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Department of Defense Pay Practices for Japanese Nationals Should Be Changed. PPCD-78-47; B-179343. May 31, 1978. 1 pp. + appendix (13 pp.).

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

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Authority: Foreign Service Act, as amended.

As of January 1978, U.S. forces in Japan (USFJ) employed about 22,360 Japanese nationals; approximately 19,650 were paid from appropriated funds. Appropriated and nonappropriated fund payroll costs totaled about \$243 million and \$27 million, respectively, in fiscal year 1977. Costs per employee have increased in recent years, and wage costs can be expected to increase further because of the comparative decline in the value of the dollar against the Japanese yen.

Findings/Conclusions: Because of Japan's reluctance to share costs or allow revisions of benefits, Japanese employees are paid well above prevailing local rates. Factors contributing to high payroll costs are the continued use of USFJ differential (a special payment for Japanese employees), language allowances, the computation formula for premium pay, and wage schedules, based on a 44-hour workweek. Severance allowances are also more generous than those in prevailing practice. Hiring Americans locally could be less costly, but constraints to such hiring are staffing ceilings, a pending decision on hiring of dependents, and certain advantages of Japanese personnel. Increasing wages and declining dollar value could lead to further reductions in force and a reduced capability to meet U.S. and Japanese mutual defense objectives. Recommendations: The Secretaries of State and Defense should urge the Government of Japan to eliminate or pay excess compensation costs. The Secretary of Defense should explore ways of hiring more Americans in Japan. (HTW)

0554

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REPORT BY THE

# Comptroller General

OF THE UNITED STATES

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## Department Of Defense Pay Practices For Japanese Nationals Should Be Changed

The Senate Committee on Appropriations asked GAO to review the compensation and use overseas of foreign national employees by the Department of Defense.

U.S. Forces in Japan employ about 22,000 Japanese nationals who are paid above prevailing local rates. Unless corrective action is taken, increasing wages and declining dollar value could well lead to further reductions in force and a reduced capability to meet U.S. and Japanese mutual defense objectives. GAO estimates that the 1977 Department of Defense payroll of \$270 million was about \$263 million in excess and the severance liability of about \$400 million was about \$127.4 million in excess. Since 1977 a wage increase and dollar devaluations have already increased these excesses.

The Secretaries of State and Defense should strongly urge the Government of Japan to eliminate or pay the excess costs above prevailing local rates. GAO also recommends that the Secretary of Defense explore ways of hiring more Americans.



FPCD-78-47  
MAY 31, 1978



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

B-179343

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

Dear Mr. Chairman:

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

This report on foreign national employment practices in Japan, the fifth in a series of reports on five countries, addresses the cost of compensation benefits, possible substitutes for Japanese nationals, and constraints against assembling the most economical work force. We are recommending that the Secretaries of State and Defense strongly urge the Government of Japan to eliminate or pay excess compensation costs, and that the Secretary of Defense explore ways of hiring more Americans in Japan.

As your office requested, we did not obtain formal agency comments on this report; however, we informed the Departments of State and Defense of our work and considered their comments. We are sending copies of this report to the Departments of Defense and State. Copies will be available to other interested parties who request them.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "James B. Atchafalua".

Comptroller General  
of the United States

IMPROVEMENTS NEEDED IN FOREIGN NATIONALCOMPENSATION PRACTICES IN JAPANBACKGROUND

As of January 1978, U.S. Forces in Japan (USFJ), which include both mainland Japan and Okinawa, employed about 22,360 Japanese nationals; approximately 19,650 paid from appropriated funds:

<u>Employer</u>	<u>Number of employees</u>		<u>Total</u>
	<u>Appropriated fund</u>	<u>Nonappropriated fund</u>	
Army	5,374	271	5,645
Navy	9,055	550	9,605
Air Force	5,223	461	5,684
Navy and Army/ Air Force Exchanges	-	1,428	1,428
Total	<u>19,652</u>	<u>2,710</u>	<u>22,362</u>

Employee costs

Appropriated and nonappropriated fund payroll costs totaled about \$243 million and \$27 million, respectively, in fiscal year 1977. In 1977 the average appropriated fund employee cost about \$15,100, including an accrued retirement allowance of about \$3,000.

Retirement allowances or separation pay entitlements are payable upon retirement, resignation, or reduction in force. As of September 1977, the appropriated and nonappropriated severance liability totaled about \$392 million and \$8.2 million, respectively. Each appropriated fund employee had an average severance pay entitlement of about \$20,100.

Costs per employee have increased in recent years. Despite appropriated fund work force reductions of almost 45 percent from 1973 through 1977, total payroll costs have decreased only 6 percent. Since 1973 wage increases averaged 13.9 percent annually.

Because of the declining value of the dollar against the Japanese yen, wage costs can be expected to increase further. The average yen to dollar exchange rate in fiscal year 1977 was about 280 to 1. By April 1978, the value of the dollar decreased about 21 percent to 220 yen to \$1. Despite recent actions to reduce payroll costs, we estimate the declining dollar value and a December 1977 pay raise of about 7 percent will add about \$62 million to USFJ's 1978 appropriated fund payroll costs. Similarly, USFJ's severance liability will increase about \$102 million.

#### Procedures to determine compensation and benefits

Section 444 of the Foreign Service Act, as amended, provides that compensation for foreign national employees will be based on locally prevailing wage rates consistent with the public interest. Department of Defense (DOD) instructions provide similar guidance to U.S. Armed Forces in foreign areas.

Under an indirect hire system, Japanese employees of USFJ are legally employed by the Japanese Government, although paid by DOD. The indirect hire arrangement evolved from early occupation days when Japanese employees were hired and paid by the Japanese Government. In 1951 the United States and Japan signed the Master Labor Contract which, with amendments, defines conditions of employment for appropriated fund employees. 1/ Nonappropriated fund employees are paid under a separate 1961 indirect hire agreement, but generally receive the same benefits, allowances, and wage increases as appropriated fund employees. Under both agreements, changes to compensation and benefits received by Japanese employees require concurrence of both DOD and the Japanese Government.

Headquarters, USFJ, coordinates the DOD employment system for the Army, Navy, and Air Force in Japan. A Joint Labor Affairs Committee, comprised of civilian personnel directors for each service command and the chief of the USFJ Labor Branch, coordinates to develop a unified position on labor matters.

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1/Sixteen appropriated fund employees are employed under a separate Mariner's Contract.

Annual wage increases for Japanese employees are determined through negotiations with the Japanese Government, but the established procedure has been to give Japanese employees the same proportional increase received by Japan's civil servants in the National Public Service. The Japanese Government annually surveys private firms (about 7,500 in 1977) to determine prevailing wages, allowances, and benefits. The resulting basic wage schedules are then adopted by the National Public Service and USFJ.

Many allowances now received by DOD's Japanese employees were adopted before Japan and the United States agreed to use the National Public Service as a model. In recent years, USFJ has attempted, with limited success, to bring benefits and allowances more in line with the private sector and Japanese civil servants.

#### LIMITED SUCCESS OF PAST COST REDUCTION ATTEMPTS

In the past, USFJ has concentrated on reducing excessive benefits and allowances rather than basic wage schedules. Under USFJ's complex base pay and allowances system, base pay represents only about 50 percent of an employee's total compensation, with as many as 18 additional allowances making up the remainder. USFJ officials estimated their 1975 and 1976 wage negotiations saved about \$10 million annually.

In a 1977 report, 1/ we recommended that the Secretaries of State and Defense obtain additional cost relief by negotiating a labor cost sharing agreement with Japan. The need for increased cost sharing was based on an increasingly costly U.S. contribution to Japan's defense, the limited budgetary support given by Japan to its own defense in view of its economic capabilities, and the chronic deficits in U.S. bilateral trade with Japan. A labor cost sharing agreement was signed in December 1977 when Japan agreed to forego DOD contributions to social welfare programs and other administrative fees. USFJ officials estimated the agreement would save about \$26 million annually.

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1/"The United States and Japan Should Seek A More Equitable Defense Cost-Sharing Arrangement," ID-77-8, June 15, 1977.

U.S. negotiators had hoped for greater cost relief, particularly where USFJ pays more than the private sector. The Japanese Government rejected U.S. proposals because it interpreted the status-of-forces agreement to require the United States to pay all direct labor costs. They ultimately agreed to fund the costs of social welfare contributions and administrative fees because these were considered indirect costs and, therefore, could be shared.

U.S. negotiators had argued that the status-of-forces agreement was a "living" document, to be interpreted according to the best interests of both parties. They also pointed to numerous precedents for labor cost sharing and noted that while the agreement does not obligate Japan to pay labor costs, neither does it prohibit it. In lieu of more reductions in force or reduced mutual defense capabilities, we believe the U.S. position is a more practical approach to an increasing labor cost problem.

#### PAYROLL COSTS REMAIN ABOVE PREVAILING RATES

Because of Japan's reluctance to share the costs or allow revision of overgenerous USFJ benefits and allowances, Japanese employees continue to be paid well above prevailing local rates. Using compensation and benefits paid to Japanese civil servants as a model, we identified four compensation factors in excess of prevailing practices which increased USFJ's fiscal year 1977 payroll costs by about \$26.3 million. Given the December 1977 pay raise and an April 1978 exchange rate of about 220 yen to \$1, excess payroll expenses have already increased to \$35.4 million (including an estimated \$31.3 million for appropriated fund activities).

The following table and discussion detail where and how much USFJ overpays.

<u>Compensation factors</u>	<u>Appropriated funds</u>	<u>Nonappropriated funds</u>	<u>Total</u>
	------(000 omitted)-----		
USFJ differential	\$12,275	\$1,463	\$13,738
Language allowance	1,091	173	1,264
Premium pay computation	1,204	61	1,265
40-hour workweek	<u>8,690</u>	<u>1,360</u>	<u>10,050</u>
Total	<u>\$23,260</u>	<u>\$3,057</u>	<u>\$26,317</u>

### Need for USFJ differential outdated

The USFJ differential is a special payment granted to all Japanese employees without relation to jobs, duties, or responsibilities. When established in the early 1950s, the differential was to compensate USFJ employees for being in the unique position of working for a foreign employer. Prior to 1963 the USFJ differential was included as a portion of the basic monthly wage. In 1963 the differential was specified as a 10-percent addition to base pay rates established by Japanese civil servant wage scales.

The rationale for paying a 10-percent differential is outdated since foreign firms are no longer unusual in Japan, and many Japanese companies have management styles similar to these firms. The American Embassy and foreign and joint venture firms in Japan employ Japanese nationals without paying a similar differential. Moreover, Japan is the only country hosting U.S. Forces which requires such a payment. Appropriated fund costs of the differential were about \$12.3 million in 1977 and will be about \$16.6 million in 1978.

### Language allowances not justified

Another holdover from compensation paid employees in the early 1950s is the language allowance which USFJ pays for English proficiency in particular positions. However, the National Public Service, American Embassy, and most foreign firms located in Japan do not pay language allowances. Also, instruction in English is widespread in the Japanese educational system, so that few, if any, job applicants would attend special classes at their own expense to qualify for a USFJ position. Appropriated fund costs of the language allowance were about \$1.1 million in 1977 and will be about \$1.4 million in 1978.

### Computation formula increases premium pay

USFJ pays considerably more for premium pay (overtime, night differential, and holiday pay) because its formula for computing premium pay is more generous than the National Public Service formula. In particular, USFJ adds the 10-percent USFJ differential, the language allowance, and the remote area allowance to its premium pay computations, while the National Public Service does not. Additional appropriated fund costs totaled about \$1.2 million in 1977 and will be about \$1.6 million in 1978.



Forty-hour workweek based on  
44-hour wage schedules

Japanese civil servants in the National Public Service work and are paid according to a 44-hour workweek. USFJ employees work a 40-hour week but use National Public Service wage schedules without modification. As a result, a portion of USFJ's compensation is for work not performed. In 1963 USFJ employees in mainland Japan were repositioned at lower wage steps to compensate for the differing workweeks. A similar repositioning of Okinawan employees occurred in 1972. However, wages for new hires and subsequent pay raises for all employees have been based on the 44-hour wage schedules. We estimate the excess attributable to the 44-hour wage schedules was about \$8.7 million in 1977 and will be about \$11.7 million in 1978. The inflated base pay rate also increases the USFJ differential, seasonal allowances, premium pay, and other allowances computed on base pay.

USFJ below Japanese civil  
servant rates in some cases

In several instances, USFJ appears to pay less compensation than the National Public Service. For example, employees who own homes or live in public housing receive a housing allowance with the National Public Service but not with USFJ. In 1976, 13 percent of the USFJ work force (renters) received a housing allowance, compared to 41 percent of the National Public Service work force.

Similarly, both USFJ and the National Public Service pay night duty allowances to nursing, communication, and public safety employees who work scheduled night hours. However, the rate schedule for Japanese civil servants is about double that paid by USFJ. Had National Public Service rates been paid to eligible employees, USFJ 1977 payroll costs would have been about \$182,000 higher.

ALTERNATIVES TO SEVERANCE  
ALLOWANCES NEEDED

Employees leaving USFJ receive a lump-sum severance payment, and employees retiring also receive a periodic annuity payment. The severance payments are more generous than prevailing practice and have resulted in excessive costs to the U.S. Government.

For the severance amount, USFJ multiplies a length of service factor (which varies by reason for termination) times the latest monthly base wage plus a number of allowances. The National Public Service, which uses its wage survey to identify prevailing practices, excludes the allowances in computing a similar allowance for its employees. The National Public Service also has a smaller length of service factor, resulting in a severance payment about 31 percent less. For example, if separated after 17 years of service, a USFJ employee would receive 36 months of base pay plus allowances, while a Japanese civil servant would receive only 27 months of base pay excluding allowances. As a result, we estimate about \$36.8 million of the \$139 million in severance payments made during 1976 and 1977 was above what would have been paid under the National Public Service formula.

As of September 1977, USFJ had a total accrued severance liability of about \$400 million. A specific comparison between National Public Service and USFJ severance entitlements is difficult because Japanese Government agencies have some flexibility to vary their entitlements. However, the following table, based on the typical USFJ employee, shows that USFJ is obligated to pay considerably greater severance benefits than the National Public Service under the stated conditions for separation.

<u>Reason for termination</u>	<u>Amount USFJ over the National Public Service</u>		
	<u>Appropriated funds</u>	<u>Nonappropriated funds</u>	<u>Total</u>
	----- (millions) -----		
Voluntary resignation	\$153.2	\$0.8	\$154.0
Reduction in force	126.9	.5	127.4
Advanced age (note a)	78.8	-	78.8

a/An estimate of the potential obligation assuming typical employees had 30 years of service and retired; few non-appropriated fund employees would be affected as current average length of service is only about 4 years.

Expected wage increases coupled with yen appreciation will increase the difference even more in 1978. For example, the \$127.4 million reduction in force difference has already increased by about 34 percent to \$171.2 million in fiscal year 1978.

A retiring employee with 20 or more years of service receives a monthly annuity in addition to the severance payment. USFJ officials stated that the USFJ annuity is less generous than the National Public Service annuity, but they had been unable to quantify the difference. Even so, adopting a retirement package more comparable to the National Public Service and prevailing practice--higher annuity and lower severance payment--would still decrease USFJ retirement costs. Severance entitlements would be less and any increased employer contributions to an annuity program would be assumed by the Japanese Government under the December 1977 cost-sharing agreement.

RESTRICTIONS ON USING MORE  
LOCALLY HIRED AMERICANS

As Japanese employees become increasingly expensive, USFJ will need greater flexibility to employ the most economical work force. Under certain circumstances Americans are less costly than Japanese; however, a number of factors prevent hiring more Americans.

Locally hired Americans--less costly alternative

Locally hired Americans, as opposed to those hired in the United States and brought to Japan, do not receive change-of-station benefits, quarters allowances, and are generally not eligible for civil service retirement. Americans can be hired locally under overseas limited appointments or a DOD program aimed at hiring dependents of DOD personnel stationed in Japan. Of more than 6,000 U.S. civilian employees in Japan, nearly 3,300 are dependents who represent virtually all the local hires.

<u>Service</u>	<u>Dependents employed (note a)</u>		<u>Total</u>
	<u>Appropriated fund</u>	<u>Nonappropriated fund</u>	
Army	110	30	140
Navy	220	b/700	920
Air Force	980	c/1,240	2,220
Total	<u>1,310</u>	<u>1,970</u>	<u>3,280</u>

a/Includes full- and part-time employees.

b/Includes Navy Exchange.

c/Includes Army and Air Force Service.

Initially locally hired Americans cost about the same as Japanese employees in entry-level positions. However, local hires are less costly after the first year, as shown below.

	<u>Annual employment cost (note a)</u>		
	<u>United States</u>	<u>Japanese national (note b)</u>	<u>Difference</u>
<b>Secretary:</b>			
1st year	\$ 9,369	\$ 9,216	\$ 153
2d year	10,229	10,915	-686
3d year	11,168	12,677	-1,509
<b>Clerk Typist:</b>			
1st year	7,404	8,311	-907
2d year	8,111	9,848	-1,737
3d year	8,855	11,444	-2,589
<b>Administrative Specialist and Management Analyst:</b>			
1st year	10,482	10,503	-21
2d year	11,444	12,429	-985
3d year	12,494	14,437	-1,943

a/Annual 6-percent pay raises and step increases were assumed for both the Japanese national and the locally hired American.

b/Based on a 220 yen to \$1 exchange rate.

Conversely, the Japanese national blue-collar worker is considerably less expensive than his U.S. counterpart. Even if cost effective, however, personnel officials doubted whether locally available Americans had the necessary skills required for blue-collar positions such as welders, carpenters, and machinists.

#### Constraints limit local hires

Civilian positions are designated either U.S. civilian or Japanese national. Appropriated-fund employees are also subject to separate direct (American) and indirect (Japanese) hire staffing ceilings. Because of the ceilings, personnel officials are constrained from filling vacant Japanese national positions with Americans.

If hired into a Japanese national position, an American is still counted against the direct hire ceiling. The Office of Management and Budget controls direct hire ceilings. Officials stated that DOD could easily request that indirect hire positions be converted to direct hire positions without any overall increase in the work force. They also felt that small increases in direct hire employment could be absorbed under DOD's current direct hire ceiling. However, such flexibility does not extend to field installations where managers are reluctant to exceed their direct hire allotments.

We believe that DOD should be able to hire the best qualified and the most cost effective employee, whether foreign national or American. In the past, we concluded that funding and program limitations provide a more effective control over the number of persons Federal agencies can employ than do personnel ceilings. 1/ Limiting the number of persons employed on a particular day deprived agency management of options for accomplishing essential work and did little to control staffing levels.

One additional constraint is the Civil Service Commission's pending decision to terminate the dependent hire program. The Commission has concluded that the program gives unfair, preferential treatment to DOD dependents and that the special economic situation originally used as justification--the need to improve the economic conditions of military families overseas--is no longer present. DOD believes the authority for preferential hiring of dependents should continue. As of April 1978, the Justice Department was still assessing the legality of the program. Even if the dependent program is terminated, personnel officials can still hire local applicants through overseas limited appointments, although DOD officials have told us relying on such appointments would increase their administrative workload.

#### Other hiring considerations

Other factors influence a hiring decision. Advantages of hiring locally available Americans include:

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1/"Personnel Ceilings--A Barrier To Effective Manpower Management," FPCD-76-88, June 2, 1977.

- The Japanese national employee would become progressively more expensive because he would tend to stay, receive step increases, and continue building up severance benefits. An American dependent hire would normally leave after 3 years and a replacement hired at the entry level.
- A portion of U.S. employees' pay returns to the U.S. Government through income taxes while a noncitizen would not pay U.S. taxes.
- Hiring U.S. employees has less effect on the international balance of payments because a substantial portion of a dependent's income will be spent in DOD facilities, such as post exchanges and commissaries.
- Japanese national employees receive two more holidays and faster step increases than U.S. employees. Further, the Japanese national's pay can increase 50 to 90 percent through step advancement compared to a 30-percent increase for U.S. employees.

Limitations to hiring Americans in Japanese national positions, in addition to staffing ceilings, include

- potential lack of special skills among local applicants,
- loss of continuity from periodic rotation,
- lack of Japanese language proficiency necessary for some positions,
- sensitivity of labor unions and the Japanese Government to increased hiring of Americans.

Even so, USFJ officials believe the number of U.S. hires could be increased if personnel officials had complete flexibility to hire the most effective and economical work force.

If DOD officials are unsuccessful in bringing Japanese national compensation more in line with local prevailing rates, hiring Americans in vacant Japanese national positions will become increasingly desirable, particularly in the next several years. About 50 percent of the Japanese national work force has more than 20 years of employment and many positions will become vacant in the near

future. Therefore this is an opportune time to eliminate or modify hiring constraints to enable increased hiring of U.S. employees. The benefits are twofold--a cost savings to the U.S. Government and a morale and material benefit to military families stationed in Japan.

#### CONCLUSIONS AND RECOMMENDATIONS

Under an indirect hire system, the Japanese Government is the legal employer of DOD's Japanese national work force and must agree to any changes to wages and benefits paid. DOD activities employ about 22,360 foreign national employees in Japan and Okinawa with 1977 payroll costs totaling about \$270 million and a separation liability of nearly \$400 million. A December 1977 pay increase and the declining value of the dollar versus the yen will add about \$62 million in payroll costs and \$102 million in separation liability to appropriated funds in 1978.

Despite DOD efforts to reduce its spiraling labor costs, Japanese employees are still paid considerably above prevailing private rates. We estimate that in 1977 DOD's Japanese national employees received about \$26.3 million more than their private sector counterparts because of a 10-percent USFJ differential, language allowance, a generous premium pay formula, and wage schedules based on a 44-hour workweek. Pay increases and the decline in the value of the dollar have already increased this excess to about \$35.4 million in 1978. In some cases, DOD pays less than prevailing local rates but these amounts appear small relative to the areas of overpayment.

We estimate also that DOD separation pay benefits are about \$127.4 million higher (under reduction-in-force entitlements) than prevailing local rates. This will increase to about \$171.2 million in 1978.

Past attempts to reduce excess labor costs through reductions in force, wage negotiations, or labor cost sharing have met with limited success. Future wage increases and the declining value of the dollar against the yen will continue to conflict with budgetary pressures to reduce costs. Faced with the alternative of more reductions in force and a reduced capability to meet mutual defense objectives, we believe labor rates, based more on prevailing local practices, are in the best interests of both Japan and the United States.

Therefore, we recommend that the Secretaries of State and Defense, consistent with other foreign policy objectives, strongly urge the Government of Japan to eliminate or pay the excess costs of

- the 10-percent U.S. Forces differential,
- language allowances,
- the generous premium pay formula,
- wage schedules based on a 44-hour workweek, and
- employee separation pay entitlements.

Areas in which DOD pays less than prevailing local rates, should also be considered in changes to compensation paid Japanese employees.

Of 6,000 U.S. civilians employed by DOD activities in Japan, about 3,300 are dependents of DOD employees. Unless efforts to bring Japanese national wages more in line with prevailing local rates are successful, it will become increasingly desirable to hire Americans in vacant Japanese national positions. Currently, however, staffing ceilings, among other things, prevent complete flexibility to increase the number of U.S. hires.

We, therefore, recommend that the Secretary of Defense explore ways of hiring more Americans, such as increasing the flexibility of using direct hires to fill vacant indirect hire positions.