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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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The Foreign Service Act provided that compensation for foreign national employees will be based on locally prevailing wage rates consistent with the public interest. Under an agreement with the Italian Government, the Department of Defense (DOD) directly employs Italian nationals, establishes pay and fringe benefits, and sets personnel policies with little involvement by the Italian Government. Findings/Conclusions: Using a complicated system patterned closely after private industry, the Army, Navy, and Air Force incur payroll costs of about \$36 million annually for their foreign national work force in Italy. Annual wage surveys help assure that DOD compensation is in line with prevailing local practice, and recent pay increases appear comparable to those granted in the private economy. However, significant savings appear possible if certain aspects of the wage setting process are changed, including hiring of more Americans. Recommendations: The Secretary of Defense should: determine if the payroll costs savings of providing subsidized dining facilities at military installations in Italy would be offset by the facilities and administrative costs incurred, determine if the extra benefits under the Army and Air Force's health insurance program for Italian employees justify higher premium costs and whether these employees should be covered under the Navy's less expensive plan, and develop plans and proposals for restructuring the civilian work force in Italy in coming years as a large number of foreign national employees retire. (RRS)

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*REPORT TO THE SENATE COMMITTEE  
ON APPROPRIATIONS*

*BY THE COMPTROLLER GENERAL  
OF THE UNITED STATES*

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**Possible Savings  
In Department Of  
Defense Personnel  
Costs In Italy**

This report on foreign national employment practices in Italy is GAO's fourth in a series on five countries. The Department of Defense employs over 3,500 Italian nationals at an annual cost of over \$36 million. Although its personnel policies and compensation there are generally in line with prevailing private practices, significant savings appear possible if certain aspects of compensation setting and administration are changed.

GAO recommends that the Secretary of Defense determine whether all Italian nationals should be covered under a single health insurance program, develop plans for hiring more Americans, and determine the cost effectiveness of providing subsidized dining facilities at all military installations.





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 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 Italy addresses the cost of compensation benefits, possible substitutes for Italian nationals, and constraints against assembling the most economical work force. We are making recommendations to the Secretary of Defense which could result in reduced personnel costs.

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 cursive script, appearing to read "James B. Stacks".

Comptroller General  
of the United States

CHANGES IN FOREIGN NATIONAL COMPENSATIONPRACTICES IN ITALY COULD REDUCE PERSONNEL COSTSBACKGROUND

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

The NATO Status of Forces Agreement and a 1957 agreement between the Department of Defense (DOD) and the Italian Government established a direct-hire system of employment for Italian nationals. Under this system, DOD directly employs Italian nationals, establishes pay and fringe benefits, and sets personnel policies, with little involvement by the Italian Government.

The U.S. European Command has designated the Navy to be the chairman of the Civilian Personnel Coordinating Committee for Italy. Army, Air Force, and Navy representatives on the committee meet regularly to review personnel matters, oversee wage surveys, and assure a unified U.S. policy on Italian national employment.

Wages paid to Italian employees are determined through annual wage surveys of private companies in areas around U.S. military bases. Patterning DOD employment policies for Italian nationals on prevailing local practices has led to a somewhat complex pay formula. Under the pay system, base pay is a relatively small fraction of the total compensation received by employees. The various pay and fringe benefit items are summarized below:

- Base pay--the basic item of compensation, varying by grade level but standardized for all DOD components in Italy.
- Cost-of-living allowance (contingenza)--an allowance established by Italian law to provide automatic pay raises as the cost-of-living index rises. The allowance is adjusted quarterly with the amount paid varying by grade.
- Third element--a DOD consolidation of various pay elements which are given separately by the private sector but are not included in other DOD pay categories. The third element varies by geographical area and is higher for white-collar than for blue-collar workers.

- Seniority pay--a biennial increase (4 percent of the total of base pay and cost-of-living allowance for blue-collar employees and 5 percent of the total for white-collar employees) for every 2 years of creditable service.
- Allowances--payments made for specific purposes, such as lunch allowances, transportation allowances (commuting expenses to and from work), language bonuses (no longer given to new employees), headset allowances (for switchboard operators who wear headsets), and family allowances (specific amounts dictated by Italian law for each family member).
- Bonuses--includes summer and Christmas bonuses, each consisting of 1 month's "regular" pay (the total of base pay, cost-of-living allowance, third element, and seniority payments) and spring and fall bonuses totaling about \$190 for most employees.
- Social security contributions--premiums for Italian social security amounting to about 20 percent of total pay to cover retirement benefits, disability, old age, unemployment, and various other social programs.
- Other insurance premiums--includes health insurance premiums for Italian group programs. The Navy uses a different, less expensive program than the Army and Air Force, as discussed later. Also included are on-the-job accident insurance premiums for employees exposed to hazardous working conditions.

Number of employees and wages

As of early 1977, DOD employed about 3,500 Italian nationals at a total annual payroll estimated at \$36.4 million. Appropriated-fund activities accounted for about 2,500 of the employees and about \$26.6 million of the cost. The table below shows the breakout of Italian employees.

| <u>Employer</u>                   | <u>Number</u>            |                             | <u>Total</u>        |
|-----------------------------------|--------------------------|-----------------------------|---------------------|
|                                   | <u>Appropriated fund</u> | <u>Nonappropriated fund</u> |                     |
| Army                              | 1,000                    | 99                          | 1,099               |
| Air Force                         | 611                      | 67                          | 678                 |
| Navy                              | 901                      | 53                          | 954                 |
| Navy and Army/Air Force Exchanges | -                        | 788                         | 788                 |
| <b>Total</b>                      | <b><u>2,512</u></b>      | <b><u>1,007</u></b>         | <b><u>3,519</u></b> |

In the past 3 years, Italian national pay rates (expressed in local currency and unadjusted for changes in the rate of exchange) increased at an average of 17.8 percent a year, about the same as increases in the Italian private economy. However, during this period the value of \$1 increased approximately 35 percent, from 650 lire in 1975 to about 880 lire in August 1977. Thus, expressed in dollars, compensation rates increased at an average of less than 10 percent a year.

Pay is increased for Italian nationals in two ways-- through changes in base pay or allowances, as indicated by wage surveys, and through increases in the cost-of-living allowance (contingenza). In recent years, much of the overall increase can be traced to the contingenza. From January 1975 to July 1977, the allowance for an average employee increased 181 percent, from about 54,400 lire per month to over 153 100 lire per month. In July 1977 a typical Italian employee at the Navy base in Naples received pay and allowances totaling about \$9,000 annually, including a contingenza of \$2,098. Other major pay components included base pay of \$1,941, seniority pay of \$1,933, bonuses totaling \$1,372, and third element pay of \$833.

Although Defense's personnel policies and compensation are, for the most part, in line with the Italian private economy, significant savings appear possible if certain aspects of the wage setting process are changed. In addition, opportunities exist for increased hiring of Americans in Italy.

#### ARMY AND AIR FORCE PAY MUCH MORE FOR HEALTH INSURANCE THAN NAVY PAYS

In accordance with prevailing practice in Italy, DOD provides health insurance coverage for its foreign nationals through health plans available in Italy. The Army and Air Force coverage, however, costs about three times as much per employee as coverage provided by the Navy and the U.S. Embassy.

The Army and Air Force enroll Italian employees in a health program called "INAM." This program is widely used by manufacturing firms and is reportedly the largest health plan in Italy. The program also defrays some salary and wage costs for certain employees who are on sick leave or hospitalized. INAM premium costs to DOD equal about 14 percent of a blue-collar employee's and 12 percent of a white-collar employee's salary. We estimate the average annual

cost of INAM to be about \$1,100 per employee, or a total of \$1.8 million for all Army and Air Force appropriated-fund foreign nationals in Italy.

The Navy and the U.S. Embassy's health insurance program is called "ENPDEP." This quasi-governmental program is used primarily by foreign missions and international organizations employing Italian nationals. The Embassy and the Navy negotiate premiums annually with ENPDEP. Currently, the program costs the Navy about \$286 annually per employee, or a total of about \$260,000 for the Navy's appropriated-fund Italian nationals.

Army officials favor retaining the INAM program despite higher premium costs because employees have grown familiar with its coverage and procedures. No comparison between INAM and ENPDEP had been made by the Army or the Air Force to determine whether the extra benefits under INAM justify the higher premium costs.

Because of the potential sizeable savings involved, we recommend that the Department of Defense conduct such a study. We estimate the Army and Air Force could save well over \$1 million annually if their Italian employees were enrolled in the ENPDEP program at premiums comparable to those paid by the Navy and the Embassy. In order to maximize total savings, action should be taken quickly. Italy is moving toward a national health insurance program which may eliminate individual private programs. This program could be in operation in 3 to 5 years.

#### SUBSIDIZED DINING FACILITY MAY BE LESS COSTLY THAN LUNCH ALLOWANCE

Employers in Italy generally provide employees with a subsidized dining hall or pay them a cash lunch allowance. Major U.S. Army posts in Italy provide their foreign employees with a subsidized lunch at an on-base dining facility while Navy and Air Force bases pay a cash lunch allowance. The Army's subsidized dining halls have resulted in lower payroll costs, and we believe that the Navy and Air Force could also reduce their payroll costs by providing subsidized dining facilities. Any savings would have to be reduced by the additional related costs incurred; however, we were not able to determine whether existing facilities were available or whether additional startup and administrative costs would offset the projected payroll cost savings.

DOD regularly surveys private companies to determine the amount and type of meal subsidies and allowances provided; then it tries to provide similar benefits to its

employees. DOD currently provides a subsidy of 950 lire (about \$1.08) per meal where facilities have a dining hall or pays a cash lunch allowance to the employee of 9,000 lire (\$10.23) per month if the facility does not have a dining hall. The two major Army posts (Livorno/Pisa and Vicenza) provide a subsidized dining hall for about 950 appropriated-fund employees; the Navy and Air Force, with about 1,500 employees, pay the monthly cash allowance.

While the lunch allowance is set at 9,000 lire per month, per employee, the true cost is considerably higher because this allowance is included when computing the extra 2 months' bonuses, severance pay, and insurance contributions. These extra provisions make the total monthly cost of the allowance per employee close to 15,000 lire per month.

Also, the 9,000 lire allowance is paid every month, whether the employee incurs any lunch expense or not. It is even paid when the employee is on annual or sick leave. The meal subsidy, on the other hand, is only incurred when the employee actually uses the lunch facility. The Army's dining halls are operated by a contractor who is paid the 950 lire for each meal served. The Army's experience in Italy has shown that less than half the eligible employees actually eat subsidized meals on an average day. For example, during May 1977 the contractor served 8,539 meals, an average of about 388 per work day. This represents a use factor of about 47 percent since at least 831 Army employees were eligible for the subsidized meals during that month. At the rates then in effect, 1/ the amount of the subsidy that month was about \$7,300; however, if a cash lunch allowance had been paid that month to Army employees, the cost would have been an estimated \$11,000, considering the effect on bonuses, severance pay, and insurance contributions.

The Navy and Air Force currently pay an estimated \$280,000 annually in total lunch allowances. If subsidized meals were provided in lieu of a lunch allowance, the appropriated-fund payroll savings--before any offset for facilities and administrative cost--could be as much as \$65,000 a year, given the Army's use rates. Additional payroll savings are possible in nonappropriated funds.

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1/During May 1977 the per-meal subsidy was 750 lire and the cash allowance was 7,000 lire per month. The increase to 950 lire and 9,000 lire, respectively, became effective on July 1, 1977.

Employee unions have asked for subsidized lunch facilities for some years. The Navy and Air Force have resisted union demands at their locations for two main reasons:

- Providing a facility entails a substantial initial investment to remodel or construct a building and obtain the major equipment items for the contractor's use.
- There are recurring administrative and utilities costs connected with operating a dining hall.

In view of the unions' interest and the possibility of sizeable payroll cost savings, we recommend that DOD conduct a cost analysis to determine the benefits of providing subsidized dining facilities in Italy and to provide such facilities if the analysis shows it to be the most economical practice.

#### CONSTRAINTS AGAINST USING MORE LOCALLY FIRED AMERICANS

DOD can benefit by using locally hired U.S. personnel in Italy to fill vacant jobs, especially in those positions previously held by Italian nationals. For the past 2 years, however, DOD has voluntarily limited the number of DOD dependents and other Americans working in Italy because of pressure from the Italian Government and major labor unions to maintain a constant ratio of U.S. to Italian employees.

Foreign national wage costs in Italy now approximate those of Americans paid under the Civil Service General Schedule (GS) scale. Costs at the lowest level--GS-1 and 2--are already less for the Americans. At higher levels, including the mid-level clerical workers at grades GS-4 and GS-5 which predominate in the foreign national work force, locally hired Americans appear slightly more expensive when comparing pay and fringe benefits costs. For example, an Italian clerk, equivalent to a GS-4, costs DOD \$7,888 for his first year of employment in Naples; in Vicenza, the first-year cost would be \$8,536. An American, locally hired for the same job, would cost an estimated \$8,898 in pay and benefits during the first year in either location.

Other factors must be considered, however. For example, turnover for Italian nationals is very low. DOD dependents, on the other hand, leave their jobs every 2 to 3 years when their sponsors rotate to another assignment. Over the years, therefore, the foreign employee will earn seniority pay and promotions, while an American would likely be replaced by

another American at the starting pay. Moreover, if foreign national pay continues to increase faster than pay under the General Schedule, costs for even first-year Italian employees will soon exceed the cost of an American at most locations.

Americans also earn 5 fewer holidays each year, 7 fewer days of annual leave, and much less sick leave than Italian employees. Americans pay a portion of their income back to the United States as income taxes, while foreign employees pay no U.S. taxes. DOD dependents also spend a large portion of their pay in U.S. military facilities overseas (such as post exchanges, commissaries, and clubs) thus reducing the impact on the balance of payments.

Under DOD's dependent-hire program begun in 1972, the services in Italy are authorized to give first choice for vacant jobs to dependents of DOD personnel stationed in Italy. As of July 1977, DOD dependent hires totaled about 780, divided about equally between appropriated- and nonappropriated-fund activities, primarily in positions designated to be filled by U.S. civilians. The Army and Air Force had about 64 dependents holding appropriated-fund positions designated for foreign nationals, while the Navy has generally avoided hiring dependents for such positions.

Italian labor unions have been suspicious of the dependent-hire program for a number of years, and they fear that the program will take away jobs otherwise available to Italians. They contend that under the NATO Status of Forces Agreement these jobs rightly belong to Italians. DOD has not agreed that the United States is required to hire Italians for all local jobs, but it recognizes and respects the pressure that the unions can bring to bear. In 1975 the unions protested the firing of five foreign national employees at the San Vito noncommissioned officers club, claiming they were being replaced by American dependents. A 2-day strike disrupted the air station and gained the attention of the Italian Government and the U.S. Ambassador. The Ambassador addressed the January 1976 Civilian Personnel Coordinating Committee meeting in Rome and called for restraint in dismissing foreign nationals and hiring dependents for jobs vacated by or available to foreign nationals. He cited the strategic importance of Italy to the United States, NATO military interests, and the volatility of the employment situation in Italy as major reasons for accommodating union demands.

Consequently, DOD altered the dependent-hire program to allow exceptions in countries where economic or political

conditions necessitate greater consideration of foreign national employment needs. The Civilian Personnel Coordinating Committee in Italy then adopted a program to maintain the same ratio of U.S. civilian to foreign employees that existed in March 1976. At that time, there were 3,475 Italian nationals and about 1,200 Americans--about 2.9 to 1. As of early 1977 DOD, overall, had maintained this ratio. Maintaining the ratio means, in effect, that Americans can only be hired to fill positions vacated by other Americans since an American taking a job formerly held by an Italian employee would upset the balance.

According to Army and Air Force officials, many current foreign nationals are long-term employees who will be retiring in the next 5 years. When this turnover begins, unions will probably pressure DOD to hire a new generation of local employees who could once again be expected to spend their careers with DOD, receive seniority pay raises, and accrue substantial severance pay benefits. DOD will then have lost an opportunity to achieve significant payroll cost savings by hiring more Americans or by reducing the total foreign national work force. We believe that DOD must begin planning now for a major restructuring of its work force as current employees retire in increasing numbers. Such a plan must consider the needs of Italian labor unions and potential repercussions of denying jobs to Italians.

Any action taken, however, should await the outcome of the Civil Service Commission decision on the future of the dependent-hire program. The Commission has taken the position that preferential consideration given to DOD dependents is unfair to other 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 the Commission 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 the Commission extended the authority until such time as the Justice Department completes its assessment. As of February 1, 1978, that assessment had not been completed.

#### CONCLUSIONS AND RECOMMENDATIONS

Using a complicated system patterned closely after private industry, the Army, Navy, and Air Force incur payroll

costs of about \$36 million annually for their foreign national work force in Italy. Annual wage surveys help assure that DOD compensation is in line with prevailing practice in Italy, and recent pay increases appear comparable to those granted in the private economy. We believe that significant savings appear possible in Italian national personnel costs, and we therefore recommend that the Secretary of Defense:

- 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 costs incurred. DOD should provide such facilities if it proves to be the most economical practice.
- 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.
- 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.