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Report to Sen. Warren G. Magnuson, Acting Chairman, Senate ~~Committee on Appropriations~~; by Elmer B. Staats, Comptroller General.

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The Army and the Air Force employ over 67,000 German nationals at an annual cost of over \$670 million. The Department of Defense's (DOD's) employment system in Germany is based on multilateral and bilateral agreements and years of precedent and tradition. Although its personnel policies there generally appear in line with prevailing private practices, some aspects of compensation setting and administration should be changed. Recommendations: The Secretary of Defense should: periodically survey wages in the German private sector in order to strengthen the U.S. position in negotiations; periodically survey private sector practices to determine how private industry is reducing over-tariff supplements and adjust DOD's reductions accordingly; examine, with the German Government, labor cost sharing opportunities, such as guaranteeing a minimum exchange rate in billing payrolls; explore methods to increase American hires by assuring that ceilings placed on American hires do not reduce present employment levels, determining the impact on DOD's payroll costs and employment flexibility of a German proposal that provides certain dependents and other Americans with the same compensation as German nationals, and having the Air Force adopt the Army's dependent hiring policy of giving priority to dependents in filling vacant German national positions; and initiate a realistic assessment of the estimated severance liability for both appropriated and nonappropriated fund activities in Germany. (Author/SC)

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*REPORT TO THE
SENATE COMMITTEE
ON APPROPRIATIONS
BY THE COMPTROLLER GENERAL
OF THE UNITED STATES*

**Department Of Defense
Pay Practices For German
Nationals Should Be Changed**

This report on foreign national employment practices in West Germany is GAO' third in a series on five countries. It addresses the high cost of compensation benefits and separation allowances, possible substitutes for German nationals, and barriers limiting U.S. control over wage increases.

The Army and Air Force employ over 67,000 German nationals at an annual cost of over \$670 million. The Department of Defense's employment system in Germany is based on multilateral and bilateral agreements and years of precedent and tradition. Although its personnel policies there generally appear in line with prevailing private practices, some aspects of compensation setting and administration should be changed.

GAO recommends that the Secretary of Defense conduct periodic wage surveys in Germany, reassess severance liabilities, examine labor cost sharing opportunities with the German Government, and explore ways of hiring more Americans.



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-179343

The Honorable Warren G. Magnuson
Acting Chairman, Committee on Appropriations
United States Senate

Dear Mr. Acting Chairman:

In response to your request of April 29, 1977, we are reviewing the compensation and use overseas of foreign national employees by the Department of Defense, including the possibility of using alternative labor sources that might be less costly to the Government.

We are recommending to the Secretary of Defense changes which would reduce local employee payroll costs and/or provide tighter control over such costs in West Germany.

As requested by your office, we did not obtain formal comments from the Department of Defense; however, we discussed the results of our work with Army and Air Force officials in Germany and considered their comments. As agreed with your office, we are sending copies of the report to the Department of Defense. Copies will also be available to other interested parties who request them.

Sincerely yours,

A handwritten signature in black ink, appearing to read "James A. Heath".

Comptroller General
of the United States

IMPROVEMENTS NEEDED IN FOREIGN NATIONAL
COMPENSATION PRACTICES IN GERMANY

BACKGROUND

Section 444 of the Foreign Service Act, as amended, provides that compensation for foreign national employees will be based on locally prevailing wage rates that are consistent with the public interest.

In Germany an indirect hire system is used as established by the NATO Status of Forces Agreement of 1951 and later clarified in a 1959 Supplementary Agreement. Although the U.S. Government is the actual employer of the German nationals, these employees are nevertheless considered indirect hires because of the German Government's role in setting wages and conditions of employment. Detailed employment practices are set out in the Collective Tariff Agreement of 1966 between the unions and the German Government on behalf of NATO countries having military forces stationed in Germany--the United States, United Kingdom, France, Belgium, and Canada. In addition, the employees are paid by the German Office of Defense Costs using funds advanced by various Department of Defense (DOD) finance offices. For this service DOD pays an administrative fee equaling 1.25 percent of its total German national payroll, or about \$8.4 million in 1977.

Pay and benefits under the tariff agreement are renegotiated annually by German labor unions and the German Ministry of Finance, the latter acting as a spokesman for the NATO forces. U.S. policy for local personnel matters in Germany is handled by a Civilian Personnel Coordinating Committee consisting of civilian personnel officials from the Army, Air Force, and the Army and Air Force Exchange Service (AAFES)--a nonappropriated fund activity which manages the post exchanges. The Army employs over 80 percent of the German nationals paid with appropriated funds, and U.S. Army-Europe (USAREUR) has been designated the lead agent in dealing with the German Government on local employment matters.

As of April 1977, DOD employed over 67,000 German nationals. This makes it Germany's fourteenth largest employer among industrial corporations and banks. Slightly over 50,000 of the German national employees were paid with appropriated funds estimated at an annual \$550 million. The remainder were paid with nonappropriated funds

totaling an estimated \$120 million. Under a separate agreement, Defense employees in Berlin are paid entirely by the German Government. The table below shows the breakout of German national employees.

<u>Employer</u>	<u>Number</u>		<u>Total</u>
	<u>Appropriated fund</u>	<u>Nonappropriated fund</u>	
Army	44,495	2,744	47,239
Air Force	6,419	367	6,786
AAFES	-	8,914	8,914
Berlin	<u>4,496</u>	<u>98</u>	<u>4,594</u>
Total	<u>55,410</u>	<u>12,123</u>	<u>67,533</u>

German employee payroll costs have increased significantly in the past decade. USAREUR estimated the average annual cost per employee has increased from \$3,000 in 1967 to over \$10,000 in 1977. And, even though the Army's German national strength has been cut by about 20 percent during this period, total German employee payroll costs have more than doubled.

Much of this increased cost can be traced to the decline in the value of the dollar relative to the German mark. Since 1973, not only have negotiated pay increases averaged 7.7 percent annually, but the dollar has declined an average of 5.4 percent a year relative to the mark. Thus, total payroll costs have increased an average of more than 13 percent a year, and DOD is, to a great extent, at the mercy of dollar fluctuations in controlling wage increases.

DOD HAS LIMITED CONTROL OVER PAY INCREASE NEGOTIATIONS

In the German private sector, wage or "tariff" schedules are negotiated annually between the labor unions and the major German industries. Similarly, wage schedules for German nationals are negotiated annually between German labor unions and the German Ministry of Finance which represents the five NATO countries having troops in Germany. The United States, however, despite having an estimated 60 percent of the total NATO employees in Germany, has limited control over this wage setting process. We believe this control should be strengthened.

The United States has no more power or voting rights in developing an overall negotiating position than any other NATO

country. Its input into these negotiations is diluted, first in reaching an agreement with the other NATO countries, and then in providing a position acceptable to the Finance Ministry. Also, the Ministry can and does exert considerable influence in reaching a final settlement with employee unions. Because of this limited input and particularly in view of the high payroll cost associated with a final settlement--a 1-percent increase means additional payroll costs of over \$6 million a year--it is essential that any U.S. input be based on a sound, independent assessment of German private sector wages.

At the time of our review, the United States had not conducted an overall wage survey in Germany since 1974. Army officials indicated such surveys would carry little weight in the negotiations because the unions press for tariff increases reported by the media and the German Government. Recently, DOD has tended to rely on tariff increases published by the news media in preparing for annual negotiations. Despite DOD's inability to directly control wage increases, final settlements in recent years were well below the unions' original demands and, according to USAREUR officials, were close to the average increases granted by German private industry.

We believe that periodic assessments of wages in Germany should add credibility to and thus strengthen the U.S. position in future negotiations. In late October USAREUR began such a wage survey in Germany. This survey is expected to be completed about mid-January.

REDUCTIONS IN OVER-TARIFF SUPPLEMENTS SHOULD BE BASED ON PREVAILING PRACTICES

Employers in Germany may pay more than the negotiated tariff rates for many skilled positions, especially in the blue-collar trades, such as plumbers and carpenters. These higher rates--termed over-tariff supplements--are used to establish or maintain pay rates that are reasonably competitive with rates paid locally for comparable work. They are intended to resolve recruitment and retention problems in times of full employment and to continue until employers decide that economic conditions no longer justify them.

In the early 1970s, virtually all DOD blue-collar German employees were paid supplements. With higher unemployment in Germany since 1975, however, private industry has been reducing the supplements. Defense has also begun such reductions and has saved an estimated \$5.6 million in

the last 2 years. Further reductions in the supplements will be made this year. USAREUR now estimates that 75 percent of its wage earners receive supplements totaling about \$9.3 million annually. About one-half of the Air Force wage earners are paid supplements costing about \$616,000 annually. We were also told that most new employees do not receive supplements unless they are justified by a separate survey.

The amount of DOD's supplement cuts was apparently set without supporting data. An Army official stated that Defense had not surveyed the rate or extent of the reductions in the private sector. DOD does not want to eliminate the supplements immediately because resultant pay cuts might result in labor problems. Instead, reductions are now linked with annual tariff increases, whereby the decrease in the supplement offsets part of the tariff increases, resulting in lower tariff increases for the affected employees. Air Force officials favor a more rapid reduction but are acceding to USAREUR's request for a more gradual reduction. Local personnel officers were unsure about what the effects of more rapid reductions might be.

We believe that periodic surveys of private economy practices are needed to determine how private industry is reducing supplements. This is especially important now, in view of Germany's current employment situation and the potential savings to be derived if prevailing practice supports a faster reduction in the supplements. The recent wage survey initiated by USAREUR will consider overtariff supplements, and survey teams will try to determine how private industry is handling the reduction.

DEFENSE SHOULD SEEK GERMAN ASSISTANCE IN REDUCING PAYROLL COSTS

In a June 15, 1977, report 1/ discussing the high cost of the DOD presence in Japan, we recommended that the State Department and DOD examine, among other things, labor cost sharing opportunities with the Government of Japan and discussions between the two governments are currently underway to examine possible alternatives. We believe similar opportunities exist for labor cost sharing in Germany.

1/"The United States and Japan Should Seek a More Equitable Defense Cost Sharing Arrangement," ID-77-8.

The need for cost reductions in Europe has been recognized by the Congress. The 1974 Defense Appropriation Authorization Act required the President to seek substantial reduction of the amounts the United States pays in budgetary costs as a result of stationing U.S. Forces in Europe. Specifically included as an example, among other items, were wages paid to foreign nationals by the United States. In our April 28, 1976, report 1/ to the Congress, we took the position that this provision of the law had not been met.

The German Government has expressed considerable interest in maintaining the high level of German national employment but has not offered to share or help stabilize the cost of that employment. Part of the cost is due to the decline of the dollar relative to the German mark.

DOD's German employees are paid by the German Office of Defense Costs, and local DOD finance offices are billed monthly for the estimated payroll. Payments are made in German marks at the then prevailing exchange rate. DOD, which prepares its budgets in dollars at the beginning of each fiscal year, is faced with the problem of predicting payroll costs that may vary from month to month depending on the exchange rate. For example, in February 1977 the German national payroll was about 115 million marks, or about \$47.9 million. By July 1977, using the then prevailing exchange rate, the same payroll of 115 million marks would be equal to \$50.4 million--a \$2.5 million increase. When the dollar's value drops relative to the mark, as it has in 1977, DOD must either obtain supplemental funds or lay off employees to stay within its budget.

Because it is in DOD's interest to stabilize costs and in Germany's interest to stabilize employment, we believe that the State Department and DOD should examine, with the German Government, labor cost sharing opportunities, such as guaranteeing a minimum exchange rate in billing these payrolls. Any payroll costs incurred because the exchange rate fell below the guaranteed minimum rate would be borne by the German Government.

USE OF LOCALLY HIRED AMERICANS IN CLERICAL JOBS SAVES PAYROLL COSTS

The Army and Air Force survey their manpower requirements and determine those positions that can best be filled

1/"Additional Costs of Stationing U.S. Forces in Europe," ID-76-32.

by German nationals. Many positions are reserved for career U.S. civilian employees because of managerial, technical, or security clearance requirements. The remainder--generally blue-collar and lower graded clerical and middle manager positions--are designated as foreign national positions and have traditionally been filled by locally recruited Germans or third country nationals. A number of these positions, however, are filled by dependents of DOD employees stationed in Germany.

The following table shows the approximate number of U.S. Forces dependent hires in Germany.

	<u>Number of dependent hires (note a)</u>		
	<u>U.S.</u> <u>positions</u>	<u>Foreign</u> <u>national positions</u>	<u>Total</u>
Army:			
Appropriated	3,800	5,800	9,600
Nonappropriated	200	2,000	2,200
Air Force:			
Appropriated	600	100	700
Nonappropriated	300	700	1,000
AAFES	-	6,600	6,600
Total	<u>4,900</u>	<u>15,200</u>	<u>20,100</u>

a/Includes full-time and part-time personnel as of March-April 1977.

On a grade-by-grade basis, American white-collar workers below U.S. Civil Service General Schedule (GS) grade 9 are less costly than German employees in comparable positions. Under DOD's dependent hire program, the Army in Germany has hired many dependents at these levels at considerable savings over both Germans and career U.S. civil service employees. For example, dependents do not receive change-of-station benefits, area differentials, or quarters allowances, and are generally not eligible for civil service retirement.

Although German national base pay rates are lower, employer contributions for benefits and allowances cost an additional 31 percent, in contrast with only 6 to 7 percent for locally hired Americans. The table below breaks out annual employer costs for a typical clerical worker at grade GS-4, step 1, and a comparable German employee.

<u>Pay category</u>	<u>Locally hired American (note a)</u>	<u>German national (note a)</u>	<u>Savings from American hire</u>
Base pay	\$8,316	\$7,736	\$ (580)
Bonuses	-	644	644
"Property accrual" (note b)	-	133	133
Insurance premiums	601	1,558	957
Service charge	-	126	126
 Total payroll cost	 <u>\$8,917</u>	 <u>\$10,197</u>	 <u>\$1,280</u>

a/Represents wage and exchange rates (2.55 to 1) effective as of June 1977.

b/A German savings program required by law under which employers contribute to an employee's investment program. For most DOD employees, this contribution is 312 marks, or about \$133 per year.

In addition, employing Americans offers other advantages. For example:

- German national employees receive as many as 13 paid holidays per year, compared to 9 for U.S. employees; annual leave for German nationals starts with 21 days a year, compared to 13 days for Americans; and German nationals are entitled to as many as 6 weeks of sick leave per illness, compared to only 13 days a year for an American employee.
- German nationals receive faster longevity step increases in each grade level, advancing to step 4 in about 18 months while an American advances to step 2.
- Part of an American's pay returns to the U.S. Government through income taxes; German nationals pay no taxes to the United States.
- Hiring Americans has much less impact on the international balance of payments because a substantial part of employees' income will be spent in DOD facilities, such as post exchanges and commissaries.

The Army and Air Force (including AAFES) currently employ about 15,000 Americans--either part time or full time in German positions. They face numerous obstacles in expanding the number of locally hired Americans, even though they currently employ another 16,000 German nationals in similar clerical positions. Some positions require German language capability or other special skills which dependents and other locally available U.S. citizens do not generally possess. Moreover, the political and labor relations repercussions of a wholesale shift in hiring practices could be detrimental. Nevertheless, we believe increased hiring of Americans is possible, and Air Force officials have indicated that, in some areas, they have an adequate pool of dependents with the needed skills to fill many of their positions at the GS-8 level and below. USAREUR, however, believes that one of the greatest constraints is a shortage of qualified dependents in the geographic locations when they are needed. Other considerations and constraints in hiring additional Americans in Germany are discussed below.

Civil Service Commission opposition
to the dependent hire program

The dependent hire program, which was approved by the Civil Service Commission in 1972, allows DOD to give hiring preferences to dependents of overseas DOD employees over other available U.S. citizens. Recently the Commission attempted to terminate the program. It feels the program may violate section 106 of Public Law 92-129, which prohibits discrimination in the hiring of U.S. citizens by DOD activities overseas. However, because of opposition raised by DOD, the Commission has extended the authority until such time as the legality of the issue is determined by the Justice Department. As of October 1977, the issue has not been resolved.

According to USAREUR, if the special authority for giving dependents preferences is revoked, the German Government will oppose further hiring of dependents in German positions to prevent DOD from also hiring American tourists and retired military personnel. In the past the German Government has allowed DOD to hire dependents in tacit recognition of the need for a supplemental income for service families stationed in Germany. Without the preferential program, this permission might be withdrawn and DOD might be pressured to hire only German nationals.

German Government seeks to limit dependents in German positions

The German Government has already complained formally about the loss of German jobs caused by the hiring of dependents and other Americans in positions formerly held by Germans. It has demanded a limit on such hires, and in early 1977, USAREUR tentatively agreed to limit the number of Americans in German positions (Army and Air Force appropriated and nonappropriated fund positions) to 11,000--well below the current level of around 15,000. 1/

The USAREUR negotiator told us that the 11,000 "threshold" figure was based on estimates available in early 1977. He pointed out that, if the limit is reached, the agreement would call for meetings to discuss appropriate action--that action could be raising the threshold or cutting the number of dependent hires. As of October 1977, the draft agreement had not yet been finalized. We believe that DOD should assure that the agreement will not reduce the current number of dependents.

If, as a result of the agreement, it becomes necessary to reduce the number of Americans, we believe that DOD should consider decreasing the number of dependents in blue-collar positions in Germany. The Army employs over 1,700 dependents in these positions, most of which were formerly held by Germans. There is presently a large discrepancy between rates paid to Americans in these positions and rates paid to Germans, primarily because the U.S. overseas blue-collar schedules are based on the average of geographic wage areas in the United States. USAREUR estimated that the difference is as much as \$3,000 a year for some positions. If Germans held the 1,700 Army blue-collar positions currently held by Americans, USAREUR would save an estimated \$1,761 per employee annually--a total annual savings of over \$3 million.

An undesirable side effect of the large discrepancy in pay rates is that German nationals complain because American dependents receive substantially more pay for the same work. This leads to morale problems and pressure by German employees to restrict the hiring of Americans.

1/This figure, however, includes 4,000 to 5,000 part-time positions held by Americans which the Germans are not concerned about.

USAREUR is studying an alternative payment method for dependents in local positions

Besides requesting a limit on Americans in German national positions, the German Government also proposed that these Americans be administered under the German wage agreement rather than the U.S. system. Americans so affected would be paid in marks and receive the same wages and benefits as German employees.

USAREUR believes the proposal could have considerable merit. One advantage could be reduced payroll costs. The USAREUR personnel director believes employer and employee contributions totaling 17 percent of compensation earned by German employees would not have to be paid because American employees would already receive such benefits or have no need for them. Examples are health insurance, property accrual bonuses, and unemployment insurance. As a result, USAREUR estimates U.S. Forces in Germany would save about \$6 million in 1977 if dependents were paid under German wage schedules rather than U.S. Federal wage plans. Primary savings would be for blue-collar workers who are already paid more than their German counterparts. (See p. 9.)

Also, the need for dependent preference authority might be eliminated because all Americans in German positions would become indirect hires--hired by the German Government. As such, nondependents would require work permits from the German Government, which under current labor conditions could be difficult to obtain. We were told that dependents would not need permits or would be issued special permits under a prearranged agreement.

Despite the obvious advantages to DOD under such a proposal, the legal and worldwide implications must also be weighed. For example, Americans are currently hired under the authority of the Classification Act of 1949, as amended. While the Department of the Army believes that, as indirect hires, dependents paid under the tariff agreement may not come under the purview of the act, as of October 1977 a final DOD position on the legality of hiring dependents outside the Classification Act had not been reached.

DOD would have to negotiate reciprocal agreements regarding collection of income tax and social security payments and on eliminating current employer contributions to German unemployment, life insurance, and health programs. In addition, dependents would receive greater holiday,

sick leave, and annual leave benefits, and would be represented by German unions and work councils, all of which could affect employee productivity. Army officials believe dependents paid in local currency would continue to spend the same proportion of wages in American exchanges and commissaries; however, the proposal's effect on balance of payments is also a consideration.

Under the proposal, German nationals and those Americans covered under the German wage agreement would receive equal pay for equal work. However, the same wage equality would not exist between Americans covered under the German wage agreement and Americans in U.S. positions who continued to be paid under the U.S. system. This could have an adverse impact on the morale and productivity of dependents in Germany.

We believe that before DOD agrees to the German proposal it should study these implications. The impact on DOD dependents in Germany as well as its possible applicability to employees of other U.S. agencies overseas must be determined.

Air Force and Army dependent hiring practices differ

Army appropriated fund activities employ about 5,800 dependents in German positions, while Air Force appropriated fund activities employ only about 100 dependents. Hiring practices account for the difference. In filling vacant German positions, the Army gives priority to dependents if the position cannot be filled by promoting a German employee. In contrast, the Air Force hires dependents for German positions only if a qualified German national is not available. Air Force officials told us they have many qualified dependents available, but they feel adverse labor reactions would prevent them from adopting the Army's policy. In view of the Army's success in placing dependents in German positions, we believe the Air Force should adopt a similar hiring strategy.

SEVERANCE PAYMENTS LIABILITY NOT HANDLED CONSISTENTLY

The current German national tariff agreement specifies that severance pay will be paid to employees separated by: reductions in force, physical disability, premature retirements, illness contracted while on work, or pregnancy. No payments are made if the employee quits or is fired for cause, starts a new job immediately after termination, or

rejects a job offered to him. The severance entitlement amounts to one-quarter of an employee's latest month's pay for each year of continuous service since 1967. The present maximum entitlement is 2.5 months' pay, and the limit will reach 4 months' pay in 1984. Payments are reduced by the amount of any unemployment or social insurance received by the employee and cease if he begins a new job before he receives his entitlement. Moreover, under an agreement with the German Government, major severance costs incurred because of military movements are paid entirely by the German Government with no cost to the U.S.

The limited circumstances under which severance payments are made make budgeting for severance obligations difficult. Army and Air Force officials could not tell us how much has been paid in severance in recent years, but they believed it was extremely small and was no drain on their personnel budgets. One local civilian personnel office with severe personnel cuts in recent years estimated that only 15 employees received severance pay and the total paid was only 30,000 marks (about \$13,000) from July 1976 to June 1977. Because of the limited liability, Army and Air Force units do not currently accrue and fund their severance pay liability for appropriated funds.

The Army, however, requires its nonappropriated fund activities to accrue severance liabilities for all German national employees and to maintain a cash fund covering at least half the total liability. Some revenue producing nonappropriated fund activities, whose financial condition permit, maintain a 100-percent cash fund, and other activities are encouraged to establish up to a 100-percent fund as financial position permits. The funds estimated their liability at \$12 million, and they are required to maintain cash funds of about \$6 million to cover it. If needed, USAREUR headquarters would use cash from nonappropriated fund alcoholic beverage outlets or construction funds to cover the portion of the liability not covered directly by the activities themselves. This policy is aimed at meeting the "worst-case" scenario of all employees being separated at one time. It appears to result in an overcommitment of cash funds because, as in the case with appropriated fund employees, many employees would not be eligible for severance pay or would be paid entirely by the German Government. Air Force officials told us they have no similar requirements for their nonappropriated fund activities because of the limited severance liability.

USAREUR nonappropriated fund officials were not aware of their limited severance liability and their overcommitment of cash funds. One official estimated that only about half their employees would ever have a chance of being paid severance and that the requirement for the individual funds to maintain \$6 million in cash reserves could probably be eliminated. The money would then be available for morale and recreation activities.

We believe that a realistic determination of the estimated severance liability in Germany is needed for both appropriated and nonappropriated fund activities. Once that is determined, the question of funding the liability can be addressed.

CONCLUSIONS AND RECOMMENDATIONS

The Army and Air Force, including the AAFES, employ over 67,000 German nationals at an annual cost of over \$670 million. An additional 15,000 U.S. citizens, mostly dependents of DOD employees stationed in Germany, are employed in German positions. In general, we believe German nationals are compensated according to prevailing practice. However, we believe DOD could reduce and/or more tightly control its German national payroll costs. We therefore recommend that the Secretary of Defense:

- Periodically survey wages in the German private sector in order to strengthen the U.S. position in negotiations.
- Periodically survey private sector practices to determine how private industry is reducing over-tariff supplements and adjust DOD's reductions accordingly.
- Examine, with the German Government, labor cost sharing opportunities, such as guaranteeing a minimum exchange rate in billing payrolls.
- Explore methods to increase American hires by (1) assuring that ceilings placed on American hires do not reduce present employment levels, (2) determining the impact on DOD's payroll costs and employment flexibility in Germany of a German proposal that provides certain dependents and other Americans with the same compensation as German nationals, and (3) having the Air Force adopt the Army's dependent

hiring policy of giving priority to dependents in filling vacant German national positions.

- Initiate a realistic assessment of the estimated severance liability for both appropriated and non-appropriated fund activities in Germany.