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The Honorable Richard J. Durbin  
Ranking Member  
Subcommittee on Oversight of Government Management, the  
Federal Workforce, and the District of Columbia  
Committee on Governmental Affairs  
United States Senate

Subject: *Military Personnel: Bankruptcy Filings among Active Duty Service Members*

A declaration of bankruptcy is an extreme example of the failure to manage personal finances. Debtors who file personal bankruptcy petitions usually file under chapter 7 or chapter 13 of the bankruptcy code.<sup>1</sup> Generally, debtors who file under chapter 7 of the bankruptcy code seek a discharge of all their eligible dischargeable debts.<sup>2</sup> Debtors who file under chapter 13 submit a repayment plan, which must be confirmed by the bankruptcy court, for paying all or a portion of their debts over a 3-year period unless, for cause, the court approves a longer period not to exceed 5 years.<sup>3</sup>

This letter responds to your December 16, 2003, request. As agreed with your office, we determined (1) the rate of personal bankruptcy filings among active duty military personnel, and how that rate compared with the rate found in the U.S. population; and (2) factors that should be considered when attempting to compare the rate of bankruptcy filings for active duty military personnel with the rate for the U.S. population.<sup>4</sup>

To respond to this request, we obtained information on the rate of bankruptcies among active duty military personnel from a 1999 Department of Defense (DOD) survey. The survey population included service members from the active duty services and reservists serving on active duty assignments for at least 6 months. We also discussed bankruptcy and compensation with officials in the Office of the Under

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<sup>1</sup> Title 11, United States Code.

<sup>2</sup> Eligible debts may be discharged in bankruptcy proceedings. A dischargeable debt is a debt for which the bankruptcy code allows the debtor's personal liability to be eliminated.

<sup>3</sup> See U.S. General Accounting Office, *Personnel Bankruptcy: The Credit Research Center Report on Debtors' Ability to Pay*, GAO/GGD-98-47 (Washington, D.C.: Feb. 9, 1998).

<sup>4</sup> For information on reservists and income changes, see U.S. General Accounting Office, *Military Personnel: DOD Needs More Data to Address Financial and Health Care Issues Affecting Reservists*, GAO-03-1004 (Washington, D.C.: Sept. 10, 2003).

Secretary of Defense for Personnel and Readiness. We used data on bankruptcy filings for the U.S. population from the Administrative Office of the U.S. Courts. We also used findings from GAO; Congressional Budget Office; Congressional Research Service; and Department of Labor, Bureau of Labor Statistics reports on compensation, military housing allowances, other benefits, and unemployment. We conducted our review from January to February 2004, in accordance with generally accepted government auditing standards.

## **Results in Brief**

DOD had limited data on the rate of bankruptcies among active duty military personnel. Responses to DOD's 1999 active duty survey—the most current data available—show that 1.2 percent, or about 16,000, of the 1.3 million active duty members in the survey population said that they had declared personal bankruptcy during the 12 months preceding the survey. This compares with a total of approximately 1.3 million personal bankruptcies filed in the United States in 1999. From 1999 through 2003, the number of personal bankruptcies increased from approximately 1.3 million to over 1.6 million for the U.S. population.

The 23.6 percent increase in personal bankruptcy filings for the U.S. population may not readily translate into a comparable rate of increase for active duty military personnel. Loss of employment and medical-related problems (e.g., medical costs and loss of income during illness or accident) are among the major causes that contribute to personal bankruptcies in the U.S. population, but unemployment and catastrophic medical expenses are factors not confronted by active duty military personnel. In addition, Congress has authorized increased cash compensation—increases in basic pay, housing allowance, and special pays—for active duty military personnel since 1999. For example, average annual military basic pay increases have exceeded average private-sector wage increases for fiscal years 2000 through 2004. DOD has also identified a need to improve the financial literacy and responsibility of military members. And in May 2003, DOD formally launched a financial readiness campaign to address military members' poor financial habits and increase financial management awareness, savings, and protection against predatory practices.

## **Limited Data Available on Personal Bankruptcies among Active Duty Military Personnel**

DOD had limited data on the rate of personal bankruptcies among active duty military personnel. DOD officials indicated that their most recent data on bankruptcies among active duty military personnel (which included reservists on active duty assignments for at least 6 months) were gathered from September through December 1999 as part of a DOD-wide survey.<sup>5</sup> For the survey population, 1.2 percent of the active duty military members said that they (and spouse, if applicable) “went bankrupt (declared personal bankruptcy)” in the 12 months prior to completing the survey. The 1.2 percent rate of personal bankruptcy projected to the 1.3 million military personnel included in the survey population translates into approximately

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<sup>5</sup> Defense Manpower Data Center, *Tabulations of Responses from the 1999 Survey of Active Duty Personnel: Volume 2: Programs and Services, Family, Economic Issues, and Background*, DMDC Report No. 2000-006 (Arlington, Va.: September 2000).

16,000 personnel on active duty declaring personal bankruptcy during the 12 months preceding the survey. The survey included neither follow-up items to determine the events that precipitated the bankruptcy nor did it include a breakout of the percentage of reservists serving on active duty assignments for at least 6 months compared with full-time active duty personnel declaring bankruptcy.

In 1999, the total number of personal bankruptcies filed in the United States was 1.3 million.<sup>6</sup> We did not calculate a per capita rate because we could not determine the number of individuals versus households filing for personal bankruptcy. Although trend data from 1999 through 2003 are not available for military personnel, the total number of personal bankruptcy filings in the United States increased by 23.6 percent to 1.6 million from 1999 through 2003.

### **Changes in Bankruptcy Rate for U.S. Population May Not Be Indicative of Changes for Military Personnel**

Changes in the rate of bankruptcy filings for the U.S. population may not readily translate into comparable rate changes for active duty military personnel. Among the factors that suggest caution in generalizing the 23.6 percent increase found in the U.S. population to the active duty military personnel population are changes in civilian unemployment rates and military cash compensation. Also, DOD has reported that it has placed additional emphasis on financial counseling since the 1999 survey data were gathered.

### **Unemployment and Catastrophic Medical Expenses Not Factors for Active Duty Military Personnel**

The 23.6 percent increase in personal bankruptcy filings for the U.S. population may not result in a similar increase in bankruptcies for active duty military personnel because (1) an increase in civilian unemployment for fiscal years 1999 through 2003 was not a factor for active duty military personnel and (2) all active duty military personnel and their families have medical coverage. Unemployment and medical expenses have been shown to be related to bankruptcy filing.

The relationship between filing for bankruptcy and unemployment is illustrated by the findings from one study in which over two-thirds of the individuals filing for bankruptcy had job-related financial stress, with layoffs being identified as a major factor.<sup>7</sup> For each of the fiscal years from 1999 through 2003, an increase or a decrease in the total number of U.S. personal bankruptcy filings was accompanied by an increase or a decrease in the unemployment rate for the same fiscal year (see table 1). In contrast to the changing unemployment picture for civilians, active duty

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<sup>6</sup> Administrative Office of the U.S. Courts, *Personal Bankruptcy Filings Continue to Rise in Fiscal Year 2003* (Washington, D.C.: Nov. 14, 2003).

<sup>7</sup> See Teresa A. Sullivan, Elizabeth Warren, and Jay Lawrence Westbrook, *The Fragile Middle Class: Americans in Debt* (New Haven, Conn.: Yale University Press, 2000). The authors noted that job-related financial stress was implicated in over two-thirds of the more than 2,400 bankruptcy filings they examined. They also noted that while layoffs were a major factor in the decision to file for bankruptcy, other serious job-related trouble could result even if workers had a job, because the job may change and both income and benefits may erode.

military members—by definition—were employed for each of the 5 years, in the sense that each military member received a regular salary while on active duty.<sup>8</sup>

**Table 1: Changes in Bankruptcy Filings and Overall Unemployment in the U.S. Population for Fiscal Years 1999–2003**

Fiscal year	Personal bankruptcy		Overall unemployment	
	Number of bankruptcy filings	Percent change from fiscal year 1999	Unemployment rate on September 30	Percent change from fiscal year 1999
2003	1,625,813	23.6	6.0	39.5
2002	1,508,578	14.7	5.7	32.6
2001	1,398,864	6.3	4.3	0.0
2000	1,226,037	-6.8	4.0	-7.0
1999	1,315,751		4.3	

Sources: Administrative Office of the U.S. Courts for number of bankruptcy filings; GAO's analysis of court data for the percent change in bankruptcies; and GAO's analysis of unemployment rates from the U.S. Department of Labor, Bureau of Labor Statistics.

DOD provides employee benefits that include health coverage to more than 1.3 million active duty service members and their nearly 2 million spouses and other dependents. The health care for active duty service members and their dependents costs the federal government about \$9 billion per year. For active duty service members, this benefit offers care in military treatment facilities and does not require enrollment fees or co-payments for care or drugs obtained from military treatment facilities.<sup>9</sup> In addition, legislation in 2000 eliminated co-payments for the families of many active duty military personnel. Medical coverage for all DOD active duty personnel and dependents is unlike the coverage for the population in a study that found approximately one household in five citing medical-related problems (e.g., medical costs and loss of income during illness or accident) as a reason for filing bankruptcy.<sup>10</sup> Given that health coverage can be a benefit offered as part of employment compensation, a higher unemployment rate may indicate that more of the U.S. population was placed at risk for medical expenses.

### Increases in Cash Compensation for Military Personnel Greater Than Those for Average Civilians

The Congressional Budget Office noted that cash compensation for military personnel consists of basic pay, allowances for things like housing and food, special pays and bonuses, and the tax advantages that military members receive because some allowances are not subject to federal income tax.<sup>11</sup> During the period from 2000 through 2004, Congress authorized increases in the pays and allowances to active duty military personnel.

<sup>8</sup> Active duty military families may, however, be influenced by civilian unemployment trends if spouses of military personnel become unemployed.

<sup>9</sup> If military treatment facilities are not available or if service member families choose to use civilian doctors or medical facilities, two other health care programs provide service member families with extensive coverage for medical costs, including a \$1,000 annual catastrophic cost cap.

<sup>10</sup> See Sullivan et al., *The Fragile Middle Class: Americans in Debt*.

<sup>11</sup> Congressional Budget Office, *Military Compensation: Balancing Cash and Noncash Benefits* (Washington, D.C.: Jan. 16, 2004).

## Military Pay Increases Exceed Civilian Wage Increases

For fiscal years 2000 through 2004, Congress provided average raises in military basic pay that exceeded the average wage increases found for all private-sector employees (see table 2).<sup>12</sup> For example, in fiscal year 2002, raises for active duty personnel increased 0.4 to 5.4 percentage points more than did the raises of the average private-sector worker, and in fiscal years 2003 and 2004, the military averaged 0.7 and 0.45 percentage points more in their raises, respectively, than did those working in the private sector. For fiscal year 2005, DOD’s budget request includes a 3.5 percent increase in basic pay, which matches the raise determined by the statutory formula. Thus, military basic pay raises have been greater than the raises in wages for the average private-sector employee for the 5 years since the 1999 data on bankruptcies among active duty military were gathered.

**Table 2: Changes in Military Basic Pay for Fiscal Years 2000–2005**

Fiscal year	Annual percent increase in active duty military pay	
	Percent indicated by statutory formula	Percent actually provided
2005	3.5	3.5 requested
2004	3.7	4.15 average, with a range of 3.7 to 6.25
2003	4.1	4.8 average, with a range of 4.1 to 6.5
2002	4.6	6.9 average, with a range of 5.0 to 10.0
2001	3.7	4.1 average, with an initial 3.7 across the board, plus a later targeted raise that averaged 0.4
2000	4.8	6.2 average, with an initial 4.8 across the board, plus a later targeted raise that averaged 1.4

Sources: Congressional Research Service and DOD.

Note: The Congressional Research Service noted that targeted and variable increases were typically keyed to pay grade groups. In fiscal years 2000 and 2001, Congress authorized additional targeted increases and they became effective on July 1 of those respective years, whereas the other raises took effect earlier in the fiscal years.

### Smaller Out-of-Pocket Housing Expenses for Active Duty Military Members

Out-of-pocket housing expenses for active duty military members living in private-sector housing have decreased during the period since 1999. In fiscal year 2000, housing allowances did not cover about 19 percent of the typical active duty military member’s housing and utility costs.<sup>13</sup> For fiscal year 2002, DOD plans called for increasing this allowance so that the out-of-pocket costs for obtaining private-sector

<sup>12</sup> See Congressional Research Service, The Library of Congress, *Military Pay and Benefits: Key Questions and Answers*, Order Code IB10089 (Washington, D.C.: Jan. 15, 2004). That report noted that upward adjustments to military basic pay are linked—but not identical—to the raises calculated with the statutory formula for determining pay increases for federal General Schedule employees. 37 U.S.C. section 1009 requires the President to increase military basic pay to match any annual pay increase for federal General Service employees as mandated by the statutory formula specified in 5 U.S.C. section 5303(a). This statutory formula is based on the Employment Cost Index, which is calculated by the Department of Labor's Bureau of Statistics and measures annual percentage increases in wages for all private-sector employees.

<sup>13</sup> About two-thirds of the married and one-third of the single military members in the United States live in private housing in the communities surrounding military installations. They receive a cash housing allowance to help defray the cost of renting or purchasing a home and the cost of utilities. The remaining military families live in government-owned or privatized housing. These latter families pay no out-of-pocket expenses for housing or utilities. Families in government housing receive no housing allowance, while families in privatized housing use their housing allowance to pay rent and normal utility costs.

housing would decrease to 8 percent in 2003 and 4 percent in 2004.<sup>14</sup> The 2005 budget request for DOD seeks to totally eliminate out-of-pocket expenses for housing for the average active duty military member.

The decreases in out-of-pocket expenses are equivalent to increases in total compensation. This point can be illustrated using the \$910 per month that DOD identified as the January 2003 national median cost of obtaining civilian equivalent housing for the most junior level of enlisted military personnel (i.e., E1-E4) with dependents. The median monthly out-of-pocket expense in 2003 was \$68 (or 7.5 percent), but it would have been about \$173 (19 percent) had the out-of-pocket percentage remained at the fiscal year 2000 level. This difference of \$105 per month translates into \$1,260 per year being available for other needs, and the yearly housing allowance of \$10,104 would have been tax exempt.

The intent of the basic allowance for housing program is to provide active duty service members with accurate and equitable housing compensation when on-base or other government housing is not provided.<sup>15</sup> The legislation establishing the program required that rates be based on the cost of adequate housing for civilians with comparable incomes, and that the rates vary by a member's rank or pay grade; by dependency status—that is, either having or not having dependents; and by geographic location.<sup>16</sup>

#### Special Pays and Tax Treatment for Deployed Active Duty Military Personnel Enhanced

Relative to their peers who deployed in 1999 when the bankruptcy data for military personnel were gathered, more recently deployed active duty military personnel may be eligible to receive higher special pays.<sup>17</sup> Since April 2003, Congress has temporarily increased the family separation allowance<sup>18</sup> by 150 percent and imminent danger pay by 50 percent (see table 3). The April 2003 increases in these special pays would result in deployed active duty personnel's having relatively higher cash incomes today than would their peers who were deployed during the 12 months prior to the 1999 active duty survey.

**Table 3: Changes in Two Special Pays for Deployed Active Duty Military Personnel—Before and After April 2003**

Special pay	Monthly pay before and after April 2003		
	Before	After	Percent increase
Family separation allowance	\$100	\$250	150
Imminent danger pay	\$150	225	50

Source: GAO.

<sup>14</sup> See U.S. General Accounting Office, *Military Housing: Management Improvements Needed as the Pace of Privatization Quickens*, GAO-02-624 (Washington, D.C.: June 21, 2003).

<sup>15</sup> See U.S. General Accounting Office, *DOD Personnel: Improvements Made to Housing Allowance Rate Setting Process*, GAO-01-508 (Washington, D.C.: Apr. 16, 2001).

<sup>16</sup> See 37 U.S.C. 403.

<sup>17</sup> Public Law 108-11, section 1316 (Apr. 16, 2003) and Public Law 108-136, sections 606, 619 (Nov. 24, 2003).

<sup>18</sup> Military families may incur additional expenses such as an increased need for childcare when active duty military members are separated from their families during deployments.

Some or all of the income that active duty military personnel earn while serving in combat zones is also tax-free.<sup>19</sup> The military pay, up to prescribed amounts, received while in these combat zones is excluded from gross income and is not subject to federal income tax.

Other special pays may be tax-free as the result of service in a combat zone. For example, service members who reenlist while serving in a combat zone are typically eligible to receive any applicable selective reenlistment bonus tax-free. For fiscal years 1999 through 2003, DOD's budget for that program grew from \$418 million to an estimated \$734 million, a 76 percent increase.<sup>20</sup>

### DOD Efforts Under Way to Improve Financial Literacy and Responsibility of Military Members

We recently reported that DOD identified a need to improve the financial literacy and responsibility of military members in its July 2002 human capital strategic plan.<sup>21,22</sup> As part of DOD's balanced scorecard, the Under Secretary of Defense for Personnel and Readiness reviews issues affecting force management risk. One of the indicators used in the review is personal finances, which is evaluated in terms of the self-reported financial condition of junior enlisted personnel (E1-E4) and their self-reported ability to pay bills on time. Data to support these evaluations are supplied on an annual basis through Defense Manpower and Data Center surveys of active duty service members. Among other things, DOD is reviewing a draft personal financial management policy that seeks to establish a uniform approach to educating and training all military service members.

In May 2003, DOD formally launched a "financial readiness campaign" to address military service members' poor financial habits and to increase financial management awareness, savings, and protection against predatory practices. DOD has also entered into a number of partnerships with nonprofit organizations and government agencies that have agreed to support counselors who offer financial assistance programs to military service members. The services have also made improvements. For example, the Navy has raised its mandatory number of personal financial management training hours, and it is using mobile financial management teams to train financial specialists, including those in geographically remote regions where

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<sup>19</sup> Department of the Treasury, Internal Revenue Service, *Armed Forces' Tax Guide: For Use in Preparing 2003 Returns*, Publication 3, Cat. No. 46072M. This publication noted that all military pay for the month is excluded from income when an enlisted service member, warrant officer, or commissioned warrant officer served in a combat zone during any part of a month or while hospitalized as a result of service in the combat zone. The amount of the exclusion for a commissioned officer (other than a commissioned warrant officer) is limited to the highest rate of enlisted pay, plus imminent danger/hostile fire pay, for each month during any part of which an officer served in a combat zone or while hospitalized as a result of service there.

<sup>20</sup> See U.S. General Accounting Office, *Military Personnel: DOD Needs More Effective Controls to Better Assess the Progress of the Selective Reenlistment Bonus Program*, GAO-04-86 (Washington, D.C.: Nov. 13, 2003).

<sup>21</sup> See GAO-03-1004.

<sup>22</sup> Department of Defense, Deputy Assistant Secretary of Defense (Military Community and Family Policy), *A New Social Compact: A Reciprocal Partnership between the Department of Defense Service Members, and Families* (July 2002).

there are no financial educators to provide training. The services also provide financial planning information on their Web sites.

### **Agency Comments**

DOD did not provide formal agency comments. Program officials from the Office of the Under Secretary of Defense for Personnel and Readiness and the military services did, however, review a draft of this report and provided technical comments, which we incorporated as appropriate.

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As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 14 days from its issue date. At that time, we will send copies of this report to the Secretary of Defense. We will also make copies available to appropriate congressional committees and to other interested parties on request. In addition, the report will be available at no charge at the GAO Web site at <http://www.gao.gov>.

If you or your staff have questions about this report, please call me at (202) 512-5559 ([stewartd@gao.gov](mailto:stewartd@gao.gov)) or Jack Edwards at (202) 512-8246 ([edwardsj@gao.gov](mailto:edwardsj@gao.gov)).

Sincerely yours,



Derek B. Stewart  
Director, Defense Capabilities and Management

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