CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

June 3, 2015

S. 1376
National Defense Authorization Act for Fiscal Year 2016

As reported by the Senate Committee on Armed Services on May 19, 2015

SUMMARY

S. 1376 would authorize appropriations totaling an estimated $604.6 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, S. 1376 would prescribe personnel strengths for each active-duty and selected-reserve component of the U.S. armed forces.

If appropriated, $515.5 billion of the authorized amounts would count against the defense cap for 2016 set in the Budget Control Act of 2011 (BCA), as amended. Another $0.2 billion would count against the nondefense cap. An additional $88.9 billion would be authorized for overseas contingency operations (OCO) that, if appropriated, would not count against the caps; of that amount, $49.9 billion would be for war-related activities, while the remaining $39.0 billion would be used for "base budget" activities that in recent years have counted against the defense caps. CBO estimates that appropriation of the authorized amounts would result in outlays of $589.2 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 $17.8 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, S. 1376 contains provisions that would affect direct spending and revenues. CBO estimates that provisions affecting direct spending would, on net, decrease outlays by $2.2 billion over the 2016-2020 period, and by $4.9 billion over the 2016-2025 period.

CBO and the staff of the Joint Committee on Taxation (JCT) estimate that enacting the bill would reduce revenues by $0.2 billion over the 2018-2020 period, and by $1.1 billion over the 2018-2025 period. In total, enactment of the bill would decrease the deficit by an estimated $2.0 billion over the 2016-2020 period, and by $3.8 billion over the 2016-2025 period.

Pursuant to section 3101 of the Concurrent Resolution on the Budget for Fiscal Year 2016 (S. Con. Res. 11), CBO estimates that enacting S. 1376 would increase projected deficits by more than $5 billion in at least one of the four consecutive 10-year periods starting in 2026.

S. 1376 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act and would impose no costs on state, local, or tribal governments.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary effects of S. 1376 are shown in Table 1. Almost all of the $604.6 billion authorized by the bill would be for activities within budget function 050 (national defense). Some authorizations, however, fall within other budget functions, including: $120 million for function 700 (veterans benefits and services) and $64 million for the Armed Forces Retirement Home in function 600 (income security).

For provisions that would affect direct spending, the bill would affect function 550 (health), function 570 (Medicare), function 600 (income security) , and function 700 (veterans benefits and services).

BASIS OF ESTIMATE

For this estimate, CBO assumes that S. 1376 will be enacted near the start of fiscal year 2016 and that the authorized and estimated amounts will be appropriated at about that time.

TABLE 1. BUDGETARY EFFECTS OF S. 1376, 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	515,131	0	0	0	0	515,131
Estimated Outlays	316,964	108,071	45,456	21,508	9,667	501,666
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 for the VA and the Armed Forces Retirement Home						
Authorization Level	185	0	0	0	0	185
Estimated Outlays	150	25	2	0	0	177
Estimated Authorizations for the VA and Other Departments and Agencies[b]						
Estimated Authorization Level	15	23	15	15	15	83
Estimated Outlays	12	21	15	14	14	76
Subtotal						
Estimated Authorization Level	515,719	23	15	15	15	515,787
Estimated Outlays	317,515	108,117	45,473	21,522	9,681	502,308
Authorization Levels for Appropriations Not Subject to the BCA Caps						
Specified Authorizations for Overseas Contingency Operations						
Authorization Level	49,945	0	0	0	0	49,945
Estimated Outlays	23,520	15,956	5,788	2,495	758	48,517

(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	38,955	0	0	0	0	38,955
Estimated Outlays	27,152	7,827	2,395	772	229	38,375
Subtotal						
Authorization Level	88,900	0	0	0	0	88,900
Estimated Outlays	50,672	23,783	8,183	3,267	987	86,892
Total						
Estimated Authorization Level	604,620	23	15	15	15	604,688
Estimated Outlays	368,187	131,900	53,656	24,789	10,668	589,200
CHANGES IN DIRECT SPENDING[c]						
Estimated Budget Authority	-304	-480	-435	-489	-605	-2,313
Estimated Outlays	-283	-459	-423	-460	-582	-2,207
CHANGES IN REVENUES[c]						
Retirement	0	0	-22	-96	-128	-246
NET INCREASE OR DECREASE (-) IN THE DEFICIT FROM CHANGES IN DIRECT SPENDING AND REVENUES						
Estimated Impact on the Deficit	-283	-459	-401	-364	-454	-1,961

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- 636, would have no effect on spending subject to appropriation in 2016.

BCA = Budget Control Act; DoD = Department of Defense; 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 making annual contributions to the joint DoD-VA Incentive Fund (section 719), 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 1107). The five-year estimated authorization levels for those provisions amount to $75 million and $8 million, respectively.

c. In addition to the changes in direct spending and revenues shown above (decreases of $2,207 million and $246 million, respectively, over the 2016-2020 period), S. 1376 would have effects beyond 2020. CBO estimates that over the 2016-2025 period, S. 1376 would decrease direct spending by $4,926 million and revenues by $1,088 million (see Table 4).

Spending Subject to Appropriation

The bill would authorize appropriations for 2016 totaling an estimated $604.6 billion—a $26.2 billion (or 5 percent) increase relative to appropriations for comparable programs in 2015. Nearly all of that amount, ($604.2 billion) would be specifically authorized by the bill (see Table 2). Most of the remaining amount ($0.4 billion) 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. Under S.1376, authorizations for most major categories of DoD spending would rise compared to funding levels for 2015. Procurement would receive the largest increase ($18.5 billion, or 18 percent), followed by research and development ($7.3 billion, or 11 percent), and military construction and family housing ($1.5 billion, or 23 percent). Authorized funding for Military Personnel and Operation and Maintenance would drop by $0.9 billion, and $0.8 billion, respectively—a change of less than 1 percent for each. All other authorizations (for DoD's revolving funds) would fall by $0.3 billion (16 percent). Funding that would be authorized by the bill for atomic energy defense activities (which primarily are carried out by the Department of Energy) would be $1.0 billion (6 percent) higher than funding provided for 2015.

Of the $604.6 billion that would be authorized for 2016 by the bill, $515.5 billion would cover "base budget" costs that, if appropriated, would count against the BCA cap on defense appropriations, while $0.2 billion would count against the cap on nondefense appropriations.

The remaining $88.9 billion would be authorized for overseas contingency operations and, if appropriated, would not count against the caps set by the BCA. However, $39.0 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 caps. Absent that amount, the remaining authorization for OCO funding would be $14.3 billion (or 22 percent), lower than the amount provided for OCO in 2015. (Authorizations for base budget costs—adjusted to reflect the $39.0 billion—would increase by $40.5 billion (8 percent) over funding provided for 2015.)

S. 1376 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 health benefits, and retirement benefits for members of the uniformed services. 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 S. 1376

	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	135,480	0	0	0	0	135,480
Estimated Outlays	129,493	4,149	175	37	0	133,854
Operation and Maintenance						
Authorization Level	167,334	0	0	0	0	167,334
Estimated Outlays	115,108	35,756	9,801	3,009	1,083	164,757
Procurement						
Authorization Level	112,568	0	0	0	0	112,568
Estimated Outlays	22,802	34,628	26,675	14,871	6,428	105,404
Research and Development						
Authorization Level	70,892	0	0	0	0	70,892
Estimated Outlays	34,638	25,656	5,263	2,379	1,639	69,575
Military Construction and Family Housing						
Authorization Level	8,305	0	0	0	0	8,305
Estimated Outlays	928	2,420	2,481	1,244	532	7,605
Revolving Funds						
Authorization Level	1,787	0	0	0	0	1,787
Estimated Outlays	1,479	262	26	13	7	1,787
General Transfer Authority						
Authorization Level	0	0	0	0	0	0
Estimated Outlays	225	-90	-68	-45	-22	0
Subtotal, Department of Defense						
Authorization Level	496,367	0	0	0	0	496,367
Estimated Outlays	304,673	102,781	44,353	21,508	9,667	482,982
Atomic Energy Defense Activities						
Authorization Level[b]	18,765	0	0	0	0	18,765
Estimated Outlays	12,291	5,290	1,103	0	0	18,684
Subtotal, Defense						
Authorization Level	515,131	0	0	0	0	515,131
Estimated Outlays	316,964	108,071	45,456	21,508	9,667	501,666

(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]	185	0	0	0	0	185
Estimated Outlays	150	25	2	0	0	177
Subtotal (subject to caps)						
Authorization Level	515,316	0	0	0	0	515,316
Estimated Outlays	317,114	108,096	45,458	21,508	9,667	501,843
Specified Authorization Levels for Appropriations Not Subject to the BCA Caps[d]						
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	39,251	0	0	0	0	39,251
Estimated Outlays	17,403	13,411	4,569	2,037	599	38,019
Procurement						
Authorization Level	7,209	0	0	0	0	7,209
Estimated Outlays	2,852	2,362	1,212	466	164	7,056
Research and Development						
Authorization Level	191	0	0	0	0	191
Estimated Outlays	87	75	15	6	4	187
Working Capital Funds						
Authorization Level	89	0	0	0	0	89
Estimated Outlays	33	29	19	6	1	88
Special Transfer Authority						
Authorization Level	0	0	0	0	0	0
Estimated Outlays	100	-40	-30	-20	-10	0
Subtotal						
Authorization Level	49,945	0	0	0	0	49,945
Estimated Outlays	23,520	15,956	5,788	2,495	758	48,517

(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	100	-40	-30	-20	-10	0
Subtotal						
Authorization Level	49,945	0	0	0	0	49,945
Estimated Outlays	23,520	15,956	5,788	2,495	758	48,517
Additional Base Budget Costs for Operation and Maintenance						
Authorization Level	38,955	0	0	0	0	38,955
Estimated Outlays	27,152	7,827	2,395	772	229	38,375
Subtotal (not subject to caps)						
Authorization Level	88,900	0	0	0	0	88,900
Estimated Outlays	50,672	23,783	8,183	3,267	987	86,892
Total Specified Authorizations						
Authorization Level	604,217	0	0	0	0	604,217
Estimated Outlays	367,786	131,879	53,641	24,775	10,654	588,735

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 effects of some of those provisions.

Numbers may not add up to totals because of rounding. BCA = Budget Control Act.

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 veterans benefits and services ($120 million) and the Armed Forces Retirement Home ($64 million).

d. Sections 1503-1511 of the bill would authorize appropriations for 2016—in specified amounts—for overseas contingency operations (OCO) and for various ‘base budget’ costs. Furthermore, section 1502 would authorize for 2016 “such amounts as may be designated” for OCO by the President and the Congress. For purposes of this estimate, CBO assumes that the amounts that would be specifically authorized by sections 1503-1511 are consistent with the authorization in section 1502.

Force Structure. The bill would affect the force structure of the various military services by setting end-strength levels for 2016. For this estimate, CBO assumes that end strength would remain at those levels over the 2016-2020 period.

Under title IV, the authorized end strengths in 2016 for active-duty personnel and personnel in the selected reserves would total 1,305,200 and 821,000 respectively. Of those selected reservists, 77,620 would serve on active duty in support of the reserves. In total, active-duty end strength would decrease by 5,480 and selected-reserve end strength would decrease by 6,800 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 Navy and Air Force would increase by 5,600 and 4,020, respectively. In 2016, DoD would face increased costs of $196 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 Navy and the Air Force 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 5,480 members over the next five years. On net, CBO estimates that DoD's costs would decline by $3.0 billion 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, 412, and 416 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 5,200 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 increase by 206 compared with current authorized end-strength levels for 2016. (Those changes incorporate the authority provided in section 416 for the Chief of the National Guard Bureau to add up to 3,000 additional members of the Army National Guard, including 615 additional full-time members. Based on information from National Guard Bureau, CBO expects that the Chief would fully exercise that authority.) In total, CBO estimates that implementing those provisions across the reserve components would decrease net costs for salaries and expenses for selected reservists by $253 million over the 2016-2020 period, assuming appropriations are consistent with those changes.

Reserve Technicians End Strengths. Sections 413 and 416 would authorize the minimum end strength level 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. Section 413 would lower the minimum number of technicians required (across multiple reserve components) by 1,274 relative to the levels currently authorized. Under section 416, the Chief of the National Guard Bureau would be authorized to disregard the reduction of 1,111 Army National Guard technicians that is established in section 413. Based on information from DoD, CBO expects that the Chief would fully exercise that authority, resulting in a net reduction of 163 dual-status technicians. CBO estimates that such a reduction would decrease costs for civilian salaries and expenses by $40 million over the 2016-2020 period.

TABLE 3. ESTIMATED COSTS FOR SELECTED PROVISIONS IN S. 1376

	By Fiscal Year, in Millions of Dollars					
	2016[a]	2017	2018	2019	2020	2016-2020
FORCE STRUCTURE						
Active-Duty End Strengths	196	-585	-791	-879	-907	-2,966
Selected-Reserve End Strengths	-54	-62	-49	-43	-45	-253
Reserve Technicians End Strengths	-4	-8	-9	-9	-10	-40
COMPENSATION AND BENEFITS						
Lower Pay Raise	-717	-975	-1,004	-1,038	-1,075	-4,809
Reduced Basic Allowance for Housing (BAH)	-389	-764	-872	-897	-922	-3,844
Reduced BAH for Those Married or Living Together	-77	-235	-403	-498	-512	-1,725
Expiring Bonuses and Allowances	827	467	285	262	156	1,997
Civilian Benefits in a Combat Zone[b]	0	36	0	0	0	36
Other Military Compensation Provisions	-23	-20	-15	-16	-16	-90
RETIREMENT						
TSP Contributions	0	0	310	1,360	1,500	3,170
Continuation Payments	0	0	130	770	950	1,850
Accrual Payments to the Military Retirement Fund[c]	0	0	-3,750	-4,150	-4,560	-12,460
Financial Literacy Training	0	5	32	37	21	95

(Continued)

TABLE 3. CONTINUED

	By Fiscal Year, in Millions of Dollars					
	2016[a]	2017	2018	2019	2020	2016-2020
TRICARE Pharmacy Benefit						
Defense Health Program	-67	-136	-173	-228	-283	-887
Accrual Payments to the MERHCF[c]	0	-330	-350	-370	-390	-1,440
TRICARE Access and Quality Metrics	15	20	20	20	20	95
DoD-VA Incentive Fund						
Department of Defense[d]	15	15	15	15	15	75
OTHER PROVISIONS						
Arleigh Burke Destroyer	400	0	1,600	0	0	2,000
Multiyear Procurement Contracts	674	0	577	586	606	2,443
Unemployment Compensation for Former Members	-59	-60	-57	-57	-60	-293

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. DoD = Department of Defense; MERHCF = Medicare-Eligible Retiree Health Care Fund; TSP = Thrift Savings Plan; 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. These proposals would change DoD's accrual contributions to the Military Retirement Fund and the MERHCF. Because those changes would affect DoD's need for discretionary appropriations, they are displayed here. However, those payments are intragovernmental transactions and have no effect on federal spending.

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

Compensation and Benefits. S. 1376 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 $135.5 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.

Lower Pay Raise. Section 601 would reduce the increase in basic pay for members of the uniformed services that is scheduled to go into effect on January 1, 2016. Under current law, the across-the-board increase will be 2.3 percent, and CBO estimates that increase will cost $1.6 billion in 2016. This section would set the pay increase at 1.3 percent for members in pay grades below O-7; the section also would eliminate the increase for officers in pay grades O-7 and above.

Most of the officers in grades O-7 and above will receive a 2.3 percent pay increase under current law. However, the monthly pay of some officers in grades O-9 and above is capped under level II of the Executive Schedule (ES). For 2015, those officers' pay was frozen at the rate of pay for level II ES in effect during fiscal year 2014. Under current law, CBO estimates that pay for those officers will increase in 2016 by 2.7 percent, the average increase in salary from the level II ES rate for 2014 to 2016. Section 601 would continue for a second year to freeze the pay for those officers at the 2014 rate; thus, the reduction in the pay increase for those officers under this legislation would be 2.7 percentage points. In total, CBO estimates that implementing section 601 would reduce the cost of pay raises by $717 million in 2016 and $4.8 billion over the 2016-2020 period.

Reduced Basic Allowance for Housing (BAH). Section 602 would authorize the Secretary of Defense to reduce the monthly housing allowance paid to service members within the United States. BAH is calculated based on the average cost of specific types of housing in the areas around members' assigned duty stations. DoD is currently authorized to reduce the portion of housing costs covered by BAH by up to 1 percent of the calculated cost of housing. Section 602 would allow the Secretary to further reduce the portion of housing costs covered by BAH by an additional 4 percentage points, for a total reduction of up to 5 percent. Based on DoD's plans for implementing this provision, CBO expects that BAH rates will be 3.5 percent less than average housing costs in 2016, and 5 percent less in 2017 and subsequent years. CBO estimates that implementing this change in the calculation of BAH would reduce the department's discretionary costs by $3.8 billion over the 2016-2020 period.

Some mandatory payments for veterans' benefits are based on the BAH rates set by DoD. Such payments from the Department of Veterans Affairs (VA) are exempt from the reductions in amounts paid to service members under current law. Section 605 would repeal that exemption, thereby reducing mandatory spending; those changes are discussed below under the heading "Direct Spending and Revenues."

Reduced BAH for Those Married or Living Together. Section 604 would provide a single BAH payment to certain dual-service military couples—those members of the military who are married to other service members. For other service members who are living together, section 604 would reduce BAH payments by 25 percent, or to the BAH rate for an E-4 without dependents, whichever is greater.

Under current law, dual-service couples receive two BAH payments. Rates vary by pay grade, duty location, and whether or not the service member has children. Couples with children receive one payment at the higher “with dependents” rate and one payment at the “without dependents” rate. Couples without children receive two payments at the “without dependents” rate. Section 604 would require DoD to make only one BAH payment to dual-service couples whose assigned duty stations are within normal commuting distance of each other. That single payment would be at the higher “with dependents” rate, regardless of whether or not the couples have children. Based on information from DoD, CBO estimates that implementing this provision would reduce the monthly BAH for dual-service couples by an average of $1,100 (or $13,200 per year) in 2016.

Of the roughly 42,000 dual-service couples, CBO estimates that 90 percent (about 38,000) receive BAH payments and that 75 percent of those couples (about 28,000) are assigned within normal commuting distance of each other. (Most of the remainder live in military housing or are obliged to maintain two households because their duty stations are too far apart; those couples would not be affected by this provision.)

The reduction in BAH payments required by section 604 would not take effect while a couple remained at their current duty station. On average, military families move about once every three years; thus, CBO estimates that about a third of the 28,000 dual-service couples affected by this provision would see a change in BAH payments in the first year. For this estimate, CBO assumes that couples will move evenly throughout the course of the year; thus, the savings in the first year would be reduced by half. On that basis, CBO estimates that about 9,500 dual-service couples would be affected by this provision in 2016 and would see an average annual reduction in BAH of $6,600.

Service members who are not married but choose to live with other members of the military each receive a BAH payment at the full monthly rate. About 120,000 service members in pay grades E-5 and above receive BAH and are single. CBO estimates that reducing BAH payments to those individuals by up to 25 percent (the reduced amount would not go below the rate paid to an E-4 without dependents) would reduce those payments by an average of $4,000 a year.

Based on the age and income levels of the affected population, CBO estimates that about 25 percent (30,500) of those individuals currently share households with other service members. CBO estimates that one-third of those members would adjust their behavior in response to receiving a reduced BAH payment and choose to live alone or with a civilian member of the community. Like the change in BAH payments for dual-service couples, only one-third of service members who live together would see a change in their payments in the first year based on estimates of how frequently members change duty locations. Again, CBO expects that service members would move at different times throughout the year, so that the savings in the first year would be reduced by half. Thus, CBO estimates that under this provision about 6,800 service members would receive $2,000 less on average in 2016.

In total, implementing the changes in BAH in section 604 that would affect dual-service couples and service members who live together would reduce costs by $1.7 billion over the 2016-2020 period, CBO estimates. That estimate accounts for interactive effects between this provision and section 602, which also would reduce BAH payments (see above).

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 1107 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 1107 would increase the costs to DoD of civilian employees by $36 million and to other federal agencies by $8 million. (The $8 million for other federal agencies is included in the amount shown in Table 1 for nondefense estimated authorizations.)

Other Military Compensation Provisions. CBO estimates that certain other provisions in titles V and VI would, on net, decrease costs to DoD by $90 million over the 2016-2020 period. Those provisions would:

- Reduce the number of training and informational events related to deployments, and

- Limit eligibility for the family subsistence supplemental allowance (FSSA) to members serving outside the United States, the Commonwealth of Puerto Rico, the U.S. Virgin Islands, or Guam. (CBO estimates that some members living in the United States, who would no longer receive FSSA under this provision, would instead receive food assistance under the Supplemental Nutrition Assistance Program (SNAP), which is treated as direct spending in the budget. Those SNAP benefits are discussed below under the heading "Direct Spending and Revenues.")

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),

- Allowing retirees to exchange part of their future annuity stream for a large lump-sum payment when they first separate from service (a near-term increase in direct spending),

- Providing new government contributions to the Thrift Savings Plan (TSP),

- 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, which are made by DoD 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 $7 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]

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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).

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 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 nonmarketable 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 631-636 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). Future retirees also would have the option of exchanging part of their future annuity stream for a large lump-sum payment when they separate from the service (a near-term increase 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

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.

100 percent of additional contributions the member makes to the TSP up to 4 percent. (Including the automatic 1 percent, total contributions by the services could be as high as 5 percent of a member's basic pay.) Those contributions would continue until the member completes 20 years of service. 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.

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 January 1, 2018. 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 during the second half 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:

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.

- 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.

- 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 (COLA) for annuities paid to certain retirees and survivors by up to 1 percent for those who first enter the uniformed service beginning in 2016. Under this bill the COLA reductions will still take place, even for those covered by the new retirement system.

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 incentive to switch to the new plan and accept a lower retirement annuity. Of those members who are close to retirement when the opt-in period occurs, CBO estimates that only about 2 percent would switch to the new plan. Those members would see their annuities significantly reduced, but would receive only one of the benefits of the new program—the option to exchange part of their future annuity stream for a large lump-sum payment.

For members with fewer years of service, the new retirement system would be more attractive. For instance, 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 even 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. [6] 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. Many younger members also enlist in the uniformed services for only a short period with no intent of remaining long

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.

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 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 3 percent of their basic pay, reflecting the assumption that most participating members would want to maximize the amount of government matching contributions (4 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 $3.2 billion over the 2018-2020 period. Costs would be lower in 2018 because current service members would first make elections and transition to the new system towards the end of that fiscal year.

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 three months of basic pay for enlisted personnel and 12 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 $1.9 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. That savings could be even greater depending on how DoD calculates the lump-sum payments for those who elect to exchange part of their annuity for those one-time payments (see the discussion in the "Direct Spending and Revenues" section of this report). 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 intragovernmental 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 its 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.

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 $12.5 billion over the 2018-2020 period.

Financial Literacy Training. Section 581 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 six months 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 581 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.

Health Care. A number of provisions in S. 1376 would affect discretionary costs in 2016 and over the 2017-2020 period, for health care spending by DoD and the Department of Veterans Affairs.

TRICARE Pharmacy Benefit. Section 702 would increase copayments for those who use the TRICARE pharmacy system beginning in 2016. Pharmaceutical costs for active-duty members, military retirees who are not eligible for Medicare, and their dependents are paid from discretionary funds.

DoD currently spends about $4 billion each year on prescription drugs for TRICARE beneficiaries who are not eligible for Medicare. An increase in copayments would reduce DoD's payments to pharmacies. In addition, CBO expects that higher copayments would lead some beneficiaries to reduce their use of medications, which, in some cases, would lead to more outpatient visits and hospitalizations. Based on information from DoD, CBO estimates that the net effect of implementing section 702 would be to reduce DoD's discretionary health care costs by about $900 million over the 2016-2020 period.

Section 702 also would increase pharmacy copayments for TRICARE beneficiaries who are eligible for Medicare. Pharmaceutical costs for those beneficiaries are paid from the DoD Medicare-Eligible Retiree Health Care Fund (MERHCF) and are treated as direct spending in the budget. While spending from the MERHCF is mandatory, the fund is credited with annual accrual payments that are part of DoD's budget and count against the caps on discretionary budget authority set by the BCA. Those accrual payments, made at the beginning of each fiscal year, represent the future costs of health care for members currently serving in the military once they retire and are eligible for Medicare. CBO estimates that implementing section 702 would reduce accrual payments to the MERHCF by about $1.4 billion over the 2017-2020 period.[7]

As with accrual payments to the Military Retirement Fund, payments to the MERHCF are intra-governmental transactions and are offset one-for-one by receipts elsewhere in the budget. However, 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 its discretionary appropriations on other things. CBO assumes that section 702 would not be enacted in time to affect the accrual payments for 2016. Details about the mandatory costs, as well as a more complete overview of section 702, are discussed below, under the heading "Direct Spending and Revenues."

TRICARE Access and Quality Metrics. Sections 711 and 731-734 would require DoD to collect and publish various data on the access to and quality of health care at Military Treatment Facilities (MTFs). This data would include wait-times to see physicians, and other measures of quality, safety, and outcomes. Based on information from DoD, CBO estimates that about $95 million would be required over the 2016-2020 period to satisfy those requirements.

DoD-VA Incentive Fund. Section 719 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 in recent years, CBO estimates that implementing this provision would cost each department $75 million over the 2016-2020 period, for a total cost of $150 million over that period. (The $75 million in added costs that would be incurred by VA is included in the amount shown in Table 1 for estimated nondefense authorizations, rather than in Table 3.)

7. The actual amount of the accrual payments are set by the DoD Office of the Actuary, and the actual decrease to the accrual payments because of section 702 would ultimately depend on that office's economic and policy assumptions.

Arleigh Burke Destroyer. S. 1376 would authorize the appropriation of $400 million in 2016 toward the purchase of an additional Arleigh Burke destroyer. CBO estimates that the destroyer would cost about $2 billion. Under section 117, the destroyer could be purchased as part of an existing multiyear contract that ends in 2017 that the Navy currently plans to use to purchase a total of 10 such destroyers. Alternatively, the provision would authorize the Navy to purchase the destroyer in 2018. Based on information from the Navy, CBO expects that the destroyer would be purchased in 2018 and that appropriations for the full cost would be provided over the 2016-2020 period.

Multiyear Procurement Contracts. Section 118 would authorize the Navy to enter into one or more contracts to purchase up to six fleet replenishment oilers. The bill would authorize the appropriation of $674 million in 2016 to purchase the first of those vessels. Based on information from the Navy, CBO expects that service would use that authority to purchase one oiler in 2016 and three additional oilers over the 2018-2020 period. CBO estimates that those four ships would require appropriations of about $2.4 billion over the 2016-2020 period. (An additional $1.2 billion would be needed to complete the purchase of the final two ships in 2021 and 2022.)

Unemployment Compensation for Former Members. Sections 535 and 592 would reduce the number of military personnel who would be eligible to receive unemployment compensation after their discharge from military service. Under section 535, veterans could no longer simultaneously receive unemployment benefits and education benefits under the Post-9/11 GI Bill (Chapter 33). Under section 592, the minimum period of continuous active service that a reservist must perform to be eligible for unemployment compensation would double from the 90 days required under current law.

DoD reimburses the unemployment trust funds in different states from appropriations for military personnel for the benefits those state trust funds paid to discharged service members. If the number of personnel who could receive those benefits declined, the need for such discretionary appropriations would likewise be reduced. Enacting sections 535 and 592 would decrease DoD’s annual reimbursement payments by approximately 10 percent, CBO estimates, reducing discretionary costs by $59 million in 2016 and $293 million over the 2016-2020 period.

Commissary Privatization Pilot Program. Section 652 would require DoD to develop a plan to privatize some or all of the commissaries operated by the Defense Commissary Agency. After it submits that plan to the Congress, DoD would be required to carry out a pilot program to privatize at least five commissaries located within the largest markets of the commissary system in the United States.

If privatization reduced the number of operating commissaries, the department could reduce costs because it would have fewer employees, lower utility expenses, and reductions in other operating expenses. Conversely, privatization could require additional expenditures for providing severance payments and unemployment compensation to current employees, capital improvements to selected commissaries prior to conveying them to the private agent, and indemnification of participating parties for losses arising from future DoD and congressional action (such as base closures or reductions in military personnel levels in the immediate area).

Section 652 provides few parameters on the execution of the pilot program; thus, CBO cannot determine what activities DoD might pursue or what form privatization may take. The department may choose to convey the buildings to private-sector retailers and simply act as a lessor for the underlying land. On the other hand, DoD might remain closely involved in the operation of the commissaries and may make commitments for the provision of future appropriations. Privatization programs for other DoD assets such as family housing units and utility systems have involved a variety of arrangements and contract types. Some of those have resulted in significant federal obligations to make payments from subsequent appropriations over the course of many years. CBO believes that the authority to incur such obligations in advance of appropriations constitutes direct spending.

In the absence of any information on DoD's plan for privatizing its commissaries, or details on the terms of agreements between DoD and any prospective grocery retailers, we are unable to estimate any net costs or savings that may result from the pilot program.

Direct Spending and Revenues

Several provisions in S. 1376 would affect direct spending. CBO estimates that, on net, enacting those provisions would decrease direct spending by $4.9 billion over the 2016-2025 period (see Table 4). In addition, one provision (which would modify the retirement system for members of the uniformed services) would lower revenues by an estimated $1.1 billion over the 2018-2025 period. In total, enacting the bill would decrease deficits over the 2016-2025 period by an estimated $3.8 billion.

Retirement. Sections 631-636 would modify the retirement system used by the uniformed services. The revised system would cover all new entrants starting in 2018 and would allow current members to voluntarily switch to the new system. Enacting those provisions would affect both direct spending for retiree annuities and revenues. Several provisions also would affect discretionary spending by DoD. Details of those effects, as well as additional background and details of CBO's cost estimating methodology can be found in the "Spending Subject to Appropriations" section of this cost estimate.

TABLE 4. ESTIMATED EFFECTS OF S. 1376 ON DIRECT SPENDING AND REVENUES

	By Fiscal Year, in Millions of Dollars											
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2016-2020	2016-2025
CHANGES IN DIRECT SPENDING												
Retirement												
Estimated Budget Authority	0	0	120	220	230	240	250	290	340	430	570	2,120
Estimated Outlays	0	0	120	220	230	240	250	290	340	430	570	2,120
TRICARE Pharmacy Benefit												
Estimated Budget Authority	-107	-205	-262	-399	-509	-600	-665	-417	-361	-361	-1,482	-3,886
Estimated Outlays	-86	-184	-250	-370	-486	-581	-653	-470	-373	-361	-1,376	-3,814
VA Housing Stipends												
Estimated Budget Authority	-213	-321	-334	-348	-361	-375	-390	-400	-412	-424	-1,577	-3,578
Estimated Outlays	-213	-321	-334	-348	-361	-375	-390	-400	-412	-424	-1,577	-3,578
Special Immigrant Visas												
Estimated Budget Authority	16	45	40	37	34	34	34	33	32	32	172	336
Estimated Outlays	16	45	40	37	34	34	34	33	32	32	172	336
Supplemental Subsistence Allowance												
Estimated Budget Authority	0	1	1	1	1	1	1	1	1	1	4	9
Estimated Outlays	0	1	1	1	1	1	1	1	1	1	4	9
Survivor Benefit Plan												
Estimated Budget Authority	*	*	*	*	*	*	*	*	*	*	*	1
Estimated Outlays	*	*	*	*	*	*	*	*	*	*	*	1
Total Changes in Direct Spending												
Estimated Budget Authority	-304	-480	-435	-489	-605	-700	-770	-493	-400	-322	-2,313	-4,998
Estimated Outlays	-283	-459	-423	-460	-582	-681	-758	-546	-412	-322	-2,207	-4,926
CHANGES IN REVENUES												
Retirement	0	0	-22	-96	-128	-140	-154	-168	-182	-198	-246	-1,088
NET INCREASE OR DECREASE (-) IN THE DEFICIT FROM CHANGES IN DIRECT SPENDING AND REVENUES												
Estimated Impact on the Deficit	-283	-459	-401	-364	-454	-541	-604	-378	-230	-124	-1,961	-3,839

Notes: Pursuant to section 3101 of the Concurrent Resolution on the Budget for Fiscal Year 2016 (S. Con. Res. 11), CBO estimates S. 1376 would increase projected deficits by more than $5 billion in at least one of the four consecutive 10-year periods starting in 2026.

Numbers may not add up to totals because of rounding. VA = Department of Veterans Affairs.

* = less than $500,000.

Outlays for retiree annuities would be affected in two ways. First, the multiplier used to calculate the amount of members' annuities would be reduced from 2.5 percent to 2.0 percent. That would effectively reduce the fixed component of the military retirement benefit by 20 percent. Retiring members also would have the option of exchanging a portion of their annuity for a single lump-sum amount, which would be paid from the Military Retirement Fund, in the case of DoD, or from mandatory appropriations for the other uniformed services. Members choosing that option would forgo their entire monthly annuity until age 67 in exchange for that one-time payment. The lump-sum amount would be payable when members retire from the service (or at approximately age 60 in the case of reservists). The retiring members also could choose to take half of the lump-sum payment in exchange for forgoing half of their annuity prior to age 67. In either instance, the annuity would be restored at age 67 with adjustments for all applicable cost-of-living adjustments that would have occurred had the retiree not elected to take a lump-sum payment.

Section 633 would require that DoD determine the amount of the lump-sum payment, and take into account reputable studies of discount rates for military personnel. For this estimate, CBO assumed the lump-sum amounts would be calculated using a real discount rate of 5 percent for each year between the age of retirement and age 67 (the discount rate increases to 8 percent per year when accounting for inflation), which is based on an examination of recent research into the personal discount rates of military personnel.[8] For those who choose to switch to the new retirement system and retire between 2018 and 2025, CBO estimates the average lump-sum payment would exceed $250,000.

The effect of the lump-sum option on outlays would change over time. Initially, very few new retirees would come under the new retirement system. As discussed earlier in the "Spending Subject to Appropriation" section of this estimate, we estimate only about 2 percent of those retiring in the first few years after 2018 would elect to transition to the new system, but we expect all of those individuals would choose to take a lump-sum payment at retirement. In 2019, the first full year after the start of the open season for switching to the new system, CBO estimates slightly more than 1,000 people would receive lump-sum payments, and this would grow to about 2,500 by 2025. The number of people retiring under the new system would continue to increase after 2025, although not all of them would choose to take a lump-sum payment when they separate. Those retiring members with low personal discount rates would not perceive the lump-sum payment as being large enough to cause them to choose to forgo their annuity until they reach 67 years

8. See the "Spending Subject to Appropriations" section of this cost estimate for additional discussion of personal discount rates. There have not been many studies of discount rates of military personnel, which adds a large degree of uncertainty to our estimates. To estimate the personal discount rate used in this report we relied primarily on the results of the recent study by Simon, Warner, and Pleeter (see footnote 6), which specifically examined military personnel who were near retirement. They estimated a personal discount rate of 7 percent for enlisted personnel and 2 to 4.3 percent for officers. Our estimate of 5 percent is a composite of those figures with a small adjustment downward to account for some observed changes in the behavior of military personnel over time and the fact that DoD would most likely be under pressure to make the calculation as favorable to the retirees as possible.

of age. In the long-run, we estimate that less than half of retirees would choose to receive the lump-sum payment.

On net, enacting the new retirement system would cause an increase in mandatory outlays over the 2018-2025 period of $2.1 billion over the 2018-2025 period. That increase would stem from members exercising the option to forgo a large portion of their annuities in favor of receiving up-front, lump-sum payments. The increase in spending would accelerate beyond 2025 as an increasing number of military members would be bound by the rules of the new retirement system and would thus be eligible for a lump-sum payment when they retire. Eventually, however, the savings from the reduced and foregone annuities would exceed the annual spending on lump-sum payments. Once all retirees are bound by the new rules, CBO estimates that the new system would reduce annual retirement outlays by over 25 percent. (If retirement outlays in 2015 were reduced by that much, they would decrease by almost $15 billion.)

The changes to the retirement system also would affect revenues. 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 $1.1 billion over the 2018-2025 period.

Over the long-run, CBO estimates that the net effect of those changes to the uniformed services retirement system would be to decrease 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.

TRICARE Pharmacy Benefit. By modifying the pharmacy benefit, section 702 would reduce health care spending for TRICARE beneficiaries who are eligible for Medicare by $3.8 billion over the 2016-2025 period. Pharmacy spending for those beneficiaries is paid from the DoD Medicare-Eligible Retiree Health Care Fund, a mandatory account. Health care spending for all other beneficiaries of the Military Health System is discretionary, and is discussed above under the heading "Spending Subject to Appropriation."

Section 702 would make the following changes to the TRICARE pharmacy benefit.

- The copayment for generic medications would gradually increase over the 2016-2025 period to $14 for both a 30-day supply from retail pharmacies and up to a 90-day supply from the TRICARE national mail-order pharmacy (TMOP).

- Copayments for generic medications are currently $8 for drugs purchased through the retail network; there is no copayment for generics if they are purchased through the TMOP.

- Copayments for brand-name drugs in the TRICARE formulary would gradually increase to $46 by 2025 for both a 30-day supply from retail pharmacies and up to a 90-day supply from the TMOP. Copayments for those medications are currently $20 for drugs purchased through the retail network and $16 for drugs purchased from the TMOP.

- Copayments for nonformulary drugs would increase from $46 to $92 by 2025.

- Service members who are retired for medical reasons, spouses of members who die on active duty, and the family members of both of those groups, would be exempt from any copay increases. Pharmacy copayments for those beneficiaries would remain at 2015 levels indefinitely.

Prescription medications obtained at the MTFs would continue to be offered at no charge, and DoD would maintain authority to increase the pharmacy copayments after 2025, to reflect inflation in pharmacy ingredient and dispensing costs.

CBO estimates that all of the changes discussed above would reduce direct spending for pharmacy benefits by about $4.9 billion over the 2016-2025 period. The largest part of the estimated savings—about two-thirds—would occur as a direct result of the lower DoD cost sharing associated with the higher copayments. In 2014, DoD helped pay for about 60 million prescriptions for TRICARE beneficiaries who were eligible for Medicare at a cost of more than $3.5 billion. Under current law, the rate of growth in TRICARE pharmacy copayments for fiscal years through 2022 is limited to the annual cost-of-living adjustment for military retired pay, which CBO projects will be about 2 percent each year. After 2022, current law gives DoD the authority to increase the pharmacy copayments as it deems appropriate. CBO estimates there is about a 50 percent probability that the higher copayments authorized by the bill would occur after 2022 under current law, which accounts for the lower savings attributed to section 702 beginning in 2023.

Various studies have shown that higher copayments lead to lower use of prescription drugs.[9] CBO estimates this lower demand accounts for the other third of the $4.9 billion in savings. However, there is also evidence that changes in prescription drug use affect the use of inpatient and outpatient medical services.[10] Thus, while the higher copayments may

9. Based on a review of various studies, CBO measured changes in demand using a price arc-elasticity of demand that ranged from -.05 to -.15 depending on the type of drug, point of service, and current copayment level.

10. For more information, see Congressional Budget Office, *Offsetting Effects of Prescription Drug Use on Medicare's Spending for Medical Services* (November 2012).

deter some beneficiaries from filling prescriptions they no longer need or use, those higher copayments also could cause some chronically ill beneficiaries to stop taking their medications, resulting in more doctor visits and hospitalizations. As a result, CBO estimates that the $4.9 billion in direct pharmacy savings would be offset by a $1.1 billion increase in other federal spending for medical services (mostly from Medicare).

VA Housing Stipends. Section 605 would reduce the housing allowances VA provides as part of two mandatory benefits programs. Under the Post-9/11 GI Bill (Chapter 33) veterans (and dependents to whom service members have transferred Chapter 33 benefits) may receive a monthly allowance equal to the basic allowance for housing that DoD pays to enlisted service members with dependents and a rank of E-5. Additionally, VA provides some disabled veterans enrolled in education and training for rehabilitation with a monthly stipend at that same rate.

The National Defense Authorization Act for 2015 (Public Law 113-291) allowed DoD to reduce BAH rates by 1 percent, but that law exempted VA's housing allowances from similar reductions. Section 605 would strike that exemption, resulting in a decrease in the VA-funded allowances.

Additionally section 602 would allow DoD to reduce BAH payments by another 4 percentage points, which, in conjunction with the effect of section 605, would cut VA's housing allowances by up to 5 percent compared with the rates that would be set under current law. (That provision also would reduce discretionary costs to DoD discussed above under the heading "Spending Subject to Appropriation."

Based on current enrollment data, CBO estimates that about 840,000 people will use Chapter 33 benefits in 2016; the housing allowance per beneficiary will average about $5,800 in 2016. (Some beneficiaries are not eligible to receive a housing allowance from VA, and most of those who do only receive the allowance during the nine-month academic year; thus the average payment is significantly less than the approximately $19,000 in BAH an E-5 with dependents would receive in 2016.) Based on DoD's plans for reducing BAH rates, CBO expects that, relative to current law, VA's housing allowance would be reduced by 3.5 percent in 2016 and 5 percent in 2017. On that basis, CBO estimates that enacting sections 602 and 605 would reduce direct spending for Chapter 33 by $3.4 billion over the 2016-2025 period.

About 19,000 disabled veterans enrolled in college, apprenticeship programs, or on-the-job training through VA's rehabilitation services receive the same housing stipend as that provided to Chapter 33 beneficiaries. Those stipends would be similarly affected by the enactment of sections 602 and 605. CBO estimates that cutting the stipends as described above would reduce direct spending for rehabilitative benefits by $154 million over the 2016-2025 period.

In total, enacting sections 602 and 605 would reduce direct spending by $3.6 billion over the 2016-2025 period.

Special Immigrant Visas (SIVs). Section 1227 would amend the Afghan Allies Protection Act of 2009 to provide 3,000 additional SIVs that could be issued to any qualified applicant who applied before the end of calendar year 2016. Afghans who would be eligible under this provision are those who were employed by the U.S. government or certain organizations associated with the U.S. mission in Afghanistan at some point since 2001 and are experiencing an ongoing serious threat as a consequence of that employment. (Additional SIVs, not subject to limitation, would be available to certain relatives of those workers.)

CBO estimates that approximately 10,000 people would receive immigrant visas under section 1227. Because special immigrants (including their spouses and children) are eligible for public benefits to the same extent as refugees, they could receive subsidies through health insurance exchanges and benefits from Medicaid, nutrition programs, and the Supplemental Security Income program, if otherwise eligible, upon arrival in the United States. On that basis, CBO estimates that direct spending for those benefits would increase by $336 million over the 2016-2025 period.

Supplemental Subsistence Allowance. Section 606 would modify a program that provides a supplemental cash allowance to service members with dependents and with incomes below 130 percent of the poverty line to help them purchase food. This provision would eliminate the allowance for military members serving in the United States, Puerto Rico, the Virgin Islands and Guam; service members overseas would still be able to receive it. Based on data from DoD about current recipients of this allowance, CBO estimates that under this provision, about 180 households would newly apply for SNAP benefits. CBO estimates that those households would receive, on average, about $325 per month in SNAP benefits over the 2017 to 2025 period. On that basis, we estimate that this provision would increase direct spending by $1 million per year, beginning in fiscal year 2017.

Survivor Benefit Plan (SBP). Section 641 would allow retired members to elect a new beneficiary under the SBP if the previously elected beneficiary was a former spouse who died while being covered. Under current law, the election of a new beneficiary under the SBP can only be made when the former spouse is still living. CBO estimates that under this provision the cumulative number of new beneficiaries covered by SBP would reach 60 by 2025. Many of the retired members sponsoring those new beneficiaries would have fully paid into the program and would therefore not be required to make monthly premium payments. Under this section, CBO estimates that additional SBP benefit payments would exceed premium receipts by about $1 million over the 2016-2025 period, thus increasing direct spending by that amount.

Long-term Contracts for Arsenals and Depots. Section 343 would lengthen the maximum term of contracts that are authorized under a program to reduce the costs of owning and operating underutilized ammunition arsenals and storage depots. Under that program DoD can lease parts of such facilities to businesses in exchange for rental payments or in-kind consideration. Such contracts are limited to a maximum term of 25 years. Section 343 would allow contracts entered during the five-year period following enactment of the bill to include an option for an additional 25-year term.

Some similar long-term contracts result in capital improvements for use by the federal government. Although the obligation to pay for such improvements is incurred up front, the costs are paid over time from subsequent appropriations. CBO treats the authority to incur such obligations in advance of appropriations as direct spending. While the cost of any capital improvement would be significant, CBO believes that DoD is unlikely to use this temporary authority in such a manner, but would instead rely on other permanent authorities for third-party financing. Thus, CBO does not estimate an increase in direct spending from enacting section 343.

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

- Sections 504 and 506 would modify the rules for the selective early discharge of certain officers. Those changes would affect when some service members would begin drawing retirement annuities.

- Section 505 would defer the mandatory retirement age for any Chief or Deputy Chief of Chaplains until age 68.

- Section 507 would clarify the pay-grade used to calculate the retirement annuity for certain warrant officers.

- Section 513 would make certain noncitizens eligible to enlist in the reserve components of the armed forces. Upon enlistment, those noncitizens would become immediately eligible to apply for citizenship, at which point they could receive a variety of federal benefits, if they were otherwise eligible.

- Section 586 would authorize the Secretary of Defense and the Secretary of Homeland Security to initiate an application for a correction of military records. This change could increase the number of cases reviewed for errors and thus change compensation paid in instances where additional errors would be corrected under this authority. Any increase or decrease in compensation payments under this provision would be direct spending.

- Section 701 would amend the pre-authorization rules for urgent care under the TRICARE health benefit. While it would lead to an increase in the use of urgent care, those additional costs would be offset by less use of other sources of medical care.

- Section 715 would allow DoD to waive the recoupment of overpayments for health benefit claims in certain instances.

- Section 720 would create a pilot program to examine incentives for providers under the TRICARE health benefit.

- Section 1111 would establish a pilot program that would expand certain personnel authorities affecting civilian employees at DoD Laboratories, including the authority to offer early retirement incentives. If the Secretary of Defense used this expanded authority to provide early retirement to employees, those benefits would be 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 outlays and revenues that are subject to those pay-as-you-go procedures are shown in Table 5.

TABLE 5. PAY-AS-YOU-GO EFFECTS FOR S. 1736, THE NATIONAL DEFENSE AUTHORIZATION ACT FOR FISCAL YEAR 2016, AS REPORTED BY THE SENATE COMMITTEE ON ARMED SERVICES ON MAY 19, 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 OR DECREASE(-) IN THE DEFICIT													
Statutory Pay-As-You-Go Impact	0	-283	-459	-401	-364	-454	-541	-604	-378	-230	-124	-1,961	-3,839
Memorandum:													
Change in Outlays	0	-283	-459	-423	-460	-582	-681	-758	-546	-412	-322	-2,207	-4,926
Change in Revenues	0	0	0	-22	-96	-128	-140	-154	-168	-182	-198	-246	-1,088

EFFECT ON LONG-TERM DEFICITS

Pursuant to section 3101 of the Concurrent Resolution on the Budget for Fiscal Year 2016 (S. Con. Res. 11), CBO estimates that enacting S. 1376 would increase projected deficits by more than $5 billion in at least one of the four consecutive 10-year periods starting in 2026. In the ten years after 2025 mandatory outlays associated with retirement reform would accelerate as an increasing number of military members would be bound by the rules of the new retirement system and would thus be eligible for a lump-sum payment when they retire. In subsequent decades, however, the savings from the reduced or foregone annuities would exceed the annual spending on lump-sum payments.

INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

S. 1376 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 benefit the following:

- Local educational agencies by authorizing federal funds to support education and services for military dependent children and by authorizing the leasing of federal property to local schools at subsidized rates;

- Public universities and research centers that enter into cooperative agreements with the Department of Defense to conduct research supported by federal funds or facilities;

- Native American tribes by authorizing the conveyance of relocatable military housing units located on military bases to tribal members; and

- State and local governments in Arkansas by authorizing the release of the U.S. Army's retained reversionary interests in a parcel of land located in Jefferson County.

Any costs to those entities resulting from those transactions would be incurred voluntarily as conditions of receiving federal assistance.

PREVIOUS CBO ESTIMATE

On May 11, 2015, CBO transmitted a cost estimate for H.R. 1735, the National Defense Authorization Act for Fiscal Year 2016, as reported by the House Committee on Armed Services on May 5, 2015. S. 1376 would authorize the appropriation of an estimated

$604.6 billion for fiscal year 2016—$0.7 billion less than the $605.3 billion that would be authorized by H.R. 1735.

In addition, both bills contain provisions that would change retirement benefits for certain future retirees of the uniformed services, with such changes affecting both revenues and direct spending. There are several significant differences between the retirement provisions of the two bills. In particular, S. 1376 would allow future retirees of the uniformed services the ability to exchange part of their future annuity stream for a single lump-sum payment. This would increase direct spending in the near term, although it would result in greater savings in the long-run relative to H.R. 1735. In addition, S. 1376 would provide for government contributions to TSP equivalent to 5 percent of a member's basic pay, whereas the government could contribute up to 6 percent under H.R. 1735.

S. 1376 also contains other provisions—primarily affecting TRICARE Pharmacy Benefits, VA Housing Stipends, and Immigrant Visas—that would affect direct spending by lowering, on net, outlays over the 2016-2025 period.

ESTIMATE PREPARED BY:

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Military and Civilian Personnel—Dawn Regan
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VA Housing Stipends—David Newman

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