Hoglan

REMARKS OF

LEONARD HOGLAN, U.S. GENERAL ACCOUNTING OFFICE

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I will first address the question that was posed to us, "How does GAO think that changing philosophies on pay setting for U.S. employees should impact on foreign national setting?" In that context I will then elaborate on two major compensation principles; average-to-average, and total compensation comparability. Then finally I will touch on what position you might expect from GAO regarding the public interest clause of the Foreign Service Act provision on foreign national pay setting, and the implications of deviations from prevailing practice.

The overall philosophy, or legislated policy guidance, for compensating foreign national employees is in essence the same as for most other Federal employees--that is, comparability with rates in the non-Federal sector for similar work.

The largest Federal pay system is the General Schedule which covers white collar employees. The authorizing law for that system says that rates shall be comparable with private enterprise rates for the same level of work. Directly linked to adjustments in these rates are the foreign service and military pay scales.

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The second largest pay system, the Postal Service, used to have its rates linked to the General Schedule, but since 1970 (Postal Reorganization Act) the Service is supposed to be achieving comparability through collective bargaining with recognized labor organizations. Early this year GAO issued a report which was critical of this approach on the grounds that comparability and bargaining for wages are not compatible or practical, and have resulted in higher wage increases than warranted.

The third major Federal pay system is the Federal Wage System covering blue collar employees. Like the General Schedule, rates are determined basically through an administrative process rather than collective bargaining. The law governing that system says that rates are to be those prevailing for comparable work in a local wage area.

The law governing foreign national pay setting expresses essentially the same philosophy--i.e., that compensation is to be based on prevailing practices for corresponding positions in the locality. Therefore, when we made our reviews of foreign national compensation we basically applied the same principles that are used or have been recommended for the domestic Federal pay systems. In taking this approach we, however, kept two features in mind that make foreign national pay setting different. One feature is provided in the law, the other is not.

The former refers to the fact that the Foreign Service Act states that our Government should follow prevailing practices "to the extent consistent with the public interest." As I mentioned I will get more into that topic at the end. The second feature which should be recognized in evaluating foreign national compensation is that because every country is a different environment, we by necessity have many different pay systems, many of which are much smaller than the Federal domestic pay systems and at the same time there are fewer resources in the field to devote to pay setting. (No BLS for instance to gather data and offer statistical expertise.) With that in mind, it was our intention to recognize differences in the various countries and recommend improvements that we thought were doable by the existing personnel staffs at the local commands.

But basically, comparability with the non-Federal sector, whether it be for foreign national or domestic compensation is the philosophy that should prevail. The comparability philosophy was established several years ago and, in itself, has not changed.

The principle has several advantages:

--it is objective and nonpolitical if allowed to operate through administrative rather than legislative action,

--it enables the Government to compete for employees on an equal footing with the private sector,

--it has a regularity which stabilizes employee expectations and allows the Government to plan ahead, and

--it is equitable to employees.

Despite the advantages, the principle is not above being challenged for economic or political reasons. A good example of such a challenge was the desire of the House Appropriation Committee this year to place the seven percent cap on foreign national pay that was put on Federal domestic pay adjustments.

I believe actions such as these, although not the best approach, come about or are threatened because problems have been pointed with the Government pay systems insofar as their not achieving comparability. There will always be some problems because the Federal and private workforces are diverse and ever changing. However, solution of the major problems in the systems including the ones we talked about in our reports would not only eliminate deviations from comparability, but should serve to head off future over reactions such as pay caps.

Controversy is also fed to some extent by the fact that pay comparability, as a technical accomplishment, is a complicated process and many of its features are not widely understood. There has properly been over the years a continuing search for ways to achieve closer comparability for

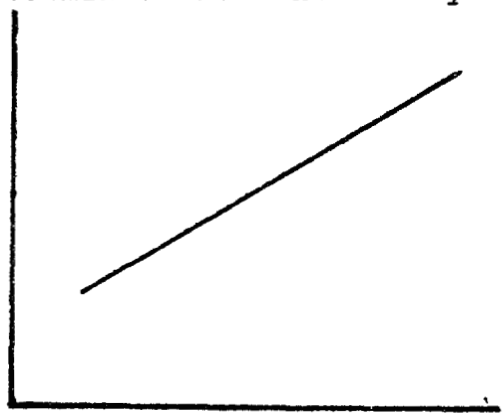
the largest possible portion of the workforce and to challenge parts of the systems with the objective of improving them.

In terms of the relationship between the U.S. and foreign national pay systems, I would now like to touch on two features of comparability that seem to have generated significant interest and concern. These are average-to-average and total compensation comparability.

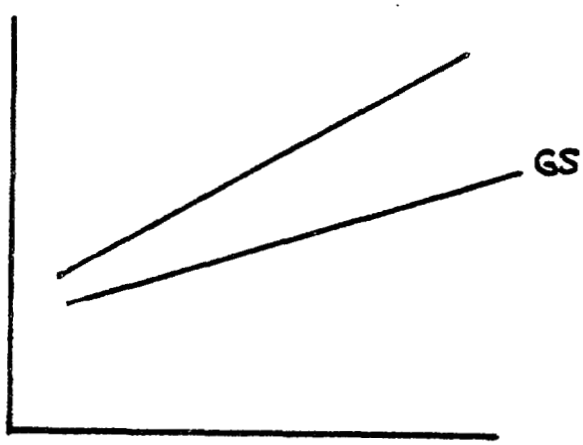
Average-to-averge is the way of implementing the assumption that paylines derived from private sector data are an average of possible earnings due to experience in the surveyed jobs. That is, a payline rate is based on employees who may have been on the job for only a few days as well as those who have been around for several years. Normally it is not known how much experience the surveyed employees have or how many pay increases they have earned that correspond to the Government's within-grade increases.

Without knowledge of where the surveyed employees fall within a pay range it is logical to treat the rate as an average, and equate it to the government sector average. This concept was introduced into the U.S. General Schedule system in 1973. Prior to that time the payline-determined from the private sector each year became step four in the ten step GS schedule. For a while that was O.K. because overall the median step for Federal employees was the fourth

step. However, over the years the median crept upward and reached step five in 1972. Rather than possibly shift the reference step from survey to survey the Civil Service Commission chose a reference point based on the arithmetic mean Federal salary at each grade. The technique is called the dual payline. First they plot the private sector payline as determined from the survey.

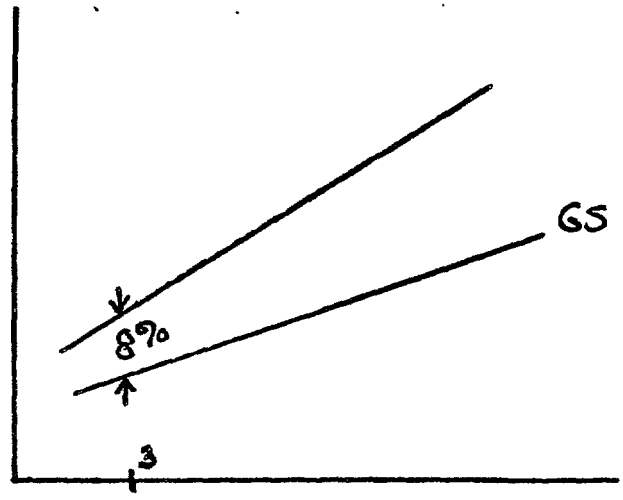


Then they plot a payline of the actual average Federal salaries that were being paid at the time the survey was taken.



It is called a GS payline. The difference between the two is the percent pay adjustment at each grade that should be made to achieve full comparability.

In one of the papers being presented later a question was posed, "At what point or step in the schedule is the adjustment made?" The question assumes adjustments from a fixed step which is not relevant under the dual payline method. Equal adjustments are made at all steps. For example:



Assume at grade 3 the difference between the Federal and private sector average was 8 percent, and the existing pay range at grade 3 was:

Step 1	Step 10
10,000	13,000 - 30% range

An increase of 8% for each step results in

10,800	14,040 - 30% range

The pay range spread is still 30% and no fixed step has been used.

The average-to-average concept has yet to be adopted in the U.S. blue-collar system. An associated problem with that system is that the law gives it too many steps--five whereas most employers have three or fewer. The private

sector payline becomes step two when most Federal blue collar employees are at steps four and five. This of course points out that along with average-to-average, the step rate features of pay schedules should be consistent with private sector practice.

GAO and the executive agencies have long felt that the fixed step feature should be corrected, and in 1977, shortly before our Korea report was issued, I came across a statement on the matter made by the Secretary of Defense. The context of his statement was the U.S. blue-collar system, but it was such a forceful criticism of the fixed step and so well stated that I added it to the report to reinforce our recommendation. (See statement, page 9 of report FPCD-77-69.) We continue to believe that average-to-averge should be adopted for foreign national pay setting.

A concern was expressed, also relating to Korea, "What if we do know how many years of experience there are in our surveyed jobs, and what if there is a significant difference in tenure between the U.S. forces employees and the local private industry workforce? Wouldn't this justify a departure from the averge-to-average computation?"

My answer would be a qualified yes. If done properly recognition of job tenure would be refinement over and above average-to-average. However, I don't know that it has ever been recommended as a normal procedure or seriously considered before because of the practical problems

involved in documenting job tenure along with all the other matching requirements. If it were to be done GAO would probably not object, but because the handling of this issue tends to have a significant effect on costs we would also want to look closely at the specific methodology used. Any such determination should be based on information specific to the surveyed jobs and not a general assessment that the U.S. forces workforce has, on the average, more length of service than the private sector workforce.

Also, to be consistent from country-to-country, DOD should consider all possibilities. The case against average-to-average in Korea stems from the fact that diversified industry there is relatively new and the workforce is young compared to the U.S. forces workforce with its longer tenure. Consider the opposite situation--say for example the Department was establishing a new facility and was recruiting relatively inexperienced employees in an area where the private sector workforce was more senior. Logical application of the departure from average-to-average would call for a downward adjustment in the payline to likewise account for the difference in tenure. I don't know if there is such a situation as I described but I merely point out the possibility to show that consideration of tenure should work both ways.

Total compensation comparability

The "how to" of total compensation comparability is something that people tend to be relatively unfamiliar with although it has been an issue for several years.

Today comparability under Federal pay systems is for the most part limited to salary or wage comparability without any direct comparison of benefits. The lack of progress in considering benefits is understandable because (1) emphasis was naturally placed on first achieving pay comparability, and (2) there has been a lack of comprehensive information on benefits. Benefit comparisons are also more difficult to make than pay comparisons--especially for contingent type benefits such as pensions and insurance.

But, in recent years as pay comparability has been refined, more attention and research has been given to benefits and total compensation comparability. GAO recommended in 1975 that a total compensation policy be developed and that legislation be proposed to establish it. The Office of Personnel Management is now testing a methodology, and legislation has been introduced to adopt it for the domestic Federal pay systems (except postal).

As an objective, we believe total compensation is appropriate for foreign national employees and could probably be argued as required under the Foreign Service Act.

Of course, the items we are talking about that have to be compared (in addition to pay as is now done) are pensions, severance, leave, holidays, insurance, bonuses, and the numerous other emoluments found in various countries.

The possible techniques for implementing total compensation comparability vary widely in their complexity. Undoubtedly the most sophisticated approach is being planned by OPM for the General Schedule and blue-collar Federal Wage System. This is being done in anticipation of the authorizing legislation being passed. In making their case for total compensation, OPM discusses two basic methods that could be used to compare Federal and non-Federal benefits. These are: cost-of-benefits, and level-of-benefits.

The cost-of-benefits method involves, for each particular benefit, determining the respective cost to the organizations being compared (Federal and non-Federal). If both organizations paid the same cost, generally expressed as a dollar outlay per employee or a percent of pay, that is an equal benefit and no adjustment to total compensation is necessary.

This approach is the easier of the two to understand and requires relatively little information to implement. However, it doesn't provide for the possibility that although costs may be the same between organizations, benefits accorded their respective employees may not be. Conversely,

benefits may be the same but costs may vary. An example is pensions whose costs and benefits depend on factors such as the characteristics of the workforce and how the plans are funded. OPM also claims that benefit cost in the private sector is sensitive information that is often hard to obtain from firms. So, for their purposes in designing total compensation comparability OPM opts for a second method it calls level-of-benefits.

Under level-of-benefits the cost to a private firm to provide a benefit is of no consequence and is not needed for the comparison. What OPM plans to do is determine the detailed benefits available at each surveyed firm and then calculate what it would cost the Government to provide those same benefits to the Federal workforce. That cost is compared to the actual cost of the Federal benefits, and the difference when combined with the customary pay adjustment becomes the total compensation adjustment. Since the level-of-benefits method deals with the details of benefit plans, large amounts of data have to be gathered. Furthermore, applying this information hypothetically to the Government workforce requires that models of the Federal workforce be constructed showing the demographic characteristics of the employees and their propensity to use a particular benefit. As you might imagine the models are very complicated--up to

several hundred pages of data and formulas requiring extensive economic and actuarial research and analysis. The private benefit plans will be fed through the respective models and what comes out will be a statement of benefit cost as a percent of pay or dollar amount per employee.

Although the level-of-benefits method is immensely more complicated than cost-of-benefits, I don't believe OPM had a realistic alternative to using it if they are to successfully sell the pay reform plan to Congress. OPM's total compensation plan would affect 2 million employees whose combined pay and benefits was about $43 billion dollars in fiscal year 1978. Obviously for a program this large sophiscated techniques are justified.

It seems also obvious that applying OPM's level of benefits methodology to foreign national compensation would not be practical. The size of the foreign national workforce is much smaller than those in the U.S. and there is a unique character and environment in each country. The effort required to gather benefit details and contruct models in each country for the relatively few employees involved would, I am certain, be too costly. In addition, one of OPM's biggest concerns is measuring the difference between the Federal and non-Federal sector for the major contingent benefits such as retirement and insurance. The level-of-benefits approach is

more helpful in dealing with these items, but since the Department of Defense overseas has the general policy of adopting the major host country benefit plans you as overseas compensation specialists should not be faced with OPM's situation in the United States where Federal and non-Federal plans are basically different. Accordingly the level-of-benefits approach is of less importance for foreign national compensation setting.

That is why in our report we were interested in simpler methodology such as the State Department's. Although it is simple, it is very comprehensive in that it touches upon virtually every type of benefit, (many of which OPM does not address) and, all in all, I believe can be effectively used by limited staffs to measure prevailing total compensation. Valuable information can be learned from both the theory and practical application of the OPM and State Department methods, from which overseas commands should be able to adopt total compensaton procedures that best fit their own needs. And, the systems devised don't have to be purely cost-of-benefits or level-of-benefits. We have seen composites of each used at the same location depending on whatever seems appropriate considering the type of benefit and the information available. Whichever techniques are used, the key thought is to bring benefits into the picture.

Based on our reviews we believe that installations are already a long way toward adopting total comparability in that they do survey benefits for comparative purposes and seem to know what is offered by private companies. I've seen one of the papers that will be presented later in the seminar on the detailed procedures that might be used to implement total comparability. I think it covers the topic quite well so I won't get into details here. I would just like to repeat that total comparability is a fundamental improvement and should be adopted in some form.

A final point I would like to emphasize has to do with revising benefits. When we initially recommended in our August 1978 report that the Department should implement total compensation comparability, the Office of the Secretary disagreed. This was mainly because we gave the misimpression in the report that total compensation means that individual benefits might have to be changed from year to year to keep them in line with the survey findings. During a subsequent meeting with Mr. Petosa we came to an agreement that that was not what GAO meant. So that there is no misunderstanding today from others I would like to repeat that benefits do not have to be changed unless you wish to change them. Whether you do or do not change them, their monetized value, similar to payments-in-kind, becomes one more factor in the calculation of compensation. In fact, on the domestic side, OPM

wants to leave the door open for possible later changes to benefits (except retirement). This part of their pay reform is being met with significant criticism, so we all appreciate the value of the expectation that employees place on a stabilized benefit package.

Public interest clause

We were also asked our views on whether compensation features that are not supported by prevailing practice can be justified under the public interest clause if the features are due to forces outside the control of the Department--for instance, international agreements. As I alluded to before, the legislation for foreign national compensation states:

> "...compensation plans shall be based upon prevailing wage rates and compensation practices for corresponding types of positions in the locality, to the extent consistent with the public interest."

When is it in the public interest to not follow prevailing practice? Since this is a legal question GAO's General Counsel researched the legislative history of the public interest provision as well as Comptroller General decisions on the matter. What they concluded was that there is no satisfactor definition of public interest in this context that could be used as a general rule of thumb. More importantly, they also concluded that the determination of a practice as being within the public interest is within the discretion of the agency head to make, provided that the decisions is

(1) carefully weighed against the stated intention of Congress that local practices be followed, and (2) that it is not made arbitrarily or unreasonably.

Some items that the research turned up are of some interest although they are not entirely conclusive:

--In 1961 the Comptroller General determined that Defense could provide a medical and hospitalization plan in Bermuda because it was prevailing practice, but not a life insurance program because that was not the prevailing practice by local employers. However in that case there is no record of whether Defense felt it would be in the public interest to provide life insurance.

--Before 1960 the law read "equal pay for equal responsibility." That was replaced with "prevailing practice . . . consistent with the public interest," and one of the reasons given in the Senate report was that overseas missions were offending some local Governments by paying women the same as men for the same work. Although not explicitly stated, this suggests that Congress was as interested in satisfying local Government concerns as it was in paying in the most desirable way.

--During hearings on the same amendment, a State Department witness was asked what the public interest clause

meant and he responded with a hypothetical example that they might choose not to follow a pay practice if its cost greatly exceeded the benefit.

In summary, the decision of whether public interest is being served (by a departure from prevailing practice) lies primarily with the Secretary of Defense. At the same time I think GAO's proper role would be to keep addressing these issues periodically and continue to ask the question, "Is this practice still in the public interest or has it served its purpose?--is it the kind of item whose cost should be borne by the host government?" Those kinds of questions are necessary, I believe, so that once an item is designated as justified under the public interest provision it is not locked in permanently.

As a related point, we also feel that U.S. forces pay procedures that depart from prevailing practice should receive more formal recognition and visibility at a higher level than we found during our work. Departures from prevailing practice might be widely understood and approved of at higher command levels or might be obscure features known only at the local level. One possible way to make these items a matter of record would be to list them together with the reasons for having them in the survey reports going up to the Pacific and European coordinating committees. This wouldn't mean that the deviations are

unjustified, but would simply be a means of documenting them so that they are subject to periodic higher level review.