHORIZATION ACT FOR FISCAL YEAR 2016

	By Fiscal Year, in Millions of Dollars					
	2016	2017	2018	2019	2020	2016-2020
SPENDING SUBJECT TO APPROPRIATION						
Authorization Levels for Appropriations Subject to the BCA Caps						
Defense:						
Specified Authorizations for Base Budget Costs for the Departments of Defense and Energy						
Authorization Level	515,228	0	0	0	0	515,228
Estimated Outlays	320,630	106,897	44,300	20,940	9,341	502,108
Estimated Authorizations for Additional Base Budget Accrual Payments[a]						
Estimated Authorization Level	388	0	0	0	0	388
Estimated Outlays	388	0	0	0	0	388
Nondefense:						
Specified Authorizations, Primarily for the VA and MARAD						
Authorization Level	398	0	0	0	0	398
Estimated Outlays	319	53	16	0	0	388
Estimated Authorizations for the VA and Other Departments and Agencies[b]						
Estimated Authorization Level	25	73	75	75	75	323
Estimated Outlays	21	67	73	74	74	309
Subtotal						
Estimated Authorization Level	516,039	73	75	75	75	516,337
Estimated Outlays	321,359	107,017	44,389	21,014	9,415	503,193
Authorization Levels for Appropriations Not Subject to the BCA Caps						
Specified Authorizations for Overseas Contingency Operations						
Authorization Level	50,949	0	0	0	0	50,949
Estimated Outlays	23,963	16,331	5,899	2,514	789	49,495

(Continued)

TABLE 1. Continued

	By Fiscal Year, in Millions of Dollars					
	2016	2017	2018	2019	2020	2016-2020
Specified Authorizations for Miscellaneous Base Budget Costs						
Authorization Level	38,290	0	0	0	0	38,290
Estimated Outlays	25,042	8,486	2,912	907	307	37,654
Subtotal						
Authorization Level	89,239	0	0	0	0	89,239
Estimated Outlays	49,005	24,817	8,811	3,421	1,096	87,149
Total						
Estimated Authorization Level	605,278	73	75	75	75	605,576
Estimated Outlays	370,363	131,834	53,200	24,434	10,511	590,342
CHANGES IN REVENUES[c]						
Retirement	0	0	-51	-125	-154	-330

Notes: Except as discussed below, the authorization levels in this table reflect amounts that would be specifically authorized by the bill (as reflected in Table 2). Some provisions in the bill also would affect the costs of defense programs in 2017 and future years; estimates for a select number of those provisions are shown in Table 3, but are not included above because specified authorizations in future NDAAs would cover funding for those activities. For example, the authorizations in this table do not reflect the effects of several provisions that would significantly change retirement benefits for members of the uniformed services. Those provisions, sections 631- 634, would have no effect on spending subject to appropriation in 2016.

BCA = Budget Control Act; DoD = Department of Defense; MARAD = Maritime Administration; NDAA = National Defense Authorization Act; VA = Department of Veterans Affairs.

Numbers may not add up to totals because of rounding.

a. This authorization reflects CBO's estimate of the added cost of certain accrual payments required under current law but not fully reflected in the amounts specifically authorized by the bill.

b. This authorization reflects the estimated costs to the VA for establishing a joint formulary for certain categories of drugs (section 701) and for making annual contributions to the joint DoD-VA Incentive Fund (section 721), and estimated costs for extending certain benefits to federal civilian workers who perform official duties in a combat zone and are employed by departments and agencies other than DoD (section 1101). The five-year estimated authorization levels for those provisions amount to $240 million, $75 million, and $8 million, respectively.

c. In addition to the changes in revenues shown above (a decrease of $330 million over the 2016-2020 period), H.R. 1735 would have effects beyond 2020. CBO estimates that over the 2016-2025 period, H.R. 1735 would decrease revenues by $1,323 million (see Table 4).

BASIS OF ESTIMATE

For this estimate, CBO assumes that H.R. 1735 will be enacted near the start of fiscal year 2016 and that the authorized and estimated amounts will be appropriated at about that time.

Spending Subject to Appropriation

The bill would authorize appropriations for 2016 totaling $605.3 billion—a $26.7 billion (or 5 percent) increase relative to appropriations for comparable programs in 2015. Nearly all of that amount ($604.9 billion) would be specifically authorized by the bill (see Table 2). The remaining amount ($0.4 billion) largely reflects CBO's estimate of the amounts necessary to fund certain accrual payments required under current law that are not fully reflected in the amounts that would be specifically authorized by the bill.

Authorizations for all major categories of spending would rise relative to funding levels for 2015. Procurement would receive the largest increase ($16.6 billion, or 16 percent), followed by research and development ($4.7 billion, or 7 percent). All other categories of DoD spending would, on a combined basis, increase by $4.2 billion (1 percent). Authorized amounts for atomic energy defense activities (which primarily are carried out by the Department of Energy) would be $1.1 billion (6 percent) higher than funding provided for 2015.

Of the $605.3 billion that would be authorized by the bill, $515.6 billion would cover "base budget" costs that, if appropriated, would count against the BCA caps on defense appropriations, while $0.4 billion would count against the cap on nondefense appropriations.

The remaining $89.2 billion would be authorized for overseas contingency operations and, if appropriated, would not count against the caps set by the BCA. However, $38.3 billion of that amount would cover operation and maintenance activities—which the bill identifies as "base requirements"—that in past years would have been counted against the defense cap. Absent that amount, the remaining authorization for OCO funding would be $13.3 billion (or 21 percent), lower than the amount provided for OCO in 2015.

H.R. 1735 also contains provisions that would affect the cost of various discretionary programs in future years. Most of those provisions would affect end strength (the size of the military forces at the end of a fiscal year), military compensation and benefits, and retirement reform. The estimated effects of some of those provisions are shown in Table 3 and discussed below. The following sections discuss how those provisions would affect the need for discretionary appropriations in future years. All such spending would be subject to appropriation action.

TABLE 2. SPECIFIED AUTHORIZATIONS OF APPROPRIATIONS IN H.R. 1735

	By Fiscal Year, in Millions of Dollars					
	2016	2017	2018	2019	2020	2016-2020
Specified Authorization Levels for Appropriations Subject to the BCA Caps						
Defense:						
Military Personnel[a]						
Authorization Level	136,443	0	0	0	0	136,443
Estimated Outlays	130,411	4,180	177	37	0	134,805
Operation and Maintenance						
Authorization Level	169,394	0	0	0	0	169,394
Estimated Outlays	118,080	35,468	9,369	2,906	1,020	166,843
Procurement						
Authorization Level	110,456	0	0	0	0	110,456
Estimated Outlays	22,668	34,194	26,184	14,439	6,165	103,650
Research and Development						
Authorization Level	68,353	0	0	0	0	68,353
Estimated Outlays	33,449	24,677	5,064	2,304	1,586	67,080
Military Construction and Family Housing						
Authorization Level	7,538	0	0	0	0	7,538
Estimated Outlays	908	2,184	2,221	1,120	476	6,909
Revolving Funds						
Authorization Level	4,189	0	0	0	0	4,189
Estimated Outlays	2,508	979	258	184	119	4,048
General Transfer Authority						
Authorization Level	0	0	0	0	0	0
Estimated Outlays	250	-100	-75	-50	-25	0
Subtotal, Department of Defense						
Authorization Level	496,372	0	0	0	0	496,372
Estimated Outlays	308,274	101,582	43,198	20,940	9,341	483,335
Atomic Energy Defense Activities						
Authorization Level[b]	18,856	0	0	0	0	18,856
Estimated Outlays	12,356	5,315	1,102	0	0	18,773
Subtotal, Defense						
Authorization Level	515,228	0	0	0	0	515,228
Estimated Outlays	320,630	106,897	44,300	20,940	9,341	502,108

(Continued)

TABLE 2. CONTINUED

	By Fiscal Year, in Millions of Dollars					
	2016	2017	2018	2019	2020	2016-2020
Nondefense:						
Department of Veterans Affairs and Other Departments and Agencies						
Authorization Level[c]	398	0	0	0	0	398
Estimated Outlays	319	53	16	0	0	388
Subtotal (subject to caps)						
Authorization Level	515,626	0	0	0	0	515,626
Estimated Outlays	320,949	106,950	44,316	20,940	9,341	502,496
Specified Authorization Levels for Appropriations Not Subject to the BCA Caps						
Overseas Contingency Operations						
Military Personnel						
Authorization Level	3,205	0	0	0	0	3,205
Estimated Outlays	3,045	119	3	0	0	3,167
Operation and Maintenance						
Authorization Level	39,450	0	0	0	0	39,450
Estimated Outlays	17,827	13,567	4,421	1,894	543	38,252
Procurement						
Authorization Level	7,457	0	0	0	0	7,457
Estimated Outlays	2,854	2,409	1,286	532	212	7,293
Research and Development						
Authorization Level	216	0	0	0	0	216
Estimated Outlays	98	86	17	7	4	212
Military Construction						
Authorization Level	532	0	0	0	0	532
Estimated Outlays	18	156	179	92	38	483
Working Capital Funds						
Authorization Level	89	0	0	0	0	89
Estimated Outlays	33	29	19	6	1	88

(Continued)

TABLE 2. CONTINUED

	By Fiscal Year, in Millions of Dollars					
	2016	2017	2018	2019	2020	2016-2020
Special Transfer Authority						
Authorization Level	0	0	0	0	0	0
Estimated Outlays	88	-35	-26	-18	-9	0
Subtotal						
Authorization Level	50,949	0	0	0	0	50,949
Estimated Outlays	23,963	16,331	5,899	2,514	789	49,495
Additional Base Budget Costs for Operation and Maintenance						
Authorization Level	38,290	0	0	0	0	38,290
Estimated Outlays	25,042	8,486	2,912	907	307	37,654
Subtotal (not subject to caps)						
Authorization Level	89,239	0	0	0	0	89,239
Estimated Outlays	49,005	24,817	8,811	3,421	1,096	87,149
Total Specified Authorizations						
Authorization Level	604,865	0	0	0	0	604,865
Estimated Outlays	369,954	131,767	53,127	24,361	10,437	589,645

Notes: This table summarizes the authorizations of appropriations explicitly stated in the bill in specified amounts. Various provisions of the bill also would authorize activities and provide authorities that would affect costs in 2017 and in future years. Because the bill would not specifically authorize appropriations to cover those costs, they are not reflected in this table. Rather, Table 3 contains the estimated costs of some of those provisions.

Numbers may not add up to totals because of rounding.

a. The authorization of appropriations for military personnel in section 421 includes $6,243 million for accrual payments to the Medicare-Eligible Retiree Health Care Fund. However, CBO estimates, that amount understates—by $388 million—the amount required for those payments; thus $388 million has been added to the estimated cost of the bill, as reflected in Table 1.

b. This authorization is primarily for atomic energy defense activities of the Department of Energy.

c. This authorization is for the Maritime Administration ($196 million), veterans' benefits and services ($120 million), the Armed Forces Retirement Home ($64 million), and the Naval Petroleum Reserves ($18 million). The authorized amount for the Maritime Administration does not include the $186 million specified in the bill for payments to shipping companies under the maritime security program because that program is authorized under current law for 2016.

Force Structure. The bill would affect the force structure of the various military services by setting end-strength levels for 2016 and modifying the minimum end-strength levels authorized in permanent law.

Under title IV, the authorized end strengths in 2016 for active-duty personnel and personnel in the selected reserves would total 1,308,915 and 818,000 respectively. Of those selected reservists, 77,005 would serve on active duty in support of the reserves. In total, active-duty end strength would decrease by 1,765 and selected-reserve end strength would decrease by 9,800 when compared with levels authorized under current law for 2016. The specified end-strength levels for each component of the armed forces are detailed below.

Active-Duty End Strengths. Compared with end strengths authorized under current law for 2016, section 401 would authorize decreases in active-duty personnel for two of the four services: 15,000 fewer for the Army and 100 fewer for the Marine Corps. The end strengths authorized for the Air Force and Navy would increase by 7,735 and 5,600, respectively. In 2016, DoD would face increased costs of $437 million because of differences in how quickly the services would make the adjustments to new end strength levels. Based on information from DoD, CBO expects the Air Force and the Navy to have a portion of the increase in personnel already in place at the beginning of fiscal year 2016. In contrast, CBO expects the Army and Marine Corps to evenly distribute the reductions in their respective strengths over fiscal year 2016. Those initial costs would be more than offset by the net decrease in active-duty personnel of 1,765 members over the next five years. On net, CBO estimates that DoD’s costs would decline by $657 million over the 2016-2020 period, assuming appropriations reflect those changes. Those savings include reduced spending for compensation and benefits as well as lower costs for individual training, base support, and unit operations, which are paid out of the operation and maintenance accounts.

Selected-Reserve End Strengths. Sections 411 and 412 would authorize the end strengths for reserve components, including those who serve on active duty in support of the reserves. Under the bill, three of the six reserve components would experience decreases in end strength: 4,000 fewer for the Army Reserve, 300 fewer for the Marine Corps Reserve, and 8,200 fewer for the Army Guard. End strength would increase for each of the remaining three components: 100 more for the Navy Reserve, 2,100 more for the Air Force Reserve, and 500 more for the Air Guard. The number of full-time reservists who serve on active duty in support of the reserves would decline by 409 compared with current authorized end-strength levels for 2016. CBO estimates that the result of implementing those provisions would be a decrease in costs for salaries and expenses for selected reservists of $1.0 billion over the 2016-2020 period, assuming appropriations are reduced by the same amount.

TABLE 3. ESTIMATED COSTS FOR SELECTED PROVISIONS IN H.R. 1735

	By Fiscal Year, in Millions of Dollars					
	2016[a]	2017	2018	2019	2020	2016-2020
FORCE STRUCTURE						
Active-Duty End Strengths	437	-91	-282	-355	-366	-657
Selected-Reserve End Strengths	-123	-212	-222	-231	-238	-1,026
Reserve Technicians End Strengths	-50	-102	-106	-109	-113	-480
COMPENSATION AND BENEFITS						
Expiring Bonuses and Allowances	827	467	285	262	156	1,997
Civilian Benefits in a Combat Zone						
Department of Defense[b]	0	36	0	0	0	36
Other Military and Civilian Compensation Provisions	57	61	66	65	65	314
HEALTH CARE						
Delay Reorganization of Military Treatment Facilities	15	25	25	25	10	100
TRICARE Coverage of Infertility Treatment	140	300	310	330	350	1,430
DoD-VA Incentive Fund						
Department of Defense[c]	15	15	15	15	15	75
RETIREMENT						
TSP Contributions	0	0	700	1,550	1,720	3,970
Continuation Payments	0	0	350	990	1,200	2,540
Accrual Payments to the Military Retirement Fund[d]	0	90	-3,080	-3,530	-3,910	-10,430
Financial Literacy Training	0	5	40	30	20	95

Notes: Amounts shown in this table for 2017 through 2020 are not included in amounts that would be specifically authorized by the bill (and therefore are not reflected in Tables 1 and 2). Rather, those amounts would be covered by specific authorizations for defense programs in future years.

Numbers may not add up to totals because of rounding. TSP = Thrift Savings Plan; DoD = Department of Defense; VA = Department of Veterans Affairs.

a. Amounts shown in this table for 2016 are included in amounts specifically authorized to be appropriated by the bill (as reflected in Table 2 and summarized in Table 1).

b. This provision also would increase costs in 2017 for departments and agencies other than DoD by an estimated $8 million. Those costs are included in Table 1 under “Estimated Authorizations for the VA and Other Departments and Agencies.”

c. This provision also would increase costs for the VA by an estimated $15 annually. Those costs are included in Table 1 under “Estimated Authorizations for the VA and Other Departments and Agencies.”

d. The proposal to change the retirement system for the uniformed services would change DoD’s accrual contributions to the Military Retirement Fund. Because those changes would affect DoD’s need for discretionary appropriations, they are displayed here. However, those payments are intragovernmental transactions and have no net effect on federal spending.

Reserve Technicians End Strengths. Section 413 would authorize the minimum end strength for dual-status military technicians, who are federal civilian personnel required to maintain membership in a selected-reserve component as a condition of their employment. The bill would lower the minimum number of technicians required by 1,274 relative to the levels currently authorized. CBO estimates that such a reduction would decrease costs for civilian salaries and expenses by $480 million over the 2016-2020 period.

Compensation and Benefits. H.R. 1735 contains several provisions that would affect compensation and benefits for uniformed personnel and civilian employees of DoD. The bill would specifically authorize regular appropriations of $136.4 billion for the costs of military pay and allowances in 2016. For related costs resulting from overseas contingency operations (primarily in Afghanistan), the bill would authorize the appropriation of an additional $3.2 billion for 2016.
Expiring Bonuses and Allowances. Sections 611 through 615 would extend for another year DoD’s authority to enter into agreements to pay certain bonuses and allowances to military personnel. The authority to enter into such agreements is currently scheduled to expire on December 31, 2015. Some bonuses are paid in a lump sum, while others are paid in annual or monthly installments over a period of obligated service. Based on DoD’s budget submission for fiscal year 2016, CBO estimates that extending that authority for one year would cost $2.0 billion over the 2016-2020 period.

Civilian Benefits in a Combat Zone. Section 1101 would extend for one year the authority to grant certain benefits to federal civilian employees who perform official duty in a combat zone. Those benefits, which expire under current law on September 30, 2016, include death gratuities, paid leave and travel for one trip home, and up to three leave periods per year for rest and recuperation. Based on information from DoD and the Office of Personnel Management, CBO estimates that about 2,400 civilian employees of DoD and 500 employees of other federal agencies will work in a designated combat zone in 2017 and, under this provision, would receive an average annual benefit costing about $15,000. Thus, CBO estimates that in 2017, section 1101 would increase the costs of civilian employees of DoD by $36 million and of other federal employees by $8 million. (The $8 million for other federal employees is included in the amount shown in Table 1 for nondefense estimated authorizations, rather than in Table 3.)

Other Military and Civilian Compensation Provisions. CBO estimates that certain other provisions in titles V and VI would, on net, increase costs to DoD by $314 million over the 2016-2020 period by reducing the number of training and informational events related to deployments and prohibiting DoD from reducing per diem rates for extended temporary duty assignments.

Health Care. A number of other provisions in H.R. 1735 would affect discretionary costs in 2016 and over the 2017-2020 period, for health care spending by DoD and the Department of Veterans Affairs (VA).

Delay Reorganization of Military Treatment Facilities. In an effort to increase efficiency and save money, DoD is planning to consolidate or eliminate some under-used services offered through some military treatment facilities. Based on information from DoD, CBO estimates those changes will result in savings of almost $200 million over the 2016-2020 period. Section 713 would delay those planned changes until various studies are completed, which CBO estimates would delay the expected savings by about two years and increase costs to DoD by about $100 million over the 2016-2020 period.

TRICARE Coverage of Infertility Treatment. Section 704 would require TRICARE to provide fertility assistance services to active-duty members and their dependents. Under current law, TRICARE will cover testing and treatments that address the underlying physical causes of infertility, but will not cover assistive reproductive technology (ART) services. Section 704 does not specify the types of fertility treatments that TRICARE would be required to provide. Because ART services are widely used and accepted as effective treatments for infertility, CBO expects that section 704 would require TRICARE to pay for such services.

The estimate for this section comprises two components: the cost of providing the services and the cost to TRICARE for providing the additional child delivery services from the resulting pregnancies. To estimate the number of active-duty members who might make use of this new benefit, CBO examined the incidence of ART services in the general population as reported by the Centers for Disease Control (CDC). Based on those data, CBO estimates that TRICARE would cover those services for about 10,000 active-duty households each year. CBO estimates that the cost of those services would be about $18,000 per household, or about $175 million per year; that estimate is based on publicly available pricing information from several fertility clinics, and includes the cost of in vitro fertilization, one of the more popular and accepted procedures.

In addition to the cost of the fertility assistance procedures, CBO also estimates that TRICARE would incur additional costs for the increased number of pregnancies resulting from those procedures. Based on information from the CDC, CBO estimates that about one-third of ART services result in a pregnancy. However, because roughly half of the affected households are currently seeking ART services on their own and TRICARE is already paying for those pregnancies under current law, CBO estimates the number of additional pregnancies resulting from this provision would be less, about 1,700 per year. Based on information from private-sector studies and DoD, CBO estimates the cost of those pregnancies would average about $60,000, or about $100 million per year. Those costs are significantly higher than the average cost of a pregnancy in the United States because of the higher percentage of multiple births and preterm deliveries associated with fertility assistance procedures.

In total, CBO estimates that providing ART services would increase costs to TRICARE by $1.4 billion over the 2016-2020 period. Costs would be lower in the first year because of the time needed to establish rules and regulations.

Joint Formulary. Section 701 would require DoD and the Department of Veterans Affairs to establish a joint formulary for certain categories of drugs that are of particular importance to service members who are transitioning from receiving medical care provided by DoD to care provided by the Veterans Health Administration. Those categories would include medications to treat pain and sleep disturbances, as well as psychiatric medications.

After analyzing data on pain, sleep, and psychiatric medications dispensed by both DoD and VA, CBO determined that DoD provides a number of such drugs that are not included in the VA formulary, and that those particular drugs are significantly more expensive, on average, than the drugs VA provides for similar purposes. In 2014, VA spent a total of $841 million for pain, sleep, and psychiatric medications. For the purposes of this estimate, CBO assumes that VA would prescribe those new drugs in the same manner as DoD. Based on information from the Government Accountability Office and an analysis of data from DoD, CBO estimates that implementing section 701 would require VA to increase its total spending on pain and psychiatric medications by about 5 percent. After factoring in the time needed to prepare regulations and the effects of inflation, CBO estimates this provision would increase VA's costs for providing drugs by $240 million over the 2016-2020 period. (That estimated amount is included in the amount shown in Table 1 for nondefense estimated authorizations, rather than in Table 3.)

DoD-VA Incentive Fund. Section 721 would extend through 2020 the requirement that both DoD and VA contribute a minimum of $15 million each year to the DoD-VA Health Care Sharing Incentive Fund. That requirement will expire at the end of 2015. The fund is used to pay for joint projects aimed at improving the quality, access, and cost effectiveness of health care provided by DoD and VA. Based on the levels of contributions from the agencies in recent years, CBO estimates that implementing this provision would cost each agency $75 million over the 2016-2020 period, for a total cost of $150 million over that same period. (The $75 million in added costs that would be incurred by VA is included in the amount shown in Table 1 for nondefense estimated authorizations, rather than in Table 3.)

Retirement. The bill would change retirement benefits for members of the uniformed services by:

- Lowering the amount of future annuities (a decrease in direct spending),
- Providing new government contributions to the Thrift Savings Plan,
- Providing additional cash payments for members who agree to extend their time in the service, and
- Requiring additional financial training and services to help members of the military and the Coast Guard understand the new retirement system and make better financial decisions.

Additionally, those changes would allow DoD to reduce accrual payments made to the Military Retirement Fund (MRF). Those payments made by the military services out of discretionary funds represent the cost of service members' future retirement benefits. CBO estimates that, taken together, changes to the retirement system would reduce net spending subject to appropriations by about $4 billion over the 2016-2020 period, assuming appropriations are reduced by the estimated amounts.[1] Those changes also would affect direct spending and revenues, which are discussed below under the heading "Direct Spending and Revenues."

Background on Retirement for the Uniformed Services. The retirement system for the uniformed services is a defined benefit that vests when a member serves 20 or more years on active duty or in the reserves. Upon completing 20 years of service, a member is eligible for a monthly annuity, which is computed by multiplying the average of their highest 36 months of basic pay by a percentage equal to 2.5 percent times their years of service.[2]

For active-duty members who have at least 20 years of service, the annuity is payable immediately upon their separation from the service. For some, this means they can start receiving a longevity-based annuity as early as age 37. Members who serve at least 20 qualifying years in the reserves or who have a combination of 20 years on active duty and

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[1] The changes to the military retirement system would affect uniformed members of the Department of Defense, Coast Guard, Public Health Service, and the National Oceanic and Atmospheric Administration. In this cost estimate, all costs related to military retirement reform include the effects on all of those services, although over 95 percent of the costs or savings would occur within the Department of Defense. The one exception is the effect on accrual payments to the Military Retirement Fund, as DoD is the only agency that makes such payments. The other agencies pay retirement benefits directly from annual mandatory appropriations.

[2] For example, the monthly annuity for a member who separates after 20 years of service with an average pay of $5,000 per month over their 36 months of highest pay, would be $2,500 per month ($5,000 x 20 x .025). If that member remained an additional 2 years and got no additional pay raises, the monthly retirement annuity would be $2,750 per month ($5,000 x 22 x .025).

the reserves are also eligible for an annuity. The calculation of the annuity for reserve retirees is roughly the same as for those who retire from active duty, but the amount is prorated for the amount of time spent on active duty or in training and generally is not payable until the member reaches age 60.

Members who separate from the service with less than 20 years of service can receive a monthly annuity if they are separated with a service-connected disability rated at 30 percent or higher (as determined by the individual service).[3] The annuity calculation for disability retirees is complicated, but for most it equals the average of their highest 36 months of basic pay multiplied by their disability rating (in percentage terms), but cannot exceed 75 percent of their pay.[4]

Benefits for retirees of the Army, Navy, Air Force, and Marine Corps are paid from a trust fund in the Treasury called the Military Retirement Fund. Each year DoD makes accrual payments into the MRF out of its annual appropriation in an amount that reflects the future retirement benefits service members accrued in that year. The payment rates are set by an independent board of actuaries and take into account military pay, the probability that members make it to retirement, and economic factors, including inflation and the fund's expected earnings from its investments (the fund invests its assets in non-marketable U.S. government debt instruments). The other uniformed services do not make accrual payments; those services pay the costs of retirement benefits directly from annual mandatory appropriations.

Proposed Changes to the Retirement System. Sections 631-634 would change the retirement system for the uniformed services in several ways. First, the 2.5 percent multiplier used in the annuity calculation would be reduced to 2.0 percent, effectively reducing the annuity for future retirees by 20 percent (a reduction in direct spending). To help make up for the reduced annuity, the services would make contributions on behalf of service members to the Thrift Savings Plan equal to 1 percent of their basic pay. After two years of service, the uniformed services also would match 100 percent of additional contributions the member makes to the TSP up to 5 percent. (Including the automatic 1 percent, total contributions by the services could be as high as 6 percent of a member's basic pay.) Those contributions would continue as long as the member is drawing basic pay from the uniformed services. As is the case with federal civilians, service members would not be allowed to withdraw any amounts from the TSP without penalty until age 59½.

[3] In periods when DoD is trying to reduce the size of the force, the Congress has authorized DoD to grant annuities to members with between 15 and 20 years of service. However, that temporary early retirement authority is only authorized for a limited time and covers only a small subset of the retiree population.

[4] If a member has a high-36 average pay of $4,000 and is separated from DoD with a disability rating of 50 percent, the member's monthly annuity would be $2,000. If that same person separated with a disability rating of 100 percent, the monthly annuity would be $3,000, as the annuity cannot exceed 75 percent of the member's average high 36 months of pay.

In addition to the TSP contributions, members would receive a cash bonus once they reach 12 years of service, if they agree to remain in the uniformed services for at least four more years. For active-duty members, that payment (also referred to as continuation pay) would range from two-and-a-half to fifteen-and-a-half times a member's monthly basic pay. For reserve component members, the bonus would range from one-half month's pay to six-and-a-half months' pay (using the same monthly pay as if they are on active duty for the entire month).

Those changes in retirement benefits would apply to all members who first enlist in the uniformed services on or after October 1, 2017. Those currently serving in the uniformed services would be allowed to enroll in the new retirement system during a one-time election period that would run through the end of calendar year 2018.

CBO's Cost Model. To estimate the budgetary effects of different retirement proposals, CBO constructed a cost model that tracks the amount of cash benefits received by members of the uniformed services from the time they enter the service throughout their lives and the lives of any surviving beneficiaries. CBO uses the model to estimate the government's lifetime costs for a group of people who enter the uniformed services in a particular year. The model then extrapolates the results to recent and future entrants, with adjustments for changes in inflation and demographics. CBO used a separate set of assumptions for officers and enlisted personnel, and modified the model to handle the unique characteristics and retirement rules that govern the part-time reserve forces.

CBO used data and information from a variety of sources to construct the model and to estimate the cost of the legislation, including data from the Defense Manpower Data Center. CBO also relied heavily on the assumptions and data published by the DoD Office of the Actuary in its annual Statistical and Valuation reports.[5] Using that information, CBO constructed a baseline that projects what government spending on uniformed services retirement benefits will look like under current law. Key inputs, observations, and assumptions for that model include the following:

- Each year, slightly fewer than 150,000 enlisted members and just over 10,000 officers will enter the full-time active-duty uniformed services and complete at least one full year of service.

- About 17 percent of those who join as enlisted personnel and around half of those who enter the service as officers will eventually earn an active-duty retirement.

[5] DoD Office of the Actuary, *Valuation of the Military Retirement System, September 30, 2013* (January 2015), http://actuary.defense.gov/Portals/15/Documents/MRF%20ValRpt%202013.pdf. Also see DoD Office of the Actuary, *Statistical Report of the Military Retirement System Fiscal Year 2013* (July 2014), http://actuary.defense.gov/Portals/15/Documents/MRS_StatRpt_2013_July.pdf.

- Over half of retirees will leave behind someone entitled to survivor benefits when they die.

- Basic pay and retirement benefits are computed using the most recent pay tables published by DoD, with adjustments for future pay raises.

- Mortality rates and mortality improvement are computed using information published by the DoD Office of the Actuary.

- Appropriate reductions to projected retirement pay are made to account for survivor benefit premiums and for reductions because of the receipt of compensation from the Department of Veterans Affairs.

- Any changes to the retirement system would be done in such a way as to maintain the current force size and experience profile. Any changes to this assumption could have a large effect on the budgetary costs or savings related to any changes to the system.

Some of the most important assumptions in the cost model are the economic variables, which include projections of inflation, military pay raises, and the rate of return earned by assets held in the MRF. Those variables have a large effect on the amount of contributions that DoD would need to make each year to the MRF to account for the benefits of future retirees. For this estimate, CBO has adopted the following economic assumptions approved by the DoD Board of Actuaries:

- Annual inflation rate equal to 3 percent,

- Annual average pay raise equal to 3.5 percent, and

- Annual rate of return on assets held in the MRF equal to 5.5 percent.

CBO uses those assumptions for two reasons. First, the DoD Office of the Actuary would ultimately be responsible for calculating any changes to DoD's monthly accrual payments that would result from changes to the retirement system. Because of the prominence those changes would have in the initial 10-year budget window, CBO chose to project the Office of the Actuary's calculation to the extent possible. Second, given the complexity of the estimate, using one uniform set of economic variables throughout the estimate simplified the modeling and ensured the economic consistency of the accrual payments with the other outputs of the model.

Importantly, in both CBO's baseline model and the cost estimate, many future retirees will be subject to a reduced annual cost-of-living increase until they reach the age of 62.

Section 403 of the Bipartisan Budget Act of 2013 (Division A of Public Law 113-67), as amended, reduced the annual cost-of-living adjustment for annuities paid to certain retirees and survivors by up to 1 percent for those who first enter the uniformed service beginning in 2016. Section 632 would delay this change so that it would take effect for those who first enter the uniformed services after the start of fiscal year 2018.

A key variable that significantly affects costs in the initial 10-year period, and an important source of uncertainty in the estimate, is the percentage of current members who would choose to switch to the new retirement plan. Members with more than 12 years of service when the opt-in period occurs in 2018 would have little or no incentive to switch to the new plan and accept a lower retirement annuity, and CBO estimates that none of those members would make the switch. However, those with 12 years of service or less during the opt-in period would be eligible for continuation pay at the 12-year point in their careers, and also would have a longer period over which to accrue matching funds in their TSP accounts. CBO estimates that about half of those members with 12 years of service in 2018 would switch to the new system; that fraction would increase for those with fewer years of service, so that close to 100 percent of those with only one or two years of service would choose to switch.

Those estimates are based on work by the RAND Corporation and others that show to what extent military members prefer cash in the near term over more valuable benefits later. That preference is referred to as a personal discount rate. Individuals with high personal discount rates are more likely to prefer near term benefits over more valuable benefits later, while those with lower discount rates are less likely to do so.[6] Many younger members also enlist in the uniformed services for only a short period with no intent of remaining long enough to earn a longevity based retirement. Members who fit that profile would find it more beneficial to switch to the new system and thus be eligible for government contributions to their TSP accounts. If the number of current members who switch to the new system is different than our estimate, the additional costs for TSP and the 12-year continuation payments would be different over the initial 10-year window.

TSP Contributions. To estimate the cost to the uniformed services of the new TSP contributions, CBO examined current TSP participation rates among uniformed services personnel and compared it to the participation rate of the federal civilian workforce. Currently, about 40 percent of military personnel make contributions to the TSP, whereas the participation rate for federal civilians is over 95 percent. That military personnel

[6] Beth J. Asch, James Hosek, and Michael G. Mattock, *Toward Meaningful Military Compensation Reform: Research in Support of DoD's Review,* RR-501-OSD (RAND Corporation 2014), http://www.rand.org/pubs/research_reports/RR501.html.
Also see Curtis J. Simon, John T. Warner, and Saul Pleeter, "Discounting, Cognition, and Financial Awareness: New Evidence From a Change in the Military Retirement System," *Economic Inquiry*, vol. 53, no. 1 (January 2015), pp. 318-334.

receive no federal contributions to their TSP accounts, matching or otherwise, have a more generous annuity than federal civilian employees, and are younger probably explains most of that difference. If the proposed changes are enacted, CBO estimates that the rate of participation in TSP among uniformed services personnel would increase to 80 percent for enlisted personnel and 90 percent for officers. CBO expects the participation rate for uniformed services personnel would always be lower than the rate for federal civilians because service members are, on average, younger, and many would not want to contribute money to a retirement account, even with the government making matching contributions.

For personnel who elect to make contributions to the TSP, CBO estimates the average government matching contribution would equal about 4 percent of their basic pay, reflecting the assumption that most participating members would want to maximize the amount of government matching contributions (5 percent). When combined with the personnel and payroll figures generated by the cost model (discussed above), CBO estimates that the proposal to provide government contributions to TSP on behalf of service members would increase spending subject to appropriation by about $4 billion over the 2018-2020 period. Costs would be lower in 2018 because current service members would have a year to make their elections and transition to the new system.

Continuation Payments. To help keep the force structure the same as today and to avoid a decrease in the number of senior personnel, the proposal to reform the retirement system would provide for cash payments when service members reach 12 years of service. In exchange for that continuation payment, the member would have to agree to serve an additional four years. Based on current continuation rates, CBO estimates that about 75 percent of enlisted personnel and 95 percent of officers would agree to serve an additional four years at that 12-year point in their careers in exchange for a cash payment.

The amount of that one-time payment could vary based on service members' occupational specialties and the overall needs of the force at any given time. Those who agree to serve an additional four years would be guaranteed a payment equal to at least two-and-a-half months of pay, in the case of regular active-duty members, and half-a-month's pay for part-time reservists. The uniformed services would have the authority to increase this to an amount equivalent to fifteen-and-a-half months of a member's basic pay.

Based on the analysis of personal discount rates for service members discussed above, CBO estimates that maintaining the current force profile would require the services to set those continuation payments for active-duty personnel so that they are equivalent to six months of basic pay for enlisted personnel and 14 months of basic pay for officers. For part-time reservists, CBO estimates the average payments would need to equal about one month of basic pay for enlisted members, and six months for officers. Using those rates in the cost model, CBO estimates that about $2.5 billion would be needed for continuation payments over the 2018-2020 period, assuming appropriation of the necessary amounts.

The additional costs for continuation pay could be significantly different if the Administration, or the Congress, changes the size and experience profile of the force.

Accrual Payments to the Military Retirement Fund. The proposed change would reduce the amount of the annuities paid to service members who eventually qualify for a longevity-based retirement by about 20 percent. As a result, the Department of Defense would lower its monthly accrual payments to the MRF that are meant to cover the cost of future retirement benefits. Those contributions to the MRF are intra-governmental transactions and have no net effect on overall spending by the government. The accrual amounts are paid out of the annual defense appropriation and they are offset one-for-one elsewhere in the budget. By effectively lowering accrual payments, the proposal would allow the Congress to lower discretionary appropriations to DoD without affecting DoD’s current level of operations. Alternatively, the Congress could keep the appropriation at the higher level, thus allowing DoD to spend it’s discretionary appropriations on other things.

To estimate the effect of this proposal on the accrual payments, CBO used its cost model to project the change in future outlays from the MRF under the bill, and then adjusted the accrual contributions accordingly so that amounts contributed to the fund would be equal to eventual outlays, with adjustments for inflation and interest earned by amounts in the MRF. Initially, only new entrants and those who choose to switch during the election period in 2018 would receive the lower annuity payments, so the reduction in the accrual payments would be less than 20 percent. The accrual savings would increase over time, as the changes to the retirement system gradually apply to a larger percentage of the force. Those savings would continue to be partially offset by DoD’s contributions to the TSP and continuation pay, which also would increase as more of the force came under the new system.

As noted above, the Bipartisan Budget Act of 2013, as amended, reduced the annual cost-of-living adjustment for annuities paid to certain military retirees and survivors by up to 1 percent for those who first enter the service beginning in 2016. Section 632 would delay that change so that it would begin to take effect for those who first enter the uniformed services after the start of fiscal year 2018. Because that change would increase the cost of annuities paid to members who first enter the service in 2016 and 2017, CBO estimates DoD would need to increase its accrual contributions by about $90 million per year beginning in 2017 (it is unlikely the changes would be enacted in time to affect DoD’s 2016 contributions).

On net, CBO estimates the proposed changes to the military retirement benefit would allow DoD to reduce its’ accrual contributions to the Military Retirement Fund by about $10 billion over the 2017-2020 period.

Financial Literacy Training. Section 651 would expand financial training and services available for members of the military and the Coast Guard by increasing the frequency of such training and by adding explanations of the new benefits under retirement reform, such as the TSP and continuation payments, to the information covered by the services' financial education programs. In addition, CBO expects that the services would provide specific training for those current members who would have one year to decide whether to opt-in to the new retirement system or stay under the current system.

Because CBO expects that DoD and the Coast Guard would require time to determine their new policy under the proposal, as well as time to develop and provide new training programs and materials, CBO estimates that expanding financial literacy training under this section would not increase costs until fiscal year 2017. Costs in 2017 would mostly reflect the cost to design, prepare, and implement the new training. CBO estimates that costs would be higher in fiscal year 2018, when the agencies would begin to provide new and more frequent training for service members and provide extensive training to help those current members make educated decisions during the limited opt-in period. Following the end of the opt-in period, December 31, 2018, costs for additional training under section 651 would fall to about $20 million a year. Thus, CBO estimates that expanding financial literacy would increase training costs by $95 million over the 2016-2020 period.

Direct Spending and Revenues

Several provisions in H.R. 1735 would affect direct spending and revenues. CBO and JCT estimate that enacting those provisions would decrease revenues by about $1.3 billion over the 2016-2025 period, and would change net direct spending by less than $500,000 over that same period (see Table 4).

TABLE 4. ESTIMATED EFFECTS OF H.R. 1735 ON REVENUES

	By Fiscal Year, in Millions of Dollars											
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2016-2020	2016-2025
Retirement	0	0	-51	-125	-154	-168	-183	-198	-214	-230	-330	-1,323

Note: CBO estimates that enacting the bill would change net direct spending by less than $500,000 over the 2016-2025 period.

Retirement. Sections 631-634 would change retirement benefits for certain future retirees of the uniformed services by lowering the amount of future annuities. Additionally those sections would provide for new government contributions to the TSP and additional cash payments for certain members who agree to extend their time in the service (an increase in spending subject to appropriation). Those changes would affect both direct spending and revenues.

Annuities for retired service members are treated as direct spending in the budget. CBO estimates that the proposed changes would have little or no effect on direct spending outlays over the 2018-2025 period, because those service members who will become eligible to begin receiving annuities over the next 10 years would have little incentive to switch to the new system and accept a lower annuity. However, CBO expects that many younger members would switch to the new system, and they would begin retiring in the decade after 2025. Eventually, when all retirees are bound by the new rules, CBO estimates that the new system would reduce annual retirement outlays by about 20 percent. (If retirement outlays in 2015 were reduced by that much, they would decrease by a little more than $10 billion.)

Requiring the uniformed services to provide matching contributions to the Thrift Savings Plan would encourage members to increase their participation in the TSP. Because income taxes are deferred on TSP contributions, the anticipated increase in contributions would initially decrease revenues. Additionally, income taxes on the earnings in TSP accounts are also deferred. Based on the payroll and TSP participation rates discussed above under the heading “Spending Subject to Appropriation,” CBO and JCT estimate that providing matching contributions for members would reduce revenues by about $1.3 billion over the 2018-2025 period.

Over the long-run, CBO estimates those changes to the uniformed services retirement system would reduce the budget deficit relative to current law, because the reductions in direct spending would exceed the amount of decreased revenue stemming from the TSP provisions.

Other Provisions. Other provisions in the bill would have insignificant effects on direct spending or revenues, generally because very few people would be affected.

- Section 502 would defer the mandatory retirement age for any Chief or Deputy Chief of Chaplains until age 68.

- Section 535 would impose the same standard-of-proof threshold on military whistleblower cases as is currently used for federal civilians who claim to have been subjected to unlawful reprisals for whistleblower activities. CBO estimates that enacting that section would result in an increased number of substantiated claims and allow those victims of reprisals to receive retroactive payments, benefits, or awards that were improperly denied.

- Section 712 would expand the network of mental health counselors that could be seen by TRICARE beneficiaries without first obtaining a referral. Health costs for certain TRICARE beneficiaries are mandatory. While enacting this provision would increase the use of mental health counselors, CBO expects those added costs would be mostly or totally offset by a decrease in the usage of other, more expensive, medical treatments.

- Section 714 would authorize the Secretary of Defense to conduct a pilot program to study the benefits of establishing a preferred pharmacy network. Some TRICARE pharmacy benefits are treated as direct spending.

PAY-AS-YOU-GO CONSIDERATIONS

The Statutory Pay-As-You-Go Act of 2010 establishes budget-reporting and enforcement procedures for legislation affecting direct spending or revenues. The net change in revenues that are subject to those pay-as-you-go procedures are shown in Table 5. Enacting H.R. 1735 would not have a significant effect on direct spending.

TABLE 5. PAY-AS-YOU-GO EFFECTS FOR H.R. 1735 AS REPORTED BY THE HOUSE COMMITTEE ON ARMED SERVICES ON MAY 5, 2015

	By Fiscal Year, in Millions of Dollars												
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2015-2020	2015-2025
NET INCREASE IN THE DEFICIT													
Statutory Pay-As-You-Go Impact	0	0	0	51	125	154	168	183	198	214	230	330	1,323

Sources: Congressional Budget Office and the staff of the Joint Committee on Taxation.

ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

H.R. 1735 contains no intergovernmental or private-sector mandates as defined in UMRA and would impose no costs on state, local, or tribal governments. The bill would authorize financial assistance for local educational agencies to fund education and services for military dependent children. The bill also would convey federal land to counties in Florida and Georgia, and release certain federal interests in land to the state of Texas. Any costs to those governments resulting from those transactions would be incurred voluntarily as conditions of receiving federal assistance.

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