

DOCUMENT RESUME

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

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As of January 1, 1978, the Department of Defense (DOD) employed about 151,800 foreign nationals at foreign installations, including about 121,200 paid from appropriated funds. Almost 90% of the employees were located in five countries--Germany, Japan, Korea, the Philippines, and Italy. The Foreign Service Act provides that compensation for foreign national employees will be based on locally prevailing rates and practices consistent with the public interest.

Findings/Conclusions: Compensation adjustments for foreign national employees are generally determined by two methods: periodic wage surveys as in Korea, Italy, and the Philippines; and government-to-government negotiations as in Japan and Germany. To establish comparability with the private sector, DOD annually adjusts the value of regular pay items but considers and adjusts benefits separately. Combined analysis of pay and benefits would give DOD more flexibility to follow changes in private sector practices. DOD is restricted from paying prevailing rates because: compensation under indirect hire systems is based on government-to-government negotiations rather than the more objective results of wage surveys; outdated labor agreements contain concessions written when labor costs were relatively inexpensive; and political sensitivities and/or influential labor unions limit opportunities for corrective action. Recommendations: DOD should: combine pay and benefits when determining annual comparability adjustments; determine whether GAO recommendations for wage survey improvements are applicable to other foreign areas and, in the future, monitor the wage setting process more closely to further improve and standardize wage survey procedures; adopt separation pay liquidation plans in areas having separation plans similar to

that of U.S. forces in Korea; pursue labor cost sharing opportunities with host governments, particularly where DOD is unable to reduce excess labor costs by other means; review existing foreign national labor agreements and initiate negotiations to revise those containing outdated or overly restrictive provisions; and continue to explore ways of hiring more Americans. (RRS)

7200

REPORT BY THE

Comptroller General

OF THE UNITED STATES

Department Of Defense Is Overcompensating Its Foreign Employees

The Department of Defense is paying more than it should for the 152,000 foreign nationals that it employs overseas. In the five countries where most of the employees are located, GAO identified annual excess wage costs of \$37 million and excess accrued separation liabilities of \$130 million.

Several changes should be made to bring pay and benefits in line with locally prevailing rates and practices, and the United States should urge host countries to eliminate or pay for certain excess costs.



FPCD-78-64
AUGUST 2, 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 request of April 29, 1977, we have reviewed 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 summarizes the recommendations in our previous reports on five countries and discusses the constraints and issues which subject the Department of Defense to unfair, high labor costs.

As you requested we did not take additional time to obtain written agency comments on this report. However, the Department has officially responded to most of our prior recommendations in each country and has also informally commented on the matters discussed in this report. For the most part the Department agrees with our recommendations, but it believes opportunities for implementing several of them are limited by host-country sensitivities. While some limitations may be unavoidable, at least for the present, we believe a more concerted effort by the Federal Government is needed to eliminate excessive amounts from foreign employee payrolls.

We are sending copies of this report to the Departments of Defense and State, the Office of Management and Budget, and the Civil Service Commission. Copies will be available to other interested parties who request them.

Sincerely yours,

A handwritten signature in black ink that reads "James A. Stacks".

Comptroller General
of the United States

D I G E S T

About 152,000 foreign nationals were employed by the Department of Defense at its overseas installations at the start of 1978. Of these, about 121,000 were paid \$1.2 billion from appropriated funds in fiscal year 1977.

Legislation provides that compensation for foreign national employees will be based on locally prevailing rates and practices consistent with the public interest.

GAO visited the countries where Defense employs about 90 percent of its foreign national work force--Germany, Italy, Japan, Korea, and the Philippines.

Although Defense generally pays prevailing rates, GAO identified instances of overcompensation in each country as well as opportunities to hire Americans at less cost. Overcompensation aggravates an already alarming balance-of-payments deficit, which is magnified by dollar devaluations in such high-cost areas as Japan and Germany.

Since mid-1976 declines in dollar values have increased Defense's wage costs in Germany by about 27 percent and in Japan by 35 percent.

In reports issued on each country visited, GAO recommended corrective actions. Defense plans to implement several of the recommendations, and it is currently conducting its own review of foreign national wage setting. It believes, however, that opportunities to implement some of our recommendations may be limited because of host-country sensitivities, including resistance to the hiring of more Americans

in foreign national positions. (See app. I.)

WAGE SETTING TECHNIQUES NEED IMPROVEMENT

Compensation adjustments for foreign national employees are generally determined by two methods: (1) periodic wage surveys, as in Korea, Italy, and the Philippines and (2) government-to-government negotiations, as in Japan and Germany.

In Korea, Italy, and the Philippines, estimated overpayments in 1977 totaled about \$10.4 million, in addition to excess severance liabilities of about \$4.1 million. (See p. 6.)

In Japan, Defense paid about \$26.3 million in excess wages during 1977 and had a separation pay liability that was excess by about \$127.4 million. In Germany, wages and benefits generally were in line with locally paid rates, although Defense lacked control over wage increases. Also, certain pay supplements paid as hiring incentives might be reduced more quickly. (See p. 9.)

To establish comparability with the private sector, Defense annually adjusts the value of regular pay items (base pay, monetized allowances, and bonuses) but considers and adjusts benefits (retirement, holidays, and medical coverage) separately. Combined analysis of pay and benefits would give Defense more flexibility to follow changes in private sector practices. (See pp. 4 to 6.)

Wage survey responsibilities generally are delegated to personnel officials in the countries where Defense employs foreign nationals. As a result, wage survey procedures varied considerably among countries. Increased monitoring of wage surveys, with the objective of standardizing and improving techniques, could prevent deficiencies in wage survey procedures. (See pp. 6 and 7.)

Many foreign employees accumulate separation pay entitlements payable upon retirement, resignation, or reduction in force. Because the entitlements are based on employees' most recent salary and years of employment, Defense's separation pay obligation has increased significantly in recent years. Under certain conditions, Defense could reduce its increasing obligations without affecting employees adversely by liquidating periodically the obligation rather than letting it accumulate. (See pp. 7 and 8.)

LABOR COST SHARING

Devaluation of the dollar in Germany and Japan is harmful to the mutual objectives of minimizing work force reductions and maintaining defensive capabilities. Accordingly, opportunities for labor cost sharing by host governments should be pursued, particularly for costs that are in excess of prevailing practice. (See p. 9.)

CONSTRAINTS ON WAGE SETTING

Defense is restricted from paying prevailing rates because

- compensation under indirect hire systems is based on government-to-government negotiations rather than the more objective results of wage surveys,
- outdated labor agreements contain concessionary benefits written in when labor costs were relatively inexpensive, and
- political sensitivities and/or influential labor unions limit opportunities for corrective action. (See pp. 11 and 12.)

OPPORTUNITIES TO HIRE MORE AMERICANS

As foreign national wages continue to increase, hiring Americans in overseas installations will become increasingly desirable from a cost standpoint, and in

some cases will provide a second income to military families. However, host-government and/or foreign employees' union sensitivities, restrictive hiring clauses in labor agreements, and staffing ceilings limit Defense's flexibility to hire more Americans. (See pp. 14 to 16.)

RECOMMENDATIONS

GAO recommends that Defense:

- Combine pay and benefits when determining annual comparability adjustments.
- Determine whether GAO recommendations for wage survey improvements (see app. I) are applicable to other foreign areas, and, in the future, monitor the wage setting process more closely, with the intent of further improving and standardizing wage survey procedures.
- Adopt separation pay liquidation plans in areas having separation plans similar to that of U.S. Forces in Korea.
- Pursue labor cost sharing opportunities with host governments, particularly those where Defense is unable to reduce excess labor costs by other means.
- Review existing foreign national labor agreements and initiate negotiations to revise those containing outdated or overly restrictive provisions.
- Continue to explore ways of hiring more Americans.

GAO was requested not to obtain written agency comments on this report. However, the Department of Defense has responded to most of GAO's prior recommendations in each country (see app. I) and has also informally commented on the matters discussed in this report. Its comments have been incorporated where appropriate.

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CHAPTER 1

INTRODUCTION

The Senate Committee on Appropriations asked us to review how the Department of Defense compensates its foreign national employees at overseas installations and whether alternative labor sources might be less costly to the Government. In the past, both Appropriations Committees of the Congress have expressed concern over rapidly increasing foreign national labor costs and have questioned whether Defense retained the flexibility to assemble the most cost effective and qualified work force.

NUMBERS AND COSTS OF EMPLOYEES

As of January 1, 1978, the Department of Defense employed about 151,800 foreign nationals at foreign installations, including about 121,200 paid from appropriated funds. Almost 90 percent of the employees were located in five countries.

<u>Country</u>	<u>Number of employees</u>		<u>Total</u>
	<u>Appropriated fund</u>	<u>Nonappropriated fund</u>	
Germany	55,351	10,115	65,466
Japan	19,370	2,461	21,831
Korea	16,032	5,086	21,118
Philippines	13,463	6,484	19,947
Italy	2,519	916	3,435
Other (85 countries)	<u>14,492</u>	<u>5,543</u>	<u>20,035</u>
Total	<u>121,227</u>	<u>30,605</u>	<u>151,832</u>

Defense's appropriated fund payroll costs for foreign nationals totaled about \$1.2 billion in fiscal year 1977-- about \$550 million was incurred in Germany and \$240 million in Japan. Estimated nonappropriated fund payroll costs were about \$197.7 million in 1976.

Costs per employee have rapidly increased. For example, in Japan from 1973 through 1977 the work force was reduced by 45 percent but payroll costs decreased by only 6 percent. Wage increases in Korea, Japan, and Germany have averaged about 21, 14 and 8 percent, respectively, since 1973.

Because foreign employees are paid in local currency, fluctuations in currency exchange rates also affect labor costs. The decline in the value of the dollar against the mark and yen since mid-1976 has increased labor costs by 27 percent in Germany and 35 percent in Japan.

Many foreign employees, in conformance with the practice in the host country, also receive lump-sum cash payments when they leave U.S. employment. Employees build up separation pay entitlements over their careers, and Defense records its increasing liability annually. Since an employee's separation pay is generally a combination of most recent salary and total years of employment, each pay increase has a retroactive effect.

With the rapid increase to employee salaries, separation pay entitlements have also increased significantly, becoming very sizable in high wage countries. For example, in Japan, the appropriated fund separation liability was over \$500 million in early 1978--about \$26,000 per employee--and represented an increase of over \$100 million since 1977. In 1977, appropriated-fund separation pay liabilities were approximately \$57 million in Korea, \$19 million in Italy, and \$18 million in the Philippines.

HOW WAGES ARE DETERMINED

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

Conditions of employment for foreign national employees are spelled out in government-to-government agreements, many of which were negotiated and signed before foreign employee costs became a significant operating expense. Defense periodically adjusts wages by either government-to-government negotiations or by wage surveys, depending on the system of employment.

In countries such as Germany and Japan, Defense's foreign employees are indirect hires because they are officially employed by the host government, although paid by Defense. While Defense may conduct wage surveys to establish bargaining limits, wage increases are set through negotiation with the employing government.

When foreign nationals are direct hire employees--as in Korea, Italy, and the Philippines--Defense assumes responsibility for all administrative and management functions. Typically, periodic wage surveys of local wage rates are used to adjust wages and benefits.

OVERSEAS U.S. CIVILIAN EMPLOYMENT

In 1977 Defense also employed about 27,600 U.S. civilians at major foreign installations. About 11,300, most of whom were dependents of Defense employees, were hired locally as opposed to being hired in the United States and brought overseas. Locally hired Americans cost less than those recruited in the United States because they do not receive change-of-station benefits, area differentials, or quarters allowances, and because they are generally not eligible for civil service retirement. In countries where foreign national wage costs are high and increasing, locally hired Americans can be less expensive than foreign nationals.

SCOPE OF REVIEW

This report discusses the compensation and benefits Defense pays to its foreign national employees, whether these employees are overcompensated relative to prevailing local rates, and the factors limiting Defense's flexibility regarding compensation programs. It also discusses whether there are opportunities to hire more Americans overseas.

We obtained information through discussions with U.S. Government agencies, particularly the Departments of State and Defense, and by reviewing agency files, documents, reports, and pertinent legislation. We visited Japan, Korea, the Philippines, Germany, and Italy. Individual reports were issued on each country visited (see app. I), and this report summarizes and consolidates the recurring issues.

The Department of Defense generally agreed with the recommendations in our individual reports. Plans are underway to implement some of them, and the Department is also conducting its own study of foreign national compensation. While agreeing in principle with our other recommendations, Defense believed their chances for implementing them were limited because of host-country sensitivities.

CHAPTER 2

COMPENSATION COSTS COULD BE REDUCED

AND WAGE SETTING TECHNIQUES IMPROVED

Defense instructions implement Foreign Service Act criteria which require that foreign national wages be based on prevailing local rates. In visits to five countries where Defense employs foreign nationals, we found Defense activities were generally complying with prevailing practice criteria. However, we also identified specific instances of overcompensation and recommended appropriate corrective actions. For the most part, Defense acknowledged overcompensation in the identified areas and agreed to initiate corrective actions subject to consideration of other constraining factors. (See app. I.)

We believe our recommendations also apply to other areas where Defense employs foreign nationals. In particular, Defense could reduce foreign national wage costs and/or improve wage setting techniques by:

- Combining pay and benefits when determining annual comparability adjustments.
- Monitoring its foreign national wage setting more closely.
- Reevaluating the financing of local separation pay plans.
- Urging host governments to consider labor cost-sharing arrangements, particularly where Defense is unable to reduce excess labor costs by other means.

EXPANDED USE OF TOTAL COMPARABILITY PRINCIPLES NEEDED

In a 1975 report 1/ GAO recommended that pay and benefits of Federal Government employees should be adjusted on the basis of comparability with pay and benefits received by non-Federal employees. Various laws require that Federal employees' pay rates be adjusted on the comparability principle.

1/"Need for a Comparability Policy for Both Pay and Benefits of Federal Civilian Employees," FPCD-75-62, July 1, 1975.

However, no method existed then or exists now for adjusting Federal employee benefits programs (for example, retirement, medical insurance coverage, leave, and vacation benefits) in accordance with prevailing non-Federal practices. These benefits are adjusted by law on a piecemeal basis. We recommended that policies and legislative proposals be developed to establish both Federal pay and benefits according to a total comparability principle, using the total of pay and benefits in the non-Federal sector as the standard for determining total Federal compensation. A total comparability principle should also be adopted in setting pay and benefits for foreign national employees.

For its direct hire foreign national employees, Defense conducts periodic wage surveys to adjust employee compensation. For the most part, Defense's practice is to equate the total of its major pay items (base pay, bonuses, and allowances) to the private sector total, but to address and adjust each benefit (separation pay, holidays, and health and life insurance) separately. This method is less flexible in establishing comparability for an employee's total pay and benefits than if benefits and pay were combined.

To illustrate, if a wage survey showed that the average number of holidays granted in the private sector had increased from 10 to 10.25 days, Defense, under its current method, would either undercompensate employees by continuing to grant 10 holidays, or overcompensate employees by granting 11 holidays (assuming that granting 10.25 holidays would be impractical). If the analysis of holidays were combined with other pay and benefits analysis, the additional quarter holiday could be reflected in a slight add-on to another compensation, such as bonuses.

An additional disadvantage is that separate treatment of benefits makes any attempt to reduce a benefit highly visible and likely to elicit an unfavorable reaction from employees. For example, in Korea, despite evidence that separation pay benefits in the private sector had decreased since the U.S. Forces plan was adopted, officials saw little likelihood of making an appropriate adjustment. If the total cost of pay and benefits were used to adjust employee compensation, a reduced separation pay entitlement could be offset against other compensation increases--the net result would likely be a smaller overall increase.

In contrast to Defense practices overseas, State Department procedures call for adjusting foreign employee wages at Embassies according to the total of prevailing pay and benefits. For each pay and benefit item, survey teams determine the difference between what the Embassy and private sector pay then net the differences, and make one plus or minus adjustment to total compensation. By so doing, the State Department is able to offset its generally more favorable retirement and holiday benefits.

INCREASED MONITORING OF WAGE
SURVEY TECHNIQUES NEEDED

Although our review in five countries indicated that Defense generally paid its foreign nationals according to prevailing practice criteria, we noted exceptions. The following are some examples.

- About \$7.6 million could have been saved in Korea and the Philippines in 1977 if the average private sector wage had been matched to the average U.S. Forces rate, rather than to a predetermined step rate.
- About \$1.8 million in annual payroll costs and \$4.1 million in separation pay liabilities could have been saved in Korea and the Philippines if allowances were not used in computing such pay items as premium pay and seasonal bonuses.
- About \$1 million might be saved in Italy if Defense provided subsidized lunch facilities instead of cash meal allowances, and if an alternative health insurance plan were adopted.
- Employees in Korea can advance to the top step of their grade in only 9 years although this was not supported by prevailing practice.
- Jobs surveyed in the private sector in Korea, the Philippines, and Italy could have been more representative of the U.S. Forces work force.

Increased monitoring of wage survey techniques--now largely the responsibility of personnel officials in each country, could improve the wage setting process.

Defense has delegated foreign national wage fixing authority to the Pacific and European Commands, which in

turn have delegated many duties to personnel officials in the countries where Defense employs foreign nationals. For most direct hire employees, periodic wage surveys are used to determine prevailing local rates in each country. Revised wage schedules are subject to approval of, first, a joint labor committee of service representatives at the country level and, second, a command level joint labor committee. For the most part, labor policy committees at the country level develop and implement wage survey procedures. As noted in our five reports, wage setting procedures varied considerably among the countries on how surveyed companies were selected, which jobs were surveyed, how wage data was collected and analyzed, and how wage schedules were structured.

Based on our recommendations, Defense has begun some corrective actions. (See app. I.) For example, U.S. Forces in Korea replaced about 20 percent of the jobs surveyed in the private sector with jobs more representative of the work force. Defense has also initiated a worldwide study of foreign national wage setting to determine how best to equate average private sector earnings with average U.S. Forces' earnings and how to eliminate excess allowances from other pay computations. Defense expects to complete its study in early 1979.

Because of the variety of wage setting techniques in the various countries visited, we believe Defense should also monitor the foreign national wage setting process more closely. While recognizing that unique circumstances in each country can require unique solutions, we believe Defense should do more to standardize wage survey procedures.

NEED TO REEVALUATE SEPARATION PAY PLANS

In many overseas installations, Defense pays lump-sum separation allowances to foreign national employees when they separate for such reasons as retirement, resignation, or reduction-in-force. In Korea, ^{1/} we projected considerable savings to the U.S. Government, with little or no adverse impact on employees, if Defense periodically liquidated its accruing separation liability. Under the plan, Korean national separation entitlements would be annually placed in a local interest bearing account under each

^{1/}"Department of Defense Should Change Pay Setting for Korean Nationals," FPCD-77-69, Sept. 30, 1977.

employee's name. Agreement would be made with the employees under which they would not withdraw these funds or the interest accruing to the accounts until they left Defense employment. Defense nonappropriated fund activities in Korea already use similar plans which were endorsed by affected employees and the Korean Government.

This method is more advantageous to the U.S. Government than plans where entitlements are based on current salary and years of service. Under such plans each pay raise retroactively increases the separation entitlement that has accumulated since the employee was first hired. Periodically liquidating this liability, as is done by nonappropriated fund activities in Korea, limits the retroactive effect of raises only to the date of the last payment to the employee's interest bearing account.

If implemented in Korea, we estimated considerable savings to Defense, even after consideration of interest costs to the Treasury for the funds that the Federal Government would have to provide to liquidate current separation obligations. Including the offsetting interest costs, we estimate that Defense would save about \$7.2 million over a 5-year period in Korea. In 1977, U.S. Forces in Korea began a study to determine whether the proposed plan was legal and feasible and whether it was acceptable to the Korean Government and the employees' union. As of June 1978, the study was not completed, although preliminary results indicated the proposal was workable and would save Defense a considerable amount.

Defense should work towards timely completion of the study and implementation of the severance liquidation plan. Where separation programs are similar--such as in Italy, the Philippines, and Taiwan--Defense should also consider adopting a similar liquidation plan. In considering the feasibility of the plan, Defense should consider whether employees would be adversely affected, whether borrowing costs to the Treasury would offset savings to Defense, and other factors already considered in Korea.

OPPORTUNITIES TO CONSIDER
LABOR COST SHARING

In our reports on foreign national compensation costs in Germany 1/ and Japan, 2/ we recommended that the Secretaries of State and Defense examine labor cost sharing opportunities with the German and Japanese Governments. The recommendation was based on the rising costs of Defense's foreign national work force, particularly in light of the decline of the dollar relative to the German mark and Japanese yen, and the mutual objective of minimizing work force reductions while maintaining defense capabilities.

In December 1977 the Japanese Government agreed to forego administrative charges and employer contributions to social welfare programs. It was estimated that this agreement would save Defense about \$26 million annually. Although the agreement was a successful first step, we estimated that about \$26.3 million of Defense's \$270 million 1977 payroll and \$127.4 million of the \$400 million separation liability remained above prevailing local rates.

In Germany, Defense's employees were generally compensated in accordance with local prevailing rates, although Defense lacked control over wage increases. However, Defense might have been able to make faster reductions of cash supplements which had been needed in the past to recruit and retain employees in some high demand positions. Its \$670 million foreign national payroll in 1977 was a significant part of the cost of the U.S. presence in Germany. In view of pressures on Defense to reduce its costs in Europe, the German Government's expressed desire to maintain a high level of German national employment and the cost sharing precedent set by the Japanese Government make labor cost sharing a desirable objective. The Department agreed and said it would pursue the matter further with the Department of State. Defense could also explore labor cost sharing opportunities in other countries, particularly in those where it is required by local agreements or political sensitivity (see ch. 3) to pay wages above prevailing local rates.

1/"Department of Defense Pay Practices for German Nationals Should Be Changed," FPCD-77-86, Dec. 2, 1977.

2/"Department of Defense Pay Practices for Japanese Nationals Should Be Changed," FPCD-78-47, May 31, 1978.

RECOMMENDATIONS

To improve the wage setting process for foreign national employees, we recommend that the Secretary of Defense:

- Combine pay and benefits when determining annual comparability adjustments.
- Determine whether our recommendations for wage survey improvements (see app. I) are applicable to other foreign areas, and, in the future, monitor the wage setting process more closely with the intent of further improving and standardizing wage survey procedures.
- Adopt a separation pay liquidation plan in other areas which have separation plans similar to that of U.S. Forces in Korea.
- Pursue labor cost sharing opportunities with host governments, particularly those where Defense is unable to reduce excess labor costs by other means.

CHAPTER 3

RESTRICTIONS ON DEFENSE'S

FLEXIBILITY AS AN EMPLOYER

Defense acknowledged most of the overpayments identified in our reports on Japan, Korea, the Philippines, Germany, and Italy, but it cited constraints which it felt would restrict corrective actions. Among the constraints were the need to negotiate indirect hire wages with host governments, restrictive and/or outdated labor agreements, strong employee unions, and political sensitivity. Although we recognize that there are some unavoidable limitations, we believe Defense should review current labor commitments and make every effort to obtain the flexibility to pay employees according to prevailing local rates.

DIRECT VS. INDIRECT HIRE ARRANGEMENTS

Of the 20 countries where Defense employs more than 200 foreign nationals, 12 (36,000 employees) have direct hire and 10 (84,100 employees) have indirect hire arrangements. ^{1/}In indirect hire systems Defense's control over wage increases is limited because employee compensation and benefits are negotiated with host governments. As such, labor issues are discussed at a government-to-government level, sometimes resulting in political considerations preventing objective wage-setting.

We visited Japan and Germany where Defense employs foreign nationals under an indirect hire arrangement. In Japan, we identified five areas of pay and severance in which Defense paid rates higher than those prevailing locally but had been unable to persuade the Japanese Government to eliminate or share the excess costs. In Germany, we found that Defense generally paid prevailing rates; however, it lacked adequate controls over wage increases.

Despite the disadvantages of indirect hire systems, Defense officials see little opportunity to convert employees to direct hires. Indirect hire systems are specified by international agreement, generally at the request of the host government. Nevertheless, Defense should continue to develop

^{1/}Defense has both direct and indirect hire arrangements in Korea and the United Kingdom.

objective ways to measure prevailing local rates and continue to emphasize to host governments the U.S. Government's intent to pay a fair wage.

OUTDATED OR RESTRICTIVE
LABOR AGREEMENTS

Many labor agreements governing conditions of employment for Defense's foreign nationals were signed years ago under economic and political conditions that have since changed markedly. For example, in Japan the Master Labor Contract which defines conditions of employment for Defense's appropriated fund Japanese employees was signed in 1951. We reported ^{1/} that at least five items were no longer supported by local prevailing practice, although required by the labor contract. We estimated that Defense incurred excess labor costs of \$26.3 million in 1977 and that separation pay liabilities were excess by about \$127.4 million.

We also reported that in the Philippines ^{2/} restrictive clauses in the 1968 Base Labor Agreement require approval by the employee's union to change wage practices, policies, and procedures. Because of the agreement, Defense officials thought it unlikely that they would be able to select more representative companies and jobs to survey, or correct data analysis procedures which caused excessive labor costs.

Despite acknowledging outdated and restrictive labor agreements, Defense officials expressed reluctance to renegotiate labor provisions that were part of status-of-forces agreements because other provisions considered favorable to U.S. Forces would then be open for negotiation. Even for those agreements where renegotiation was considered feasible, Defense officials doubted whether host-government or employee's union negotiators would agree to suggested changes. Nevertheless, we believe Defense should review its existing labor agreements and attempt to update those which restrict the paying of a fair wage.

^{1/}"Department of Defense Pay Practices for Japanese Employees Should Be Changed," FPCD-78-47, May 31, 1978.

^{2/}"Department of Defense Should Change Pay Setting for Filipino Nationals," FPCD-77-70, Oct. 5, 1977.

RECOMMENDATION

Although we recognize that political considerations may constrain Defense's flexibility as an employer, we recommend that the Secretary of Defense

- review existing foreign national labor agreements and initiate negotiations to revise those containing outdated or overly restrictive provisions.

CHAPTER 4

LIMITED OPPORTUNITIES FOR HIRING

MORE AMERICANS OVERSEAS

In March 1977, Defense employed 27,600 U.S. civilians at its major foreign installations, of which about 11,300 were locally hired dependents of Defense employees. In addition to dependents, a small number of Americans were hired locally through overseas limited appointments. Because of the rising pay of foreign national employees, hiring Americans--particularly those hired locally--is becoming increasingly desirable from a cost standpoint. Locally hired Americans, as opposed to those hired in the United States and transferred overseas, do not receive change-of-station benefits or quarters allowances, and they are generally not eligible for civil service retirement. Also, hiring more Americans, particularly dependents of junior enlisted personnel, provides them a second income in these high cost areas.

In Japan, Italy, and Germany, locally hired Americans cost less in some positions than foreign nationals. However, a number of constraints prevents Defense from hiring more Americans.

COUNTRY-TO-COUNTRY AGREEMENTS RESTRICT HIRING OF AMERICANS

In its report on the Supplemental Appropriation Bill for 1977 (House Rept. 95-68), the Appropriations Committee requested that Defense review all country-to-country agreements which might restrict its flexibility to employ the lowest cost and most efficient work force, commensurate with welfare and morale considerations for Defense personnel. In April 1978, Defense replied that country-to-country agreements and economic/political factors reduced its hiring flexibility in six countries--Australia, the Philippines, Spain, Turkey, Italy, and Germany.

In Italy and Spain, Defense has acceded to host-government and State Department pressures to establish foreign national-to-American employment ratios. As a result, increased hiring of Americans would require corresponding increases in foreign national hires, with little opportunity to place Americans in vacant foreign national positions.

In Germany, Defense has, with acquiescence of the German Government, placed dependents in vacant German national positions. However, faced with growing unemployment and pressure

from employees' work councils, the German Government has become reluctant to continue this practice. Discussions are currently underway between the two countries concerning the issue. Proposals under consideration include establishment of a ceiling or a guideline figure on the number of dependent hires and the possible application of German labor and social laws to dependents in German national positions.

The current Base Labor Agreement in the Philippines requires that Filipino nationals be given preferential consideration when civilian positions are filled, except when security or other special management needs require a U.S. citizen. As part of current negotiations on a new agreement, Defense officials expect the Philippine Government to want further restrictions on hiring U.S. civilians rather than to agree to removing the existing preferential hiring clause.

Defense concluded its reply to the Committee by saying it saw little opportunity to replace foreign nationals with Americans, but it agreed to continue seeking ways to reduce foreign national costs and to increase the number of Americans hired into positions vacated by foreign nationals.

STAFFING CEILINGS ALSO LIMIT AMERICAN HIRES

When foreign employees are indirect hires--as in Japan and Germany--direct hire staffing ceilings can limit the number of Americans placed in foreign positions. If an American replaces a foreign national in an indirect hire position, the American is still counted against the direct hire ceiling, thus causing the ceiling to be exceeded (assuming all direct hire positions are filled), even though the total number of employees has not increased. Although there were differences of opinion between officials of the Office of Management and Budget, which controls direct hire ceilings, and Defense on how restrictive the ceilings were, it was apparent that ceilings limited the hiring of Americans in foreign national positions in Japan and Germany.

In 1977 we concluded that funding and program limitations provided 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

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

accomplishing essential work and did little to control staff-levels. Overseas, ceilings have also been a barrier to the hiring of less costly Americans.

HIRING AMERICANS COULD ALLEVIATE FINANCIAL HARSHIPS

In its May 1978 hearings to consider financial hardships of junior enlisted personnel and their dependents stationed overseas, the House Committee on Armed Services considered a number of proposals to relieve sharply increased living costs in such areas as Germany and Japan. Defense estimated that the cost of relief measures, such as transportation overseas and increased cost-of-living and housing allowances, could run to over \$100 million. Most of this is for overseas transportation, but to the extent dependents of these personnel could be productively employed at Defense installations, relief could be provided at no additional cost to Defense.

CONCLUSION AND RECOMMENDATION

As a practical matter, political considerations would likely prevent large scale substitution of Americans for foreign nationals, even if enough qualified local applicants were available. However, both Appropriations Committees maintain, and we agree, that Defense should make every effort to retain the flexibility to hire the most cost effective and best qualified candidate--whether foreign national or American. Where foreign national labor costs are surpassing U.S. Government wages, the restrictions discussed above become increasingly important. Consequently, we recommend that the Secretary of Defense continue to explore ways of hiring more Americans.

PRIOR GAO RECOMMENDATIONS ON
FOREIGN NATIONALS AND AGENCY RESPONSES

I. "Department of Defense Should Change Pay Setting For Korean Nationals," FPCD-77-69, September 30, 1977.

We recommended that the Secretary of Defense direct the military departments to:

- A. Develop and implement an annual severance liquidation plan in Korea.

Defense response:

Defense planned to study the annual severance liquidation plan and reach a decision by April 1, 1978, on whether the plan was legally permissible, and desirable. As of June 1978, the study had not been finalized, although preliminary results showed the plan was workable and would result in considerable savings to Defense.

- B. Include Government of Korea employees in future wage surveys.

Defense response:

Defense concurred. The 1977 wage survey included data on one Korean Government position. Future wage surveys are expected to include more data from Korean Government agencies.

- C. Annually adjust wages by equating survey results to the average of U.S. Forces in Korea earnings rather than to a predetermined step. 1/

Defense response:

Defense concurred in principle and has initiated a study to determine whether the "average to average" recommendation can be implemented worldwide.

1/Because of excessive labor costs incurred in this area and in the one following, the Senate Appropriations Committee decreased Defense's 1978 appropriations by \$5.2 million.

D. Discontinue including allowances in premium pay. 1/

Defense response:

In its 1977 and 1978 wage surveys, Defense studied whether local Korean companies include similar allowances in premium pay computations. Results supported our recommendation, and Defense plans to approach the Korean Government and the employees' union to take appropriate corrective action.

E. Identify all contract areas with potential dollar savings and present its case to the Government of Korea with the objective of eliminating or modifying contracting restrictions.

Defense response:

Defense stated that U.S. Forces in Korea are continually evaluating their service requirements to determine the most cost effective or otherwise appropriate means to satisfy them. However, in the case of selective enforcement of Korean Government labor laws against prospective contractors, Defense believes it would be improper and contrary to the existing status-of-forces agreement to demand that the Korean Government not enforce its own labor laws.

GAO comment:

Defense is restricted by the Korean Government from contracting out for services at less than the in-house cost. We believe that the Korean Government should be approached on what appears to be a selective interpretation of labor laws.

II. "Department of Defense Should Change Pay Setting For Filipino Nationals," FPCD-77-70, October 5, 1977.

We recommended that the Secretary of Defense direct the military departments to:

A. Initiate action to obtain control over the selection of companies surveyed.

1/Because of excessive labor costs incurred in this area and in the one preceding, the Senate Appropriations Committee decreased Defense's 1978 appropriations by \$5.2 million.

Defense response:

Defense agreed with the objective of the recommendation, but believes implementation would require negotiation and modification of the U.S./Philippines Base Labor and Collective Bargaining Agreements. Defense officials said the matter would be pursued through the negotiation process, but they were not optimistic that the Philippine Government or the employees' union would agree to a change which might result in surveys that included lower paying companies.

- B. Separate monetized allowances from base pay, thereby reducing the basis for computing separation pay liabilities, premium pay, and yearend bonuses.

Defense response:

Defense stated that the recommendation was solidly supported by prevailing practice and that implementation would be vigorously pursued through the negotiation process. Defense believes unilateral action on its part would violate the Base Labor Agreement.

GAO comment:

We continue to believe Defense could implement this recommendation unilaterally, particularly if implementation were phased over several years to minimize adverse effects on employees. Neither the Base Labor Agreement nor the Collective Bargaining Agreement specify what constitutes base pay or how wage survey data will be analyzed. In fact, both state that employee wages will be based on prevailing local wages, which seems to require that the recommendation be implemented.

- C. Make mid-year bonuses part of, instead of an addition to, total compensation based on prevailing amounts.

Defense response:

Because the mid-year bonus originated as an inducement to the Philippine Government to sign the 1968 Base Labor Agreement, Defense

believes that it should be kept separate from wages determined by the prevailing practices concept.

- D. Apply average survey results to the Filipino average step rather than to a predetermined midpoint step.

Defense response:

Defense reiterated its concurrence, as cited in a similar recommendation made above for Korean nationals.

- E. Develop and coordinate occupational inventories to ensure that survey key jobs represent the work force of Defense and U.S. civilian agencies.

Defense response:

Defense concurred but stated that changes to the job survey list would require negotiation with the employees' union.

III. "Department of Defense Pay Practices for German Nationals Should Be Changed," FPCD-77-86, December 2, 1977.

We recommended that the Secretary of Defense:

- A. Periodically survey wages in the German private sector in order to strengthen the U.S. position in negotiations.

Defense response:

In October 1977, subsequent to our fieldwork, Defense conducted a wage survey. It stated that the survey result; and future surveys will be one of several factors used to negotiate wages with the German Government.

- B. Periodically survey private sector practices to determine how private industry is reducing over-tariff supplements and adjust Defense's reduction accordingly.

Defense response:

Private sector reductions of the overtariff supplement were included in Defense's October 1977 wage survey. No consistent prevailing practice was identified, and Defense plans to continue its own reductions.

- C. Examine, with the German Government, labor cost-sharing opportunities, such as guaranteeing a minimum exchange rate in billing payrolls.

Defense response:

Defense concurred and agreed to pursue the recommendation with the Department of State.

- D. 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 Defense's payroll costs and on the employment flexibility of a German proposal to provide certain dependents and other Americans with the same compensation as German nationals.
 - (3) Having a hiring policy of giving priority to dependents in filling vacant German national positions.

Defense response:

Defense stated that efforts are being made to minimize or eliminate ceiling restraints to employment of Americans. A preliminary conclusion of Defense's General Counsel is that dependents may not be paid under local compensation plans (as opposed to U.S. wage plans) when they are directly employed by Defense. However, in indirect hire countries, for example Germany and Japan, dependents may be hired in foreign national positions and paid under local wage plans. The Air Force, with a view toward standardizing practices, has agreed to look into the Army's system of hiring dependents.

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

Defense response:

Defense believes the limited circumstances under which employees in Germany receive severance pay do not warrant budgeting appropriated funds. The Department of the Army is conducting a study to determine whether its nonappropriated fund activities need to continue funding 100 percent of the severance pay.

IV. "Possible Savings in Department of Defense Personnel Costs in Italy," FPCD-78-9, March 1, 1978.

We recommended that the Secretary of Defense:

- A. Determine if the payroll cost savings of providing subsidized dining facilities at all military installations in Italy would be offset by the facilities and administrative cost incurred. Defense should provide such facilities if it proves to be the most economical practice.

Defense response:

Defense stated that the Civilian Personnel Coordinating Committee for Italy will conduct a feasibility study on the recommendation.

- B. Determine if the extra benefits under the Army and Air Force's health insurance program for Italian employees justify the higher premium costs, and whether these employees should be covered under the Navy's plan.

Defense response:

Defense stated that it had studied this in 1973 and had decided not to develop a single health plan for all the services. It agreed, however, to study the area again, concentrating on comparing costs and benefits of existing plans.

- C. Develop plans and proposals for restructuring the civilian work force in Italy in upcoming years as a large number of the foreign nationals retire.

Ways in which more Americans could be employed should be considered, along with possible reactions of employee unions and the host government.

Defense response:

Defense concurred on the idea of increased hiring of American dependents, but it does not believe that conditions in Italy are currently conducive to increasing the number of local American hires. Defense expects that economic conditions in Italy and the Italian Government commitment to full employment will bring pressures to hire more rather than fewer Italians.

V. "Department of Defense Pay Practices for Japanese Nationals Should Be Changed," FPCD-78-47, May 31, 1978.

We recommended 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.

We also recommended 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.

Agency responses:

Agency comments are being prepared at this time. Informally, Defense officials agreed with our recommendations.

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