

DOCUMENT RESUME

03774 - [A2794023]

Department of Defense Should Change Pay Setting for Korean Nationals. FPCD-77-69; B-179343. September 30, 1977. 2 pp. + appendix (12 pp.).

Report to Sen. John L. McClellan, Chairman, Senate Committee on Appropriations; by Robert F. Keller, Acting Comptroller General.

Issue Area: Personnel Management and Compensation (300); Federal Personnel Management and Compensation: Pay Principles and Pay Determination Processes (306); Federal Personnel Management and Compensation: Retirement Policies and Practices (307).

Contact: Federal Personnel and Compensation Div.

Budget Function: National Defense: Department of Defense - Military (except procurement & contracts) (051); Income Security: Federal Employee Retirement and Disability (602).

Organization Concerned: Department of Defense.

Congressional Relevance: House Committee on Post Office and Civil Service; Senate Committee on Appropriations; Senate Committee on Armed Services.

Authority: Foreign Service Act, sec. 444, as amended.

The United States Department of Defense employs about 23,000 Korean nationals in Korea who are paid more than the local wages. Findings/Conclusions: The Department of Defense puts considerable effort into establishing employment practices in Korea that are fair to both our Government and the Korean national employees. However, there are certain aspects of compensation setting and administration in Korea that should be changed in order to bring wages and benefits paid more into line with local practices, improve procedures, and reduce costs. Because the wages that the United States pays its Korean employees generally exceed local wages, there is considerable savings potential in contracting out services now done by directly hired personnel. However, the manner in which Korean labor legislation is interpreted and applied to Defense precludes any savings from actually taking place. Recommendations: The Secretary of Defense should direct the U.S. Forces in Korea to identify all contract areas with potential dollar savings and present its case to the Government of Korea with the objective of eliminating or modifying current contracting restrictions. (Author/SC)

03774 4023



***REPORT TO THE SENATE COMMITTEE  
ON APPROPRIATIONS***

***BY THE COMPTROLLER GENERAL  
OF THE UNITED STATES***

---

**Department Of Defense  
Should Change Pay Setting  
For Korean Nationals**

U.S. Forces in Korea employ about 23,000 Korean nationals who are paid more than the local wages. The Secretary of Defense should make changes to bring wages and benefits paid to Korean nationals more in line with local practices and to improve procedures. Also, money could be saved by contracting out services, but Korean labor law, as now interpreted, prevents this from happening. The Department of Defense should present its case for eliminating or modifying contracting restrictions to the Republic of Korea Government.



COMPTROLLER GENERAL OF THE UNITED STATES

WASHINGTON, D.C. 20548

B-179343

The Honorable John L. McClellan  
Chairman, Committee on Appropriations  
United States Senate

Dear Mr. Chairman:

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

This report on foreign national employment practices in Korea, the first in a series of reports on five countries, addresses the cost of compensation benefits and separation allowances and the constraints against assembling the most economical work force.

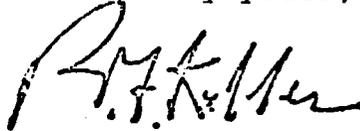
Defense puts considerable effort into establishing employment practices in Korea that are fair to both our Government and the Korean national employees. There are, however, certain aspects of compensation setting and administration in Korea that should be changed. The changes, which we are recommending to the Secretary of Defense, would bring wages and benefits paid more into line with local practices, improve procedures, and reduce costs. Certain of the changes were discussed with your office and were presented in Senate Committee Report 95-325 on the 1978 Defense appropriation bill.

Because wages that the United States pays its Korean employees generally exceed local wages, there is considerable savings potential in contracting out services now done by directly hired personnel. But the manner in which Korean labor legislation is interpreted and applied to Defense precludes any savings from actually taking place. We therefore are also recommending that the Department identify all contract areas with potential dollar savings and present its case to the Republic of Korea Government with the objective of eliminating or modifying contracting restrictions.

B-179343

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

Sincerely yours,

A handwritten signature in black ink, appearing to read "R. F. Keller". The signature is written in a cursive style with a large, prominent initial "R".

Acting Comptroller General  
of the United States

IMPROVEMENTS NEEDED IN FOREIGN NATIONALCOMPENSATION PRACTICES IN KOREABACKGROUND

United States Forces in Korea (USFK) employs about 1,900 U.S. civilians and 23,000 Korean nationals. Most of the U.S. employees are supervisors, whereas Korean employees generally occupy lower grade white-collar and virtually all blue-collar positions. Korean nationals were employed in the following categories on December 31, 1976.

Appropriated fund:		
Army and DOD	11,498	
Air Force	1,652	
Navy	138	
Korean Service Corps	<u>3,322</u>	
Total		16,610
Nonappropriated fund:		
Army	2,620	
Air Force	868	
Navy	32	
Korea Regional Exchange	<u>2,053</u>	
Total		5,573
Invited contract:		
Army	164	
Air Force	<u>361</u>	
Total		<u>525</u>
Total		<u><u>22,708</u></u>

The Korean Service Corps is an organization of civilian personnel hired by the Republic of Korea to provide logistical support to USFK. Invited contract employees are employees of U.S. contractors providing support services to USFK. With the exception of these two groups, all the Korean employees are direct hires; USFK, as the official employer, assumes responsibility for all administrative and management functions in connection with their employment. However, the Korean Service Corps and invited contract employees generally are covered by the same wage schedules as other employees. Nonappropriated fund employees work for military exchanges, clubs, and various recreation facilities and are paid from the proceeds earned by

these activities under the same wage schedules as appropriated fund employees.

Estimated payroll costs for U.S. civilian employees in Korea will be about \$38.9 million in fiscal year 1977, an average of about \$27,000 per employee. This includes base salary, a 10-percent post differential allowance, living quarters allowances, premium pay, and agency contributions to employee retirement and insurance programs. In Korea, U.S. civilian employee allowances, post differential, and change of station costs increase employee cost by about 38 percent of base pay.

Estimated payroll costs for appropriated fund foreign national employees will be about \$69.4 million in fiscal year 1977, or about \$4,200 per employee. Employees also accrue a separation allowance, which is payable in a lump sum when they terminate employment with USFK. The appropriated fund separation allowance liability was about \$57.3 million (\$3,450 per employee) as of January 1977.

#### Administration of foreign national compensation

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

Primary responsibility for foreign national personnel policies in Korea is vested with Headquarters, U.S. Forces, Korea, which acts on the advice and consent of a triservice Joint Labor Affairs Committee. Each service has one voting member on the committee, while the U.S. Embassy, nonappropriated fund representatives, and other interested parties participate as nonvoting members.

The joint committee conducts wage surveys of Korean companies to determine local prevailing wage rates and compensation practices. Recommendations for wage increases are forwarded to the triservice Pacific Command Joint Labor Policy Committee in Hawaii, which coordinates DOD foreign national personnel policies in the Pacific area. Acting on this latter committee's decision, the Commander, U.S. Army Support Group to the Commander in Chief, Pacific, in Hawaii, relays revised wage schedules to Korea.

Comparative cost--U.S. and Korean employees

While Korean labor costs remain well below U.S. civilian costs, they are catching up. Korean national wages increased 23 percent a year since 1970 in a period of rising economic activity and inflation. Using a comparison of entrance wage costs for similar positions, we estimate a locally hired U.S. civilian (no change of station costs, post differential, or housing allowance paid) would cost twice that of a Korean employee. However, costs could become comparable in 4 or 5 years if local U.S. citizen and Korean wage costs increase at an annual rate of 5 and 20 percent, respectively, and assuming a 20-percent tax return to the U.S. Government from the U.S. employee. Should this occur, USFK will need to reconsider its policy of using Korean labor to the maximum extent.

Programs for hiring local U.S. civilians

USFK hired about 240 employees under the DOD dependent hire program and through overseas limited appointments without paying change of station costs, living quarters allowances, or post differential. These employees are paid from U.S. pay schedules, covered by social security, and entitled to premium pay and leave benefits.

Under the DOD dependent hire program, the Civil Service Commission (CSC) has granted special appointing authority to overseas DOD activities to permit preferential hiring of dependents who accompany DOD employees overseas. For example, dependents in Korea are employed in U.S. positions at the GS-8 level or below by competing only with other DOD dependents.

CSC, however, recently reviewed this authority and concluded that it is no longer appropriate. They have taken the position that preferential consideration given to DOD dependents is unfair to other local U.S. citizens in each country and that the special economic situation originally used to justify the authority--the need to improve the economic conditions of military families overseas--is no longer present. The Department of Defense believes that the authority should be retained. The issue remains to be resolved. In June 1977 CSC extended the authority for an additional 60 days so that it, DOD, and the Justice Department could assess the legality of the authority. In August 1977 CSC extended the authority until such time as the Justice Department completes its assessment.

If the dependent hire program is terminated, USFK may continue to hire locally available U.S. citizens under its authority for overseas limited appointments. Subject to CSC approval for each exempted position, agencies may give overseas limited appointments without competitive examinations to U.S. citizens who are recruited overseas.

USFK officials expect a heavier administrative workload if the dependent hire program is terminated. Opportunities for hiring locally available U.S. citizens, however, may increase due to State Department dependents and U.S. veterans in Korea receiving the same consideration as DOD dependents.

REDUCED SEVERANCE COSTS POSSIBLE  
WITHOUT ADVERSE IMPACT ON EMPLOYEES

Appropriated fund employees accrue a separation, or severance, allowance as long as they are employed by USFK. At separation they receive a lump-sum payment according to a schedule that varies with the type of separation. Employees separating voluntarily generally receive less than those separating involuntarily (reduction in force, mandatory retirement). There is very low employee turnover, and nearly all separations have been involuntary.

DOD nonappropriated club and mess activities in Korea currently liquidate their severance liability every 2 years by depositing their employees' accrued severance in a Korean bank. The employee gains interest benefits (presently about 18 percent) but cannot withdraw the funds without proof of separation from USFK employment. The Korea Regional Exchange adopted a similar plan in April 1977. Both the Korean Office of Labor Affairs and affected employees endorsed the exchange's plan.

One advantage of the nonappropriated plan is that the severance liability is liquidated before accruals begin to accumulate at an accelerated rate. Under the current appropriated fund method, an employee earns credit months of salary for severance purposes at the accelerated rate shown below.

<u>Years of service</u>	<u>Credit months of salary earned (involuntary separation)</u>
2	2.0
5	7.5
10	20.0
15	35.0
20	43.5

Also, each pay raise has a retroactive effect on the entire severance liability. Periodically liquidating the severance liability limits the retroactive effect to the date of last payment.

By adopting the nonappropriated biennial plan or an annual payment plan, appropriated activities could realize sizeable savings. We projected severance owed under the current accrual method--which assumes involuntary separation--and compared the liability with the cost of annual and biennial payment plans. The following table shows the estimate of savings.

	<u>Cumulative severance liability under current method</u>	<u>Cumulative payments under annual plan</u>	<u>Cumulative savings</u>	<u>Cumulative payments under biennial plan</u>	<u>Cumulative savings</u>
----- (000 omitted) -----					
Jan. 1977	\$ 57,339	\$ 57,339	\$ -	\$ 57,339	\$ -
After 5 years	125,904	98,249	27,655	101,156	24,748
After 10 years	341,601	206,980	134,621	221,478	120,123

The above computations assume (1) projected base pay increases of 15 percent per year and total compensation (base pay plus allowances and bonuses) of 20 percent per year; (2) an average increase to the work force of one promotion, two step increases, and 3 additional years of service over a 10-year period; and (3) a work force of constant size.<sup>1</sup>

Moreover, these savings would not be at the expense of the employee. We projected total severance accumulated under the various accrual methods for a typical Korean national--a manual worker at the average grade with average length of service. Base pay and total compensation were again projected to increase at 15 and 20 percent, respectively, and the employee was estimated to receive one promotion and four step increases over 10 years. Our comparison of severance payments under the various accrual methods follows.

	<u>Current method (voluntary separation)</u>	<u>Current method (involuntary separation)</u>	<u>Annual plan at:</u>		<u>Biennial plan at:</u>	
			<u>18 percent interest</u>	<u>26 percent interest</u>	<u>18 percent interest</u>	<u>26 percent interest</u>
After 5 years	\$ 9,432	\$12,576	\$11,282	\$14,817	\$11,351	\$14,795
After 10 years	31,339	35,998	35,062	57,602	35,311	57,220

Nonappropriated fund employees receive about 18 percent from 2-year time deposits in local banks. A representative of the Army Comptroller suggested that severance payments could perhaps be added to a newly initiated payroll savings program, which was expected to earn 26 to 28 percent interest

<sup>1</sup>The President's announced program to reduce U.S. Forces in Korea may reduce savings.

annually. The potential savings and simplified administrative procedures warrant consideration of the annual plan

### Recommendation

We recommend that the Secretary of Defense direct the military departments to develop and adopt an annual severance liquidation plan in Korea. USFK officials generally agreed that a periodic payment plan was workable and accordingly have undertaken a study to develop detailed plans for converting to an annual liquidation severance plan. The estimated date of conversion is April 1, 1978.

### WAGE SURVEY IMPROVEMENTS NEEDED

The annual USFK wage survey entails considerable effort and requires extensive data analysis. The 1976 wage survey involved about 4 staff-years of effort at a cost of over \$50,000. Survey teams visited over 100 Korean companies and obtained compensation data on selected key jobs. The data was edited, summarized, and used as a basis for establishing USFK's wage rates.

To more fully bring USFK compensation in line with local prevailing compensation levels, we believe the following changes should be made to USFK wage surveys and compensation practices.

- Include employees of the Korean Government in the surveys in order to get a more representative sampling of local wages.
- Select survey key jobs that more accurately represent the USFK work force.
- Equate survey results to the average earnings of USFK employees rather than a predetermined step of the wage schedule, so that average USFK earnings will equal average local earnings.
- Calculate premium pay on base pay only instead of base pay plus allowances.

### Surveying employees of the Korean Government

Although the Government of Korea is the largest employer in the country, USFK does not include those employees in the wage survey. A Korean maintenance depot was surveyed during the 1976 wage survey; however, only partial information was provided, and the data was not included in survey results.

Officials stated that in prior years the Korean Government paid low salaries but acknowledged that recent wage increases had made Government positions more representative of the local economy.

USFK officials were concerned that surveying large numbers of Government employees might bias survey results downward. However, without this data USFK surveys do not accurately reflect average prevailing rates. In 1976, 108 Korean companies were surveyed under USFK's criteria that surveyed companies be reputable, responsible, and representative. Officials acknowledged that the criteria limit selection to the higher paying Korean companies and that they intended to exclude those employers whose pay practices are substandard or have "sweat shop" working conditions.

Independent wage statistics show, in part, the effect of selecting higher paying companies. The Bank of Korea estimates that the monthly average wage for mining and manufacturing employees during the first 10 months of 1976 was \$105. A Korean Government employee equivalent to the average USFK employee currently earns about \$183 monthly. This contrasts with the average monthly salary for all USFK employees, which is about \$250. We believe prevailing pay and benefits would be more truly reflected by including at least a selected sample of Government employees in the USFK wage survey.

Joint Labor Policy Committee members in Hawaii agreed that more effort should be made to survey Government employees, particularly in those agencies which could provide job matches for USFK positions not found in the private sector, such as water treatment operators and firefighters. At the conclusion of our review in Korea, USFK officials were planning to include Government of Korea employees in future surveys.

#### Selecting key jobs that represent the work force

Rather than survey wages paid for each position, about 90 key jobs are used to represent the USFK work force. Selecting representative key jobs is essential to obtaining prevailing wage rates; however, key jobs were not always representative of the USFK work force.

The wage survey included some jobs, such as messenger and gardener, that had few employees but excluded other positions, such as water treatment and power plant operators, that had as many as 300 employees. These are jobs not common in private industry that could be matched in the survey by including employees of the Korean Government.

Some key job positions were representative of the work force but their grade levels were not. For example, USFK had 4 personnel clerks at the surveyed grade 4 level and 40 at the unsurveyed grade 5 level. As another example, the grade 3 telephone operator position was surveyed although USFK had one employee at that level, while the grade 4 position with 160 incumbents was not surveyed.

Some grade levels for nonmanual positions were overrepresented in the survey while others were underrepresented. For example, nonmanual employees at grades 3 and 4 represented only 37 percent of the total USFK work force, but 83 percent of the surveyed nonmanual employees. Conversely, employees at grades 5, 6, and 7 represented 42 percent of the USFK work force, but only 8 percent of the surveyed employees.

Key job selection is hampered because personnel managers do not monitor the makeup of the USFK work force to determine which jobs and grade levels are representative. Also, the key job list is not systematically updated except to add or drop specific jobs at the request of various activities. USFK officials agreed that the key job list needs to be revised and therefore established a procedure to review the list every 6 months to eliminate nonrepresentative jobs and add representative ones.

#### Equating survey results to average USFK earnings

The average local wage as determined by wage surveys is established as step 5 of USFK's 10-step manual and nonmanual wage schedules. We believe that private sector average pay rates should be related to average earnings, as is the case with Federal white-collar workers, rather than to a predetermined step. The Office of Management and Budget, the Civil Service Commission, and we reasoned this was appropriate because private sector averages represented neither an entry rate nor a final rate but, rather, a rate earned by persons who averaged an unknown number of years' experience and an unknown number of pay increases corresponding to Federal within-grade increases.

We believe a similar rationale is applicable in determining wages of Korean employees of USFK. The average step for nonmanual and manual Korean employees generally varied between step 7 and step 9. Had 1976 wage survey averages been equated to step 7 rather than step 5, 1977 USFK payroll costs would have been reduced by about \$6.4 million (\$4.5 million for the Army, \$.5 million for the Air Force, and about \$1.4 million for nonappropriated fund activities). If equated to step 9, about \$12.5 million could have been saved.

Joint Labor Policy Committee members in Hawaii felt that equating prevailing rates to step 5 was the best available method of establishing comparability. Because of the relatively recent advent of diversified industry in Korea, USFK believes not many firms have employees with long tenure. Therefore, the average USFK employee may have more experience than the average private sector employee.

Nevertheless, the fact remains that under present methods of equating wage rates, the average USFK employee may receive from 7 to 14 percent more than the comparable private sector employee. In the absence of data on pay-range spreads and actual location in the salary range of surveyed employees, it is logical to equate the averages of the USFK and surveyed work sectors. The Secretary of Defense recently commented on this point in a letter to the Chairman of the Armed Services Committee endorsing Federal blue-collar wage reform in the United States. He reported:

"True comparability cannot be achieved, however, as long as there is a requirement for any fixed step as the payline rate. It can only be achieved by comparing average private industry earnings as determined by surveys to the average earnings of Federal blue-collar workers and then making adjustments in rates to bring Federal rates in line with local prevailing rates."

Korean blue- and white-collar employees are paid from 13-grade, 10-step wage schedules. These schedules were adopted in the 1950s and patterned after the U.S. civil service system rather than local prevailing practices. Employees advance from step 1 to step 10 in only 9 years. As a result, over half the work force is at the top step and the union has strongly urged that additional steps be added. Such action would, in our opinion, compound the problem of wage comparability caused by equating survey results to the predetermined step 5.

Prevailing practices on within-grade step increases have not been thoroughly studied, but limited information at USFK suggests that local firms use wage schedules having several more steps than USFK's 10-step schedules. If this is shown to be the case, it is appropriate that a change to the average-to-average method for setting wages, as discussed above, should go hand in hand with rev. sing within-grade step increases to conform to local practices.

Excluding allowances in calculating premium pay

Premium pay, or overtime, is calculated by USFK as 150 percent of base pay plus an allowance called Consolidated Allowance Payment (CAP). CAP represents cash payments for such things as a special skill or responsibility and amounted to 5.8 percent of total compensation in 1976. After attempting to follow USFK's method in computing premium pay, the U.S. Embassy was told by the State Department that premium pay should be computed on base pay only. The State Department judged that including allowances in premium pay is prohibited by the Foreign Affairs Manual and also is not a prevailing local practice in Korea.

USFK officials agreed to include CAP in calculating premium pay at the request of the Republic of Korea Office of Labor Affairs. Officials stated that even though Korean labor laws are not binding on U.S. Government agencies, USFK seeks to conform to Korean Government requests when possible. We estimate that including CAP in premium pay cost an additional \$246,000 in 1977 for appropriated fund activities.

Conclusions and recommendations

Compensation payments for the 23,000 Korean nationals constitute a considerable cost for the U.S. presence in that country. Much effort is expended by USFK to establish compensation levels that are comparable to local prevailing rates, thereby providing equity to both employer and employee. We believe that some changes to the compensation system are called for in order to more fully realize wage comparability. Some changes have already been made and others are underway.

We recommend that the Secretary of Defense direct the military departments to

- include Government of Korea employees in future wage surveys,
- annually adjust wages by equating survey results to average USFK earnings rather than to a predetermined step, and
- discontinue including allowances in premium pay.

RESTRICTIVE LABOR LEGISLATION

In the Status of Forces Agreement, the United States agreed to conform with Korean labor laws to the extent not

inconsistent with military requirements. In the past, USFK has generally complied with labor laws and that country's interpretations of those laws. However, this is adversely affecting USFK's contracting flexibility and could prevent USFK from implementing cost-saving measures applicable to its own Korean work force.

Korea's labor laws are selectively enforced for Korean companies, depending on their economic condition. Because USFK is considered a solvent operation--it has the capability to pay--the Korean Government has been reluctant to exempt USFK from labor law provisions.

Those provisions state, "An employer shall not resort to dismissal, temporary rest of work, suspension, transfer, reduction of wage, or any other disciplinary action without justifiable reason." Korea's Office of Labor Affairs has interpreted this to mean--and USFK has accepted the interpretation--that no reduction of wages or deterioration of compensation will occur when an in-house function is contracted out. The contractor must hire the separated in-house personnel and pay the same wages that USFK paid, which effectively negates any personnel cost savings.

USFK officials generally agreed that opportunities to contract were restricted by the Korean Government's interpretation. The Director of Civilian Personnel stated that USFK had little recourse because the issue involved Korean contractors complying with Korean laws and that USFK was not actually prevented from contracting for any service. Other officials, however, cited that article XVI of the Status of Forces Agreement grants USFK the right to unrestricted contracting.

A number of USFK functions could be accomplished at less cost by unrestricted contracting. In 1975 the Air Force attempted to contract out its in-house mess attendant operation at an estimated annual savings, primarily in personnel costs, of over \$30,000. The Office of Labor Affairs exerted pressure on the Korean contractor to hire the Air Force mess attendants at their current wages, citing the no-deterioration interpretation as the rationale. The Air Force canceled the contract and has continued its mess attendant operation on an in-house basis.

The Army is currently considering contracting for guard services, now provided in-house, at an estimated savings of \$1 million annually. Officials, however, are not optimistic about this because the Korean Government will probably impose the no-deterioration clause on any potential contractor, thus eliminating personnel cost savings. This clause has also prevented serious consideration of other in-house functions,

such as firefighting and laundry services, which, according to officials, might also be contracted out at a lesser cost.

Officials have also suggested that the no-deterioration interpretation may also restrict actions to reduce the costs of its direct-hire work force. Accepting this interpretation could limit opportunities to change the step system, the method of computing premium pay, and the method of matching wage rates, as well as the pursuing of other potential cost-saving measures.

#### Conclusions and recommendation

USFK's compliance with the Korean labor law interpretations appears to limit cost-effective contract opportunities and possibly precludes economical changes to the Korean work force. Based on the criteria that USFK wages be determined by prevailing practices and public interest, we disagree with any restrictions which force USFK to pay wages above or below levels dictated by these criteria. We therefore recommend that the Secretary of Defense direct USFK to 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.

(963064)