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TESTIMONY

**Approaches to Reducing the
Department of Defense's
Compensation Costs**

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Before the Subcommittee on Personnel
Committee on Armed Services
United States Senate

Chairwoman Warren, Ranking Member Scott, and Members of the Subcommittee, I appreciate the opportunity to appear before you today to discuss approaches to reducing the Department of Defense's (DoD's) compensation costs.

Summary

Some components of DoD's compensation budget are clear, including the military personnel accounts, health care costs for active-duty and retired military personnel, and compensation for DoD's civilian workforce. But other components are less clear, including some smaller noncash elements of military compensation and, in particular, the size and cost of DoD's workforce of service contractors.

In biennial reports and other studies requested by the Congress, the Congressional Budget Office regularly analyzes and presents a range of policy options that would reduce spending across the federal government. Among those options are some that address DoD's compensation costs. CBO has examined several ways that DoD could reduce those costs by changing the size of military forces while still meeting the goals of national security strategy.¹ CBO has also reported on ways to lower such costs without changing the size of military forces.

None of those options address the size or cost of DoD's service contractor workforce. Although CBO has done preliminary analysis of the costs associated with service contractors, a full analysis is not possible using the incomplete data that DoD provides to the Congress. Comprehensive data from DoD would allow CBO to supply the Congress with information about the scope and cost of the department's large workforce of service contractors—which could prove to nearly rival the size of DoD's federal civilian workforce. Such data could also help DoD manage its total workforce.

Components of DoD's Compensation Costs

DoD's total labor force (which it calls its total force) consists of three types of labor: military personnel (divided into full-time and part-time personnel), federal civilians, and service contractors. Compensation for the three types of labor is spread across several categories of

DoD's budget, but most of the compensation is recorded in the military personnel account and the operation and maintenance (O&M) account.

The term "contractor" can mean many things. In this case, contractor describes service contract labor—that is, personnel hired by private companies under service contracts awarded expressly to augment DoD's military and civilian workforce.² (The service contractors discussed here are thus separate and distinct from the individuals employed by companies to produce weapons and provide other goods to DoD.) Service contractors provide a wide range of services that are not inherently military or governmental. They are assigned specific tasks that could be performed by military or civilian personnel, including administrative support, equipment maintenance, lawn maintenance, food services, installation security, and analytic support.

Size of DoD's Workforce

The size and cost of DoD's military and civilian workforces are documented in the department's budget, although it is a challenge to identify all the components of military compensation because they are not recorded in one place. The size and cost of the service contractor workforce, however, are poorly documented.

By the end of 2023, DoD expects to have 2.2 million full-time employees, including 1.4 million active-duty military personnel and 0.8 million civilian personnel. There is no centralized accounting for the number of service contractors, but estimates range from 0.25 million to roughly two or three times that number.

Size of DoD's Compensation Budget

Roughly one-third of DoD's annual budget is devoted to compensation for military and civilian employees working directly for the department—about \$279 billion in 2023.³ Appropriations for military personnel amount to \$172 billion of that total, including cash pay for active-duty personnel and reservists, and DoD's contributions for retirement benefits. (That total excludes the health

1. Congressional Budget Office, *Illustrative Options for National Defense Under a Smaller Defense Budget* (October 2021), www.cbo.gov/publication/57128.

2. Heidi M. Peters, *Defense Primer: Department of Defense Contractors*, Report IF10600, version 12 (Congressional Research Service, January 17, 2023), p. 1, <https://tinyurl.com/kbkfypnv>.

3. Department of Defense, Office of the Under Secretary of Defense (Comptroller), *National Defense Budget Estimates for FY 2024 (Green Book)* (May 2023), Tables 6-1 and 6-14, <https://tinyurl.com/3m4sctm6>.

Table 1.

Options to Reduce DoD's Personnel Costs

Billions of Dollars

	Change in Spending Over 10 Years	
	Discretionary Outlays	Mandatory Outlays
Cap Increases in Basic Pay for Military Service Members ^a	-22.4	6.7
Replace Some Military Personnel With Civilian Employees ^b	-18.5	6.6
Reduce the Basic Allowance for Housing to 80 Percent of Average Housing Costs ^c	-14.7	-3.7

Data source: Congressional Budget Office.

The estimates in this table are for the 2023–2032 period and were developed in relation to CBO's spring 2022 baseline budget projections. The baseline projections against which future proposals would be measured have changed. Thus, future estimates of the budgetary effects of these options would differ from the estimates presented here.

DoD = Department of Defense.

a. For details about this option, see www.cbo.gov/budget-options/58657.

b. For details about this option, see www.cbo.gov/budget-options/58658.

c. For details about this option, see www.cbo.gov/budget-options/58666.

care costs in the O&M budget for active-duty personnel and their families and for retired service members who are not yet eligible for Medicare. It also excludes the costs of a variety of smaller family support programs.) Civilian compensation accounts for the remaining \$107 billion.

Those totals omit the cost of compensation for service contractors. Including that cost would increase the total cost of compensation to between one-third and one-half of DoD's annual budget; CBO cannot develop a more precise estimate at this time. Still, small adjustments to slow the annual growth of compensation costs could compound into large savings over time, given the size of DoD's compensation budget.

CBO's Analysis of Approaches to Reducing DoD's Compensation Costs

CBO regularly produces reports describing DoD's compensation policies and providing illustrative examples of ways for the department to reduce its compensation costs. Every two years, CBO produces a series of updated budget options that provide examples of alternative policies or procedures to reduce spending across the federal government, including spending by DoD and the Department of Veterans Affairs (VA).⁴ Those options are

typically based on analyses contained in more comprehensive research reports that describe the changes in policy that would result in the estimated savings and the consequences of pursuing each policy.

CBO has examined options that would generate savings in DoD's military and civilian compensation budgets. However, CBO has not been able to examine options that would limit DoD's costs for service contractors, because the data for that portion of DoD's labor force are incomplete. Three recent policy options directly relate to savings in the cost of DoD's military personnel (see Table 1). Each would save between \$1 billion and \$2 billion a year, on average, over 10 years—roughly 1 percent of the department's military compensation budget each year.

DoD's expenditures for military health care in 2021 amounted to roughly \$52 billion, or about 7 percent of its budget that year.⁵ DoD has worked to find savings in health care programs without reducing the quality of care.⁶ CBO has examined several policy options that could further reduce DoD's health care costs (see Table 2). Each would save between \$1 billion and \$3 billion a year, on average, over 10 years.

4. In 2022, CBO produced two such volumes describing options that would lead to larger and smaller reductions in the deficit, respectively. See Congressional Budget Office, *Options for Reducing the Deficit, 2023 to 2032—Volume I: Larger Reductions* (December 2022), www.cbo.gov/publication/58164, and *Options for Reducing the Deficit, 2023 to 2032—Volume II: Smaller Reductions* (December 2022), www.cbo.gov/publication/58163.

5. Defense Health Agency, *Evaluation of the TRICARE Program: Fiscal Year 2022 Report to Congress* (February 2022), p. 3, <https://tinyurl.com/2esdaw2a>.

6. *Ibid.*, p. 4.

Table 2.

Options to Reduce DoD's Health Care Costs

Billions of Dollars

	Change in Spending Over 10 Years	
	Discretionary Outlays	Mandatory Outlays
Introduce Enrollment Fees in TRICARE for Life ^a	0	-15.6
Introduce Minimum Out-of-Pocket Requirements in TRICARE for Life ^b	0	-32.6
Modify TRICARE Enrollment Fees and Cost Sharing for Working-Age Military Retirees ^c	-11.4	1.8

Data source: Congressional Budget Office.

With one exception, noted below, the estimates in this table are for the 2023–2032 period and were developed in relation to CBO's spring 2022 baseline budget projections. The baseline projections against which future proposals would be measured have changed. Thus, future estimates of the budgetary effects of these options would differ from the estimates presented here.

TRICARE for Life is a supplement to Medicare for military retirees and their Medicare-eligible family members. Beneficiaries who are eligible for TRICARE are automatically enrolled in TRICARE for Life, and there are no enrollment fees (although beneficiaries must pay their premium for Medicare Part B, which covers physicians' and other outpatient services).

DoD = Department of Defense.

a. For details about this option, see www.cbo.gov/budget-options/58645.

b. For details about this option, see www.cbo.gov/budget-options/58646.

c. The estimates are for the 2019–2028 period and were developed in relation to CBO's spring 2018 baseline budget projections. For details, see www.cbo.gov/budget-options/2018/54763.

CBO has also examined options that would limit the growth in compensation for federal civilian employees, including reducing the annual across-the-board adjustment to their pay and increasing their contributions to the retirement system.⁷ Because those options would apply to the entire federal workforce and not just DoD's employees, the amount of savings they would generate is not directly comparable with the previously mentioned savings in the cost of military personnel. (DoD's civilian employees account for more than one-third of the total federal civilian workforce, excluding the Postal Service.)

Though not a direct cost to DoD, veterans' benefits support the department's mission to recruit and retain high-quality personnel and are an important part of military compensation. Those benefits are provided largely by VA, whose total funding request (including mandatory and discretionary funding) in the President's 2024 budget was \$320 billion (more than one-third the size

of DoD's total budget).⁸ CBO and the staff of the Joint Committee on Taxation have examined several policy options to lower the cost of veterans' compensation (see Table 3 and Table 4). Savings from those options range from less than \$1 billion a year to as much as \$25 billion a year, on average, over 10 years.

Implications of DoD's Incomplete Data on Service Contractors

Attempts to estimate the size and cost of DoD's workforce of service contractors are hampered by known shortcomings in the data the department provides to the Congress in its budget documentation.⁹ Those shortcomings are evident when DoD's data are compared with data from other sources. For example, DoD reports that its budget authority for service contracts in 2022 was

7. Congressional Budget Office, "Reduce the Annual Across-the-Board Adjustment for Federal Civilian Employees' Pay," in *Options for Reducing the Deficit, 2023 to 2032—Volume II: Smaller Reductions* (December 2022), www.cbo.gov/budget-options/58672, and "Increase Federal Civilian Employees' Contributions to the Federal Employees Retirement System," in *Options for Reducing the Deficit, 2023 to 2032—Volume I: Smaller Reductions* (December 2022), www.cbo.gov/budget-options/58710.

8. Office of Management and Budget, *Budget of the U.S. Government, Fiscal Year 2024: Public Budget Database* (March 2023), <https://tinyurl.com/yckyw2t4>. VA's funding is listed under budget subfunction codes 701–705; DoD's funding is listed under budget subfunction code 051.

9. Government Accountability Office, *Service Acquisitions: DOD's Report to Congress Identifies Steps Taken to Improve Management, but Does Not Address Some Key Planning Issues*, GAO-21-267R (February 22, 2021), www.gao.gov/products/gao-21-267r.



Table 3.

Options to Reduce Costs of Veterans' Compensation

Billions of Dollars

	Decrease (-) in the Deficit Over 10 Years
Means-Test VA Disability Compensation for Veterans With Higher Income ^a	-253
Include VA's Disability Payments in Taxable Income ^b	-161
Narrow Eligibility for VA's Disability Compensation by Excluding Veterans With Low Disability Ratings ^c	-7 to -48
End VA's Individual Unemployability Payments to Disabled Veterans at the Full Retirement Age for Social Security ^d	-9 to -47
Reduce VA's Disability Benefits for Veterans Who Are Older Than the Full Retirement Age for Social Security ^e	-15

Data source: Congressional Budget Office.

The estimates in this table are for the 2023–2032 period. The baseline budget projections against which future proposals would be measured have changed. Thus, future estimates of the budgetary effects of these options would differ from the estimates presented here.

VA = Department of Veterans Affairs.

- a. The estimate was developed in relation to CBO's spring 2022 baseline budget projections. For details, see www.cbo.gov/budget-options/58631.
- b. The estimate was prepared by the staff of the Joint Committee on Taxation. For details, see www.cbo.gov/budget-options/58695.
- c. The estimate was developed in relation to CBO's spring 2022 baseline budget projections. For details, see www.cbo.gov/budget-options/58655.
- d. The estimate was developed in relation to CBO's spring 2022 baseline budget projections. For details, see www.cbo.gov/budget-options/58653.
- e. The estimate was developed in relation to CBO's spring 2022 baseline budget projections. For details, see www.cbo.gov/budget-options/58654.

about \$95 billion.¹⁰ DoD acknowledges that its estimates do not include all data on funding for service contracts, but the amount of funding omitted appears to be large: In its object class analysis published annually with the President's budget, the Office of Management and Budget (OMB) has indicated that the funding obligated by DoD for service contracts in 2022 was roughly \$274 billion.¹¹

Implications for Workforce Management

The lack of accurate data about service contractors has practical implications for DoD's ability to manage its workforce. For example, to control costs or realize savings, DoD might seek to reduce the labor costs associated with lower-priority missions by moving military personnel to other missions, replacing those personnel with lower-cost civilian personnel, or eliminating some positions altogether.¹² DoD could also opt to fill the

positions with service contractors, but the resulting costs or savings may not be apparent in the absence of complete data. Providing transparency about its service contractors would help DoD make decisions with more complete information. Transparency would also help ensure that costs were not simply shifted from military and civilian personnel to service contractors and that costs of personnel changes were more easily tracked.

Implications for the Information That CBO Provides to the Congress

Compensation of DoD's service contractors is an active area of research at CBO and other Congressional support agencies, but such analysis is limited by shortcomings in the relevant data.¹³ Moreover, those shortcomings diminish CBO's ability to project the costs of DoD's plans. For example, in CBO's annual projections of the 15-year costs of those plans, one of the most important elements is funding in the operation and maintenance account. Indeed, O&M funding is the largest single component of DoD's budget and accounts for most of the projected growth in that budget.

In previous years, CBO included compensation for service contractors funded under O&M in the category

10. Department of Defense, Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer, *Defense Operation and Maintenance Overview Book* (May 2023), p. 160, <https://tinyurl.com/3m4sctm6>.

11. Office of Management and Budget, *Budget of the U.S. Government, Fiscal Year 2024: Object Class Analysis* (March 2023), p. 9, <https://tinyurl.com/yzkyjt8c>. That total reflects amounts for object classes 25.1 through 25.8.

12. Congressional Budget Office, *Replacing Military Personnel in Support Positions With Civilian Employees* (December 2015), www.cbo.gov/publication/51012.

13. Heidi M. Peters, *Defense Primer: Department of Defense Contractors*, Report IF10600, version 12 (Congressional Research Service, January 17, 2023), p. 1, <https://tinyurl.com/kbkfypnv>.

Table 4.

Options to Reduce Federal Costs of Veterans' Health Care

Billions of Dollars

	Change in Spending Over 10 Years	
	Discretionary Outlays	Mandatory Outlays
End Enrollment in VA Medical Care for Veterans in Priority Groups 7 and 8 ^a	-121	40
Increase Prescription Drug Copayments for All Veterans ^b	-27.4	0

Data source: Congressional Budget Office.

The estimates in this table are for the 2023–2032 period and were developed in relation to CBO's spring 2022 baseline budget projections. The baseline projections against which future proposals would be measured have changed. Thus, future estimates of the budgetary effects of these options would differ from the estimates presented here.

VA = Department of Veterans Affairs.

a. For details about this option, see www.cbo.gov/budget-options/58671.

b. For details about this option, see www.cbo.gov/budget-options/58670.

“Other O&M” (along with miscellaneous activities), which the agency has projected to grow according to historical trends. To better understand the different sources of growth in DoD's O&M budget, CBO began in 2023 to include a separate analysis of compensation for service contractors in its projections of DoD's funding.¹⁴

Using the limited data available in DoD's budget documentation for 2023, CBO developed a rough estimate of the amount of contractor compensation in the department's 2023 budget request. CBO used the number of full-time-equivalent contractors reported in the budget documentation for O&M and estimated a rate for their compensation on the basis of pay rates for DoD's civilian employees.¹⁵ Using that method, CBO estimated that proposed funding for contractor compensation under O&M service contracts in 2023 was between \$40 billion and \$50 billion. (The range of that estimate reflects, in part, the uncertainty in the difference between compensation costs for contractors and civilian employees.)¹⁶

Using the midpoint of \$45 billion (which amounts to 15 percent of DoD's total request for O&M funding in

2023) to illustrate the scale of the change, CBO estimates that moving contractor compensation into its own category would reduce the size of the Other O&M funding category from 59 percent to 44 percent of total O&M funding. Making that change would also allow CBO to project those two budgetary components separately. However, CBO's estimate is limited by the data on service contractors identified in DoD's budget documents, which the department acknowledges are incomplete. CBO's estimate therefore probably understates the size of DoD's service contractor workforce—and it may significantly understate it if OMB's estimates of the size of DoD's budget authority spent on service contracts are correct.

Making the Cost of Compensation for DoD's Service Contractors Transparent

Making information about DoD's workforce of service contractors transparent would help the department's leaders make and enforce management decisions, allowing them to track changes in the composition of the workforce. Such transparency would also improve the Congress's understanding of DoD's total workforce.

Currently, personnel data that DoD reports in the Future Years Defense Program (FYDP) do not include the number of full-time-equivalent contractor positions, identified by program. DoD's documentation also lacks a breakdown of the costs of service contracts into categories of compensation and noncompensation.

14. For a detailed description of that analysis, see Congressional Budget Office, *Long-Term Implications of the 2023 Future Years Defense Program* (January 2023), p. 12, www.cbo.gov/publication/58579.

15. Data are aggregated from the fiscal year 2023 O&M justification books for the military services and defensewide organizations.

16. Congressional Budget Office, *Long-Term Implications of the 2023 Future Years Defense Program* (January 2023), p. 12, www.cbo.gov/publication/58579.



Thus, DoD could immediately improve the data it supplies to the Congress by:

- Reporting, in the FYDP manpower database, the number of service contractors that the department employs, in the same way the number of civilian personnel is reported there, and by
- Creating budget displays for data on service contractors in the O&M overview book similar to the displays (called the Civilian OP-8 displays) the department uses to present data on its civilian workforce. The displays could provide the same metrics that are currently provided for civilian personnel, as well as the aggregate size and average cost of service contracts, including the labor and nonlabor components of those contracts.

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