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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 89/163

10:00 a.m., December 15, 1989

M. Camdessus, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
F. Cassell	
	G. C. Noonan
Dai Q.	
T. C. Dawson	C. S. Warner
J. de Groote	
	L. B. Monyake
E. A. Evans	
E. V. Feldman	
	A. Napky, Temporary
	N. Kyriazidis
M. Finaish	A. M. Othman
M. Fogelholm	
	O. Kabbaj
G. Grosche	
	S. P. Shrestha, Temporary
	S. Gurumurthi, Temporary
A. Kafka	F. A. Quirós, Temporary
J.-P. Landau	
	J. K. Orleans-Lindsay, Temporary
	M. Al-Jasser
	G. P. J. Hogeweg
	K. Ichikawa, Temporary

J. W. Lang, Jr., Acting Secretary
K. S. Friedman, Assistant

<u>Also Present</u>

Administration Department: G. F. Rea, Director; D. S. Cutler, F. X. Hogan, K. M. La Fleur. European Department: D. M. Ripley. Exchange and Trade Relations Department: J. T. Boorman, Deputy Director; E. Brau, M. R. Kelly, A. K. McGuirk. External Relations Department: I. S. McDonald. Fiscal Affairs Department: R. Hemming. Legal Department: W. E. Holder, Deputy General Counsel; T. M. C. Asser, R. C. Effros. Secretary's Department: L. Van Houtven, Secretary and Counsellor; C. Brachet, Deputy Secretary; R. S. Franklin, A. Tahari. Middle Eastern Department: C. A. Yandle. Western Hemisphere Department: S. T. Beza, Counsellor and Director. Bureau of Language Services: A. Wright, Director. Bureau of Statistics: R. T. Stillson. Office of the Managing Director: R Noë, Internal Auditor. Personal Assistant to the Managing Director: H. G. O. Simpson. Advisors to Executive Directors: M. B. Chatah, Z. Iqbal, J.-L. Menda, P. O. Montórfano. Assistants to Executive Directors: J. R. N. Almeida, G. Bindley-Taylor, C. Björklund, B. A. Christiansen, A. Y. El Mahdi, C. J. Jarvis, G. Montiel, N, Morshed, P. Peeters, A. Rieffel, H.-J. Scheid, M. J. Shaffrey, Shao Z.

1. REPORT BY MANAGING DIRECTOR

The Managing Director commented that during his recent visit to Poland he had discussed with the authorities the text of a letter of intent. Agreement had been reached on the most substantive and difficult issues, particularly the income restraint necessary to eliminate the currently skyrocketing inflation. He hoped that agreement on the letter of intent would be reached in the coming days.

One of the main concerns at present was the need to quickly assemble and introduce the crucially important Stabilization Fund, the Managing Director continued. Such a fund would normally be unnecessary if the Fund's quotas were adequate. He hoped that those working on the Stabilization Fund would avoid imposing excessive regulations and constraints on that fund, so that the authorities would feel confident that it would be effective in practice. The meeting of the gOroup of Twenty-Four countries convened by the Commission of the European Communities to coordinate assistance to Hungary and Poland had recently welcomed the attainment of the $1 billion goal for the establishment of the Stabilization Fund for Poland. At the same time, the Ministers recognized that it was imperative that the remaining technical questions related to establishing the fund be dealt with without delay.

The proposed program for Poland was very ambitious, and there was no certainty that it would be socially and politically acceptable, the Managing Director said. After all, the program entailed a 30-40 percent drop in real wages in 1990, which the authorities had agreed was necessary. One of the main purposes of his visit to Poland had been to ascertain whether there was sufficient support for the program. To that end, he had held discussions with the head of Solidarity, the President of the Senate, church leaders, the leader of the former official unions--whose membership exceeded that of Solidarity--the Prime Minister, and the President. The President and the Prime Minister had stressed that they would remain committed to the program as long as necessary to ensure its successful implementation despite the difficulties that were likely to be encountered.

He was strongly convinced that centrally planned economies must act immediately to unleash prices and wages, recognize and deal with hidden unemployment, and face the problem of foreign debt, the Managing Director continued. In so doing, there was no room for gradualism or a piecemeal approach. Governments must act when they enjoyed the credibility needed to introduce important changes.

The proposed program had not been imposed on the Polish authorities; it was the product of negotiations, during which the staff and management had stressed the consequences of failure to implement needed measures, the Managing Director commented. While the authorities clearly wished to move to a market economy, they lacked experience with the economic culture of such an economy, including a full appreciation of the interrelationships among all the various important economic and financial variables. The role of the Fund team in Poland had been to shed light on those interrelationships although the team had done so without the benefit of any precise model of change--concerning, for example, the likely supply response to market signals, and particularly the process of abandoning customs created by 40 years of constraints imposed by key, centrally adopted economic decisions.

Every effort had been made to ensure that the program would prove to be workable, and he was pleased that the program was to be made more acceptable and workable through important social safety nets, the Managing Director remarked. Two important parts of the program were a labor fund to encourage mobility by providing retraining and vocational training, and provisions to try to shelter the most vulnerable persons--including children and single-parent families--from the adverse effects of the increases in prices of basic products.

The roles that each of the main institutions in Poland should play had not yet been fully defined, the Managing Director noted. But the church, the Government, and the unions realized that there was an urgent need to act.

While in Brussels for the meeting of the Group of Twenty-Four countries to which he had referred, following his visit to Poland, he had met with the Finance Minister of Hungary, the Managing Director continued. After discussions with the staff, the authorities were now willing to accept the required harsh budgetary measures, particularly a cut in subsidies equivalent to 2 percentage points of GDP, and they had accepted the targets suggested by the Fund for the balance of payments in 1990. The discussions with the authorities had not yet been completed; there were still two major problems to settle, namely, monetary targets and the final assessment of the country's debt. The negotiations thus far suggested that it should be possible to conclude a stand-by arrangement that could help the authorities through the transitional period in 1990. To that end, there would have to be a new round of negotiations at the end of 1989 or the beginning of 1990. EC balance of payments support of $1 billion was fully linked to an agreement with the Fund. He had told the Ministers in Brussels that their contribution would be most welcome in view of the extreme stress and strains on the exchange rate that seemed likely in Hungary during the first part of 1990.

Mr. Al-Jasser commented that the planned wage cuts in Poland seemed substantial. It would be useful to know how large the cuts were likely to be in real and historical terms.

The Managing Director noted that real wages had been increased by 25 percent at the beginning of 1989 and again in the recent past. The proposed cuts would take wages back to the situation prevailing before the current transitional period. The cuts were particularly difficult because it was always hard to rescind a wage increase to which workers had become accustomed to receiving, and because, with the lifting of price controls, the rate of inflation could reach 50-60 percent per month for a while;

moreover, much smaller than usual compensatory wage increases, of about 20 percent, would be permitted during the three or four months of the pass-through effect of the liberalization of retail prices.

Mr. Fogelholm said that he wondered whether the Managing Director had the impression that the general public was aware of the severity of the adjustment program. Presumably the effects of the program could be a major shock unless the public was well prepared by the politicians and other leaders.

The Managing Director replied that Mr. Walesa had stressed that, while the public would support the program in the coming months, the program must clearly be seen to be successful. The church leaders had said that they recognized the serious adverse effects of the program, but they had noted that Poland had faced and withstood many tests in the past; at the same time, the church leaders planned to press the Government to shelter the poorest segments of the population from the effects of the adjustment effort. The leader of the official unions had said that he agreed with the Government's objectives but not its strategy; he preferred to see production rise first and then reduce inflation and the economic imbalances. He himself had responded that inflation must be reduced if output was to be strengthened, and that eliminating the budget deficit was a prerequisite for containing the inflation. During his discussions with the authorities, he had stressed the importance of establishing a market that would attract foreign investors, who were waiting to see whether Poland would succeed in controlling the inflation in the country and whether Solidarity and the Government were firmly behind the adjustment program.

If the contributions of bilateral donors were to be effective, the terms would have to be very simple, the Managing Director said. In that connection, the bilateral donors must avoid linking conditions to their contributions; the donors must be extremely flexible--for example, in permitting the authorities to use counterpart funds, which would have to be sterilized for monetary policy purposes.

2. SIERRA LEONE - 1989 ARTICLE IV CONSULTATION; AND OVERDUE FINANCIAL OBLIGATIONS - REVIEW FOLLOWING DECLARATION OF INELIGIBILITY - POSTPONEMENT

Mr. Monyake noted that a staff mission to Sierra Leone was due to return to headquarters in the coming days, and that it might be helpful to postpone briefly the discussion, now planned for December 22, 1989, on the staff report for the 1989 Article IV consultation with Sierra Leone (EBS/89/233, 12/7/89) and a staff paper on Sierra Leone's overdue financial obligations.

After a brief discussion, the Executive Directors agreed to schedule the discussion on Sierra Leone for January 3, 1990 and approved the following decision:

> Paragraph 4 of Decision No. 9239-(89/108), adopted August 23, 1989, shall be amended by substituting "by January 3, 1989" for "within four months from the date of this decision."

Decision No. 9324-(89/163), adopted
December 15, 1989

3. STAFF RETIREMENT PLAN - REVIEW

The Executive Directors considered an interim report from the Acting Chairman of the Pension Committee on management's proposed changes in the Staff Retirement Plan (EBAP/89/296, 12/13/89).

Mr. Evans made the following statement:

> In the light of the Pension Committee's recent interim report (EBAP/89/296), this statement reviews some problems which arose in the course of the Committee's consideration of the proposed changes to the Staff Retirement Plan and suggests consideration of an alternative approach to addressing those problems. That approach is put forward in the belief that debate on the revised Plan is unlikely to produce a result satisfactory to both the staff and the Board; and, more fundamentally, a firm belief that retirement plans should not be reviewed or changed other than at lengthy intervals, and that changes should only be made if they yield substantial and sustainable improvements. The revised Plan proposed by management does not meet that criteria well.
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> The revised Plan incorporates two main changes to the present Plan: (i) a revision to the grossing-up formula, used to convert actual salaries to notional "grossed-up" salaries as a basis for calculating member contributions and exit benefits; and (ii) revised accrual rate formulas designed to provide higher exit benefits to certain staff (mainly those with 20-30 years experience) and earlier access to benefits.
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> In addition to those changes, and a number of lesser ones, the proposed changeover to the new Plan provides for phased transitional arrangements, which fully preserve already accrued benefits; immediate introduction of the benefits of the revised accrual rate formulas; and a grandfathering provision, which allows staff who might potentially be disadvantaged by the new Plan to remain with the old Plan.

This combination ensures that most staff (and the Fund) will be better off after the changes, particularly when account is taken of lower contributions and even more so in after-tax terms. The revised Plan nevertheless poses problems.

The main problems relate to the two key changes noted above--the grossing-up formula and accrual rates--and the proposed "parallelism" of the Fund and Bank schemes.

The grossing-up approach is sound in principle. In practice, however, it is not feasible to apply the approach with precision (i.e. to every individual) and approximations and compromises must be made in devising a universal formula. Doing so requires choices on the following: for each country, the appropriate tax rate scale (married, single, etc.) and relevant deductions; the countries to be chosen as representative of the full membership; and the weighing and the exchange rates between those countries. As the questions directed to the Administration Department indicate, the scope for differing judgments on those choices is infinite. The arbitrariness of the process is indicated by the perceived need in the revised Plan to adjust the formula derived from one set of choices among the above factors because it did not yield the desired result over a substantial income range.

The changes to accrual rates, including the introduction of a split rate and shortening of the periods required to accrue maximum unreduced benefits are variously justified as encouraging earlier retirement and better matching the recent and expected retirement experience of staff. Alternatively, they might simply be viewed as "sweeteners" which partially offset the reduced benefits flowing from the revision to the grossing-up formula. Either way, and as Directors' questions indicate, there is scope for differences as to the "appropriate" accrual rate; and as to whether such rates should be changed to meet personnel policy objectives.

The parallelism issue arises because the current retirement plan in the Bank is somewhat less generous than that in the Fund; and defining parallelism as two lines that converge in the shortest possible time necessarily involves large costs for the Bank. Those costs could only be minimized by amending the Fund Plan or more sensibly interpreting parallelism.

The genesis of an alternative approach lies in the recognition that the types of choices involved in individuals' retirement savings decisions typically involve large elements of consumer surplus. Exploiting that surplus, by increasing the choices available to each individual, can provide greater benefits to the employee at less cost to the employer. This is no more than an application of the principle, generally

supported by the Board, that free markets offer efficiencies not least through better satisfying consumer preferences.

With that starting point, and recalling the problems listed above, an alternative approach might include some or all of the following features:

(i) Variable contribution rates: maximum attainable benefits would be fixed, as they are now, but the service period required to achieve such benefits would vary with the employee contribution rate, as would the employer contribution rate, to retain some premium for long service. The employee contribution rate could also be varied, at the employee's discretion, from year to year to suit his/her current and prospective financial circumstances. Employee contributions would cease once maximum benefits had accrued.

(ii) Variable exit benefits: exit benefits could be taken as combinations of lump sums and pensions, within proscribed commutation limits. This would yield considerable savings to the employer, because employees' revealed preferences for lump sums permits those to be pitched below an actuarially neutral level. The employee also has greater ability to meet the taxation and social security constraints applicable to his place of retirement.

(iii) Pension indexation: in the context of points (i) and (ii), there might be scope for meeting the staff's request for explicit indexation of pensions; and for reviewing the necessity and form of the first-year adjustment.

(iv) Actual salary basis: adopting an actual "net" salary basis would not completely remove the grossing-up problem, as a grossing-up formula would still be implied. It would, however, greatly simplify the system, remove a constant source of debate, and obviate the necessity for periodic reviews. A pragmatic approach would be to agree now upon an "appropriate" scale of benefits linked to net salaries, with that choice being informed by, but not specifically linked to, the data produced for the current review. Henceforth, contributions and benefits would be linked to actual salaries and would not be changed to compensate for taxation changes in one or more member countries.

It is recognized that consideration of such alternatives would take some time and add to the uncertainty occasioned by the current prolonged review. That, however, may be a small price to pay if sustainable improvements were to result.

Continuing, Mr. Evans said that, in making his alternative proposal, he had acted with great reluctance and had not wished either to undo in any way the considerable work that had already been done, or to prolong the uncertainty that the staff had faced for very many years in the area of pension benefits. However, the discussions in the Pension Committee, in which a number of Board members had participated, had led him to conclude that the Committee seemed unlikely to agree on a proposal that would, in his view, prove to last long enough to provide the staff with sufficient certainty about their retirement plans.

Mr. Fogelholm considered that it would be useful to have at the outset the staff's reactions to Mr. Evans's proposal.

The Director of Administration said that his reactions at the present stage were preliminary and followed on his comments at the recent meetings of the Pension Committee, which itself might wish to focus more explicitly, and express some view as a group, on Mr. Evans's proposals. Those proposals were interesting, but also somewhat controversial; it was his understanding that participants in the Plan would not wish to see such a far-reaching change be undertaken.

For example, the Director continued, the proposal to introduce variable contribution rates was clearly very controversial. Some staff members, particularly those with relatively high salaries, might welcome the opportunity to contribute more money into the Plan in return for some additional benefits. On the other hand, lower-paid staff in particular, freed in effect from the discipline of a mandatory contribution rate, would probably be inclined to contribute the absolute minimum, a decision they might well come to regret. One of the main issues with respect to a variable contribution rate system was the extent to which the differing contributions of the employees were to be matched by contributions of the employer. If the system were such that higher-paid staff could afford to make adequate contributions on which they received a large return, while lower-paid staff felt that they could not afford to make adequate contributions and therefore did not receive what they considered to be an adequate pension, then the system would certainly be controversial with the staff.

Variable exit benefits were not provided under the present Plan, the Director said. Apparently Mr. Evans wished to devise a scheme under which the staff might be encouraged to take out lump sums at a lesser actuarial value than their pension entitlements, thus enabling the Fund as Employer to save money. In that connection, the major issue would be to what extent the participants and the staff would be prepared to accept a system under which the lump-sum benefits, if they became a major part of the Plan, were in fact pitched below an actuarially neutral level. If lump-sum payments were a major part of the Plan, there would probably be strong pressure from long-term, career staff members to ensure that those lump sums would be actuarially neutral. As a result, he doubted whether the benefit that Mr. Evans foresaw from his proposal would necessarily be realized.

Indexation of pensions was possible under any pension scheme, including the Fund's present Plan, the Director commented. The Executive Board could agree to assure pension indexation in the future. Staff members had already asked for greater assurances in that connection.

Another feature of Mr. Evans's proposal was that the Fund's pension system would be based on net salaries rather than on a grossing-up formula, the Director remarked. As he understood it, Mr. Evans's scheme would involve some implicit adjustment to reflect the fact that, while the revised Plan would be based on net salaries, salaries outside the Fund were typically paid on a gross basis. One of the main issues that would need to be resolved in introducing such a system was what kind of an adjustment would be made, and which elements of the total pension formula would be adjusted, to reflect the fact that those net salaries were substantially less than the taxable salaries that most employees were receiving in the market.

The proposals by Mr. Evans obviously raised a number of questions, although none of the questions would in itself argue strongly against moving to the kind of approach that Mr. Evans favored, the Director commented. It was useful to bear in mind the reasons why management's proposals did not involve some such a radical change of approach. In the early stages of the ongoing review, consideration had been given to the possibility of a more radical approach than was subsequently chosen--including, for example, a system under which pensions were paid on a net basis with an additional amount that would reflect the amount of tax payable on a pension. However, the representatives of the staff had expressed considerable unwillingness to depart too radically from the present Plan. In addition, the mandate that the review committee had received basically was to re-examine certain aspects of the present Plan. Given both those factors and the fact that the review committee had no guidance at all as to what elements should be emphasized in developing a radically different approach, management had decided that such an approach would not be practicable. Of course, it was naturally assumed that the more management's proposals departed from the basic elements of the present Plan, the more controversial they would become, and the more difficulty there would probably be in reaching a consensus among the staff, management, and Executive Directors in both the Fund and the World Bank. Therefore, management had concluded that it would be preferable to limit the survey basically to a revision of the present Plan rather than the adoption of a completely new plan. Clearly, if the Board were to reach a decision that that was not the appropriate course of action--that some entirely new approach should be adopted or examined--then the staff would of course follow that guidance. But many questions would need to be answered before the staff could seriously embark upon such a radical new approach.

Mr. Landau made the following statement:

> This reform package is both comprehensive and complex, and I am grateful for all the information and clarifications that

have been presented by the staff. In my view, this is a balanced and sensible package. I would like to comment on its more technical aspects before making some personal remarks.

The proposed package seems to have many advantages. The present scheme incorporates some features that act as disincentives to early retirement. Those disincentives will be removed under management's proposals, owing mainly to the introduction of a split accrual rate and changes in the early retirement provisions.

The present accrual rate is reduced when one retires before the mandatory retirement age of 65 years. The split accrual rate proposed in the new Plan is designed to compensate for the modification of the grossing-up formula and to facilitate early retirement as well as shorter careers. Therefore, this change is an essential element for the new Plan's equilibrium. According to my information, the use of a split accrual rate seems relatively common outside the Fund. Front-loaded accrual rates such as the one envisaged can be found in many plans--for instance, those of the Inter-American Development Bank and the Organization of American States, as well as in some U.S. private sector entities. The proposed break point, and the relatively small difference between the accrual rate before and after this point, are justified for demographic reasons, and in order not to discourage too strongly long careers.

The proposed modification of provisions for early retirement is also very important. Two changes are envisaged: the Rule of 90 would be replaced by the Rule of 85, and the age at which a full pension would be available would be lowered to 62. Both changes should reduce significantly the heavy penalties under the present system.

The package brings the definition and calculations of compensation under the Fund's Plan closer than before, reflecting actual conditions outside the Fund especially by introducing a new grossing-up formula that reflects more clearly the tax structure of member countries. In my view, this is a welcome and necessary move.

There was considerable discussion in the Pension Committee on the comparators that are used to establish the grossing-up formula and assess the relative value of Fund compensation vis-à-vis the market. In this connection, one could of course theoretically envisage a broader reference than the present set of three countries. I am not sure, however, that this would yield a significant improvement, for two reasons. First, we are looking for a representative sample, not an exact duplicate of reality, which, by definition, is impossible to achieve. We must assume that there is always a trade-off between realism and feasibility. Second, I am not convinced that the results would be significantly different. The present sample mixes both countries with a relatively high level of personal taxation--Germany and France--with a country that has a low level of taxation, namely, the United States. If we were to introduce another country with a low level of taxation--say, the United Kingdom, as has been suggested--then of course part of its share would have to be taken from that of the United States to preserve the representativeness of the sample. Since U.K. personal taxation rates are still higher--although significantly reduced in the past years--than U.S. rates, the overall effect of this change would not be significant. We must remember that, at the very least, the proposed new formula brings a large decrease in grossing-up and, consequently, savings for the Plan.

On the whole, under management's proposals, the rights and benefits of the staff will be preserved or improved, which is an essential precondition for making that package workable and acceptable in the institution. Although some individuals' situations might be adversely affected, the number of cases is limited and should not affect our assessment of the measures before us. Under management's proposals, present staff members will be able to preserve their pension situation, but future staff members will have to face a different environment. This is a good balance for a reform of this nature: the package is both acceptable in the near term, and far-reaching in its consequences in the longer run. In addition, the proposed reform would not place an unbearable financial burden on the Bank and the Fund, which, of course, is an essential consideration.

I have nevertheless a question related to the financial commitment by the Fund and the Bank: I understand that it is dependent on hypotheses that have to be made on the parameters affecting wages, age structure, and other factors. Are there any circumstances in which the Plan as now proposed by management would become a significant, additional financial burden?

I will now make two personal remarks. First, parallelism and grandfathering are very delicate issues. We are all aware that their definitions and consequences are not assessed in the same way in the Fund and the Bank. There could be a feeling in the Fund that its Plan has been somehow scaled down to accommodate specific constraints facing the World Bank. My personal view is that we have attained at present the right balance between the Fund and the Bank's propositions. Any attempt by either institution to improve the relative position of its Plan, particularly by changing the scope for grandfathering, would jeopardize the successful conclusion of the whole review exercise. In particular, the provisions for grandfathering under the present proposals to revise the Plan are entirely appropriate.

I wish to stress that, in my view, this package should be examined by the Board on its own merits--that is to say, with no connection to any subsequent review of benefits. The Plan is a specific set of measures--if only because it is partially funded by contributions from the staff--and should be considered as such.

On the whole, subject to the remarks I have made and questions I have raised, I can go along with the proposed changes.

Mr. Grosche said that he welcomed the substantial work that had gone into the interim report and staff paper on the Plan, which, next to the medical benefits, was the key element of the Fund's overall benefits package. The Plan determined to a large extent whether the Fund's benefits package as a whole was considered to be competitive; it affected decisions by persons considering whether to enter or leave the organization. Insecurity or lack of assurance about future pensions could seriously damage the attractiveness of a pension scheme, even a most generous one. Therefore, he fully agreed with Mr. Evans that the Plan should be amended only at lengthy intervals, and that any review should be carried out as carefully as possible. At the same time, as the Director of Administration had stressed, if changes seemed to be absolutely necessary, they should be as limited as possible.

The interim report of the Pension Committee indicated that a number of issues had been discussed, and that a consensus had emerged in the Committee in favor of maintaining the package as it had been proposed, Mr. Grosche remarked. But it had become clear that a few fundamental points needed more clarification. The present discussion was the first occasion on which the whole Board had taken up the review of the Plan, and it appeared that considerable additional time would have to be spent before a decision commanding broad support could be found.

The features of the proposed package with which he had most difficulty were the splitting of the accrual rate resulting in a front-loading of pension benefits, the raising of the maximum pension up to 73 percent, and the increased incentives for early retirement by replacing the rule of 90 with the rule of 85, Mr. Grosche continued. The problems he saw with those proposals had less to do with the technical solutions that had been suggested than with the underlying philosophy and the long-term impact on personnel management. It was not clear to him how the desire to release human capital at an earlier age fit with demographic trends in most industrial countries. In Germany, substantial efforts were under way to streamline the social security system, and especially the pension schemes, because of the projected changes in demographics. The potential shortages of human capital of high caliber during the coming decades, as well as the significant increase in life expectancy on average, had led his authorities to linearize and backload the accrual rate to prolong active working time and even cut maximum pension benefits. As to the costs incurred by the Fund's Plan, he wondered whether rewarding early retirement was in line with basic actuarial principles. Could the financial soundness of the Plan be preserved without higher contribution rates by staff members? Could the costs to the Fund be kept within reasonable levels?

He was also concerned about the long-term cost of the proposed early retirement provisions, Mr. Grosche continued. Obviously, the costs would depend on the actual retirement pattern. He wondered whether it was realistic to assume that retirement behavior would be more or less the same after the changes in the Plan were made, and especially after improving the early retirement provisions so dramatically. Was the aim of the whole exercise to induce at least part of the staff to retire earlier? It would be helpful to have comments on the impact on the costs and contribution rates if retirement behavior were to change more than the paper assumed.

It might well be true that the Fund considered it appropriate to encourage early retirement, but he doubted whether all staff should be encouraged to leave at an earlier age, Mr. Grosche went on. If the aim was to encourage only a few to retire early, then a more individualized, sort of golden handshake scheme might prove to be more effective and less costly overall. Such questions went far beyond the Plan itself and might warrant some informal discussion by the Board.

The proposal by Mr. Evans to increase the flexibility for individual staff members by giving them the choice to increase their pension rights by making additional payments on a voluntary basis was certainly attractive, Mr. Grosche said. Each staff member could thereby be given more freedom to choose when to retire, although in that connection there might be a potential conflict with the proper interests of the organization: staff members who decided to retire early might be exactly those the Fund would wish to keep, and vice versa. But again the question arose whether it would not be worthwhile to look for individual solutions rather than adapt the whole Plan in a generalized manner.

The Fund should shy away from too narrow a definition of the principle of parallelism, particularly in the area of benefits, Mr. Grosche considered. Given the different hiring and retention patterns in the Fund and the World Bank, there was no need for the organizations to have identical benefits packages. Each organization should devise schemes best suited to its needs and then check whether the values were more or less in line with the outside market. In checking comparators, one should not aim at identical values, but should merely be assured that the Fund was broadly in line with the market and was thus broadly competitive.

In sum, the proposed changes raised a number of questions that would need to be carefully considered, Mr. Grosche said. Further reflection and discussion seemed to be warranted, since the proposals were far-reaching, involving general administrative policies. He would welcome a further discussion by the Committee of the Whole, eventually leaving technical questions to the Pension Committee. It would be regrettable if such a procedure were to lead to unavoidable delays, but a comprehensive review of the Plan did not--and should not--take place often. Some more time was needed before the Executive Directors could reach a final view on the current review of the Plan.

Mr. Cassell commented that the issues relating to the review were obviously difficult and complex. He fully agreed with Mr. Grosche's comments on that point and with his conclusion that more time was needed for the deliberation on the proposed changes. The Pension Committee had done some good work, but it was clear that much more remained to be done. As Mr. Evans had stressed in his opening statement, the Fund could not afford to change its Plan very often, and when changes were to be made, every effort must be made to ensure that the changes would prove to be the right ones. He shared Mr. Evans's concern that the current proposals might not have struck the right balance. Certainly, the question of variable contribution rates deserved looking into--indeed, he had assumed that such an examination was a part of the original terms of reference for the current review.

Since the previous review of the Fund's Plan, many other organizations had moved in the direction indicated by Mr. Evans, Mr. Cassell remarked. In principle, certainly, more consumer choice under any pension scheme was to be welcomed, but that possibility did raise problems for the Fund. Both sides of the issue must be examined. In considering possible options, it would be helpful to have an estimate of the overall benefits that would result, so that the proposals could be seen in a wider context.

The fundamental question at hand was whether or not the Fund's pensions were competitive, Mr. Cassell commented. The attempt in RP/CP/89/17 (11/14/89) to compare Fund pensions under management's proposals with pensions in the United States, France, and Germany was helpful, but he found some aspects of the comparison curious, despite the answers the staff had given to Directors' questions. It was still not clear to him why Fund pensions should be set at a 10 percent premium above the average in the comparator markets. Provided Fund salaries were fully competitive, it should then only be necessary to ensure that the pensions and other benefits were in line with market levels to guarantee the competitiveness of the Fund's overall remuneration package. It was his understanding that the World Bank had said that the companies in the survey were blue chip and were therefore already offering pensions that were above average.

In comparing Fund pensions with those in the comparator organizations, the staff had assigned equal weights to the United States, on the one hand, and France and Germany on the other, Mr. Cassell noted. The weights clearly affected the overall picture: if the United States were given a larger weight, the Fund's pensions would appear to be more competitive; and if Germany were given a larger weight, pensions would appear to be less competitive. Giving Germany a heavy weight in comparing relative pension levels seemed odd, since only 5 of the 600 actual Fund retirees currently lived in Germany. The issues that he had raised should be looked at in the light of not only the benefit to the individual who decided to retire to a particular country, but also the cost to the Fund as Employer, given the particular national characteristics of the social security and tax systems in the selected countries.

The various issues that had been raised were very difficult and controversial, Mr. Cassell remarked, and it would be essential to proceed at a pace that would allow the Board adequate time to assess them. Five questions seemed to require particularly close attention by the Board. First, with respect to the weighing of the tax rates used in the grossing-up formula, the present proposals seemed to underweight the United States. The World Bank had originally advocated a 60-20-20 weighing with 60 for the United States, and the Board should consider whether that might not be a more rational solution. Second, the argument that the maximum accrual should be raised from 70 percent to 73 percent of the highest gross remuneration should also be examined. The third issue was the proposal that the annual accrual rate be changed from a uniform rate of 2 percent to a rate of 2.2 percent for the first 25 years of service and 1.8 percent thereafter. Fourth, the Board should look carefully at the actual cost of the proposed different arrangements to the institution. Accordingly, the Executive Board, like the Joint Committee on Staff Compensation, should look at the differential effects on nationals of particular countries; it might be possible to obtain the desired equity between different individual retirees by a more carefully targeted arrangement rather than one that tried to find an across-the-board solution to the equity problem. The fifth issue was parallelism with the World Bank. While it was tempting to argue that the proposals would not cause problems for the Fund because they seemed to be cash neutral, they seemed to be far from cash neutral for the Bank, owing to the different career patterns in the two institutions. In that connection, it would be helpful to have additional information on the demographic characteristics of the two institutions. The Fund should not go too far in striving to achieve complete parallelism; doing so might well lead to some odd results.

Mr. Warner remarked that the various issues were indeed complex. He wished to stress that his authorities were fully committed to ensuring that the Plan provided staff members with retirement incomes commensurate with their service to the Fund, and that the Plan was internationally competitive and cost-effective. In achieving those objectives with some emphasis on international competitiveness, the Executive Directors also must avoid concluding their work with a plan that could be perceived as providing pensions that were excessive. His comments on the specific aspects of management's proposals would include some remarks on alternative approaches. Those comments were meant to help speed up some of the conclusions that the Board could reach at the present meeting on how to ensure efficient future discussion on the pension issues.

He recognized that there was some merit in management's proposals, Mr. Warner continued. Specifically, he recognized the rationale for revising the grossing-up formula, which had the effect of lowering pension yields, and for offsetting that change by offering larger benefits for staff members who wished to retire before they reached the mandatory retirement age.

However, a number of features of management's proposals required careful examination, Mr. Warner continued. First, he was concerned about the methodology used in examining benefits in the comparator market. For example, he questioned the rationale for adding a 10 percent premium to pensions in the comparator market, and he doubted whether the weights assigned to each of the comparator countries was appropriate. He also questioned the decision to ignore benefits from national social security systems, as there was evidence that they represented a significant factor in retirement income for many Fund retirees. That question had been posed by other Directors to staff in the Pension Committee discussion. In addition, it was advisable to re-examine the tax treatment of pension benefits, particularly in countries where retirees tended to live.

Second, the weakest aspect of the proposals appeared to be the grossing-up formula, Mr. Warner said. He had reservations about the selection and weighing of the tax rates in comparator countries, which were heavily biased against the country where the vast majority of retirees lived, a point that Mr. Cassell and others had made. Also, the adjustment for net salaries below $80,000 appeared to be discontinuous and, therefore, arbitrary, as Mr. Evans had remarked. As Mr. Cassell had observed, the Bank had shown that, in a significant number of countries in which retirees resided, there was no basis whatsoever for making tax comparisons. In that connection, the suggestion by Mr. Evans for avoiding grossing-up was intriguing and warranted further review.

Third, he had a flexible position on possible moderate changes in the accrual rate, provided they were properly related to the other changes in the system, Mr. Warner said. He had two reservations about the specific proposals. The suggested break point seemed to come late in a staff member's career. He could accept some revision of the accrual rate structure, but he was concerned about how the proposed system would work. In that connection, the increase in the accrual cap from 70 percent to 73 percent seemed unjustified. At the same time, he had been impressed by the suggestion made by Mr. Evans that the introduction of variable contribution rates and variable exit benefits might bring the Fund's Plan closer to the state of art in pensions; that proposal should therefore be given a very thorough review. Appropriate provisions facilitating discretionary decisions could provide significant advantages to individual retirement plans. Mr. Evans had appropriately reinforced his proposal by noting that free markets offered efficiencies not least through better satisfying consumer preferences. Management had stated on several occasions that the purpose of revising the Plan was to bring it up to date with comparable plans worldwide. The thrust of Mr. Evans's proposed approach should be measured against that very goal. He was concerned about the possibility of grafting on a voluntary contribution plan at a later date; if the staff wished to have that benefit, it should be provided at the present stage, in the context of the ongoing review of the Plan.

When seen in isolation, the proposals to reduce the rule of 90 to a rule of 85, and to reduce the age for unreduced pensions from 65 to 62, together with other proposed changes intended to encourage retirement before the mandatory retirement age, seemed to have merit, Mr. Warner commented. However, as Mr. Grosche had noted, those proposals represented a fairly dramatic departure from the current Plan in terms of the effects on human resource management in the Fund. Therefore, a cautious approach was warranted in promoting early retirement, especially to avoid creating problems for the Fund in the years ahead. Useful points on human capital management had been made by Mr. Grosche.

He has not had an opportunity to fully examine the proposed changes in survivor benefits, Mr. Warner said. His first impression was that the changes seemed to be out of line with practices in comparator markets. He looked forward to further discussion on that element. He and several other Directors would likely propose relatively small, yet important changes.

A number of Directors had commented on the issue of parallelism with the World Bank, Mr. Warner recalled. He shared the concerns that had been expressed by previous speakers, especially Mr. Evans, Mr. Grosche, and Mr. Cassell. Parallelism was an important principle, but there were limits to it. The issue of parallelism should be given further careful consideration in both the Fund and the World Bank, where the effect of adhering strictly to the principle of parallelism would have the greatest impact. It would be useful to have more information on demographic differences between the Fund and the Bank and some elaboration of the explanation of the difference in contribution rates between the two institutions.

In commenting on procedural matters, he wished to reiterate two points that he had made during recent discussions in the Pension Committee, Mr. Warner said. The first had to do with the deadline that Executive Directors might wish to give themselves for concluding the current review of the Plan. His position was similar to that of Mr. Grosche: he, too, was sensitive to the eagerness of the staff to see the review concluded in a reasonable amount of time; at the same time, the substantive issues had to be addressed, and he would not wish to see the Executive Directors complete the current review knowing that they would have to reopen their discussion on the new Plan sometime in the coming period. Examinations of pension plans should occur only very infrequently and should be thought out over long periods. Before agreeing on the new Plan at the end of the current review, Executive Directors should be certain that there was broad support for that Plan, so that they could be confident that it would remain in place for a long time. The committee reviewing the Bank's Plan had recognized the importance of those points and had decided to resume its discussion in January to thoroughly examine the many questions that had been raised in the Bank. That committee would certainly continue to closely follow the discussion in the Fund before making a final recommendation to the Bank Board. Thus, the judicious approach that had been suggested at the present meeting was identical to the course that the Bank Board intended to follow. The Fund Board should not delay its action unnecessarily, however; in that connection, there was a delicate balance that he was confident the Directors would be able to find.

He strongly supported Mr. Grosche's suggestion to continue the review of the Plan in the Committee of the Whole, Mr. Warner went on. That move would likely accelerate, rather than decelerate, a successful conclusion. Notwithstanding the technical character of the Plan, and the burden the review placed on Directors, a discussion in the Committee of the Whole would facilitate a further in-depth examination of the issues that might offer guidance to the Pension Committee, which, under its mandate, needed to complete a plan that it knew would receive broad support in the Executive Board.

His second procedural point was that further thought should be given to the relationship of the Board's decision on the Plan to other decisions that the Board was expected to make in the coming several months--for example, the relationship to the quadrennial survey of staff benefits, Mr. Warner said. As he understood it, several other Directors shared his concern in that area. Taking benefits issues one at a time was attractive because it helped to avoid overloading Directors, but the disadvantage was that it prevented the Board from achieving a balance among the different parts of the total compensation package. The process of drawing discrete conclusions on parts of a whole, rather than appraising interrelated components as a whole, could be unsound and should be avoided in the present case. To strike a proper balance, the Board might wish to conclude its review of the Plan at a time when it would have an opportunity to consider with reasonable thoroughness the quadrennial survey of benefits, which apparently was to be circulated in the coming several weeks. In addition, the Board might also deem it appropriate to carry on the review of the Plan in the context of its review of proposals for the 1990 salary adjustment. Those were merely examples of the procedural approach that could be taken. It would be most helpful to use an umbrella approach to the Board's appraisal of staff benefits rather than view in a discrete fashion factors that actually constituted the parts of a single whole.

Mr. Grosche said that he was somewhat concerned about the suggestion to place the review of the Plan in the context of the overall compensation package. The revised Plan should remain in operation as long as possible; hence, the review should be seen in a very long-term perspective. Annual salary reviews were of course short term in nature. In addition, benefits and cash compensation, although two parts of the overall compensation package, were different in character. Benefits were very difficult to value, and it was very difficult to make comparisons with the outside market. Usually such comparisons were made on the basis of the cost to the employer. Unlike weekly cash compensation, it was hard to tell how much individuals valued pension benefits. Hence, the suggested comprehensive look at the total compensation package would be difficult for the Board and the Administration Department to manage. Instead, there should be a comprehensive and thoroughly thought-out review of the Plan, with a view to introducing a Plan that could be sustained for a very long time. The Fund could then try to value the weight of that part of its total benefits package and make comparisons with the outside market. If as a result it was felt that the total benefits package was not large enough, steps could be taken outside the Plan--for example, increasing the subsidy on food services, reducing parking fees, or increasing vacations--to enhance the value of the total benefits package without tampering with the pension scheme, which was certainly the most important part of the benefits package and which should not be changed often.

Mr. Warner commented that his views on parallelism were actually similar to those of Mr. Grosche. It was clearly understood that a review of a pension plan took time, and that there should be lengthy intervals between such reviews. As Mr. Grosche had stressed, the pension scheme was the keystone of a compensation package. The largest comparator market that had been examined--namely, the United States--had a discrete character in the area of the determination of pensions. At the same time, any organization typically referred to its pension benefits in the context of its umbrella benefits package; therefore, notwithstanding its discrete character, a pension plan was part of a global, package approach to benefits. Pensions were also an element of the Fund's international competitiveness as an employer. He was not suggesting that a determination on pensions was necessarily firmly linked to the discrete elements of the quadrennial review or to compensation issues. However, the Board should know what the global benefits package looked like and the significance of the Plan in that package. That knowledge was useful background information for considering future decisions on benefits.

Mr. Ichikawa made the following statement:

> I welcome this opportunity to discuss the proposed changes in the Plan, as this chair has emphasized the importance of this subject on previous occasions, including during the discussion of the work program. The Plan is complicated and technical, and this chair has yet to finalize its views on the proposed changes. I will therefore limit my intervention to a few preliminary observations and questions.
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> I support the basic orientation of management's proposals, in the sense that they maintain the overall framework of the present Plan. However, one of the critical outstanding issues is the extent to which parallelism between the Fund and the Bank should be pursued in this reform of the Plan. While there are certainly benefits to parallelism, there is also the possibility that the Fund's Plan will become less efficient. I believe that this possibility should be kept in mind in considering every possible aspect of the proposed changes. Another general issue

in which I am interested is the implication of the proposed changes on the other compensation systems of the Fund. I wonder whether the proposed changes will necessitate changes in salaries and other benefits in order to maintain the overall efficiency of the Fund's compensation system. This viewpoint can also be extended to the adequacy of the personnel management, compensation, and benefits policy mix. For example, encouragement of early retirement might be supported not only by changes in the Plan, but also by the adjustment of the salary structure. I would appreciate the staff's comments on this matter.

The questions and answers that have been circulated are very useful. In particular, the answers to the wide-ranging questions from Mr. Dawson's office have provided us with detailed information that otherwise might have been overlooked. Nevertheless, there remain many specific issues that are worth further scrutiny. I will touch upon those that particularly warrant the Board's attention.

As Mr. Evans pointed out in his opening statement, many questions were raised about the proposed revisions of the grossing-up formula. In this area, attention is focused on the selection of tax rates, exchange rates, and weights. There seems to be a wide discrepancy between management's proposal and alternative proposals. I currently have an open mind on these issues. However, the staff's reasoning with regard to weights is not sufficiently strong, and I hope that the discussion that follows will lead to a greater understanding of this issue.

The important question of the difference between U.S. residents and nonresidents with regard to social security contributions has been raised by Mr. Landau. Mr. Cassell suggested more explicitly that it may involve an "expatriate problem" that should be solved outside the Plan. Despite its importance, this problem is not clearly addressed in the staff paper. While I appreciate the elaboration on this area by the Director of Administration, it is a little disappointing that the impact of the reimbursement benefit was not taken into account even in the comparability study. Also, the answer that was given to Mr. Cassell's question in this connection seems to be insufficient to preclude the possibility of his proposed solution. Further examination might be needed in this area. I would also encourage the staff to broadly review the proposed changes from the standpoint of assuring the provision of appropriate expatriate benefits.

While I understand the staff's view on the need to adjust accrual rates in the proposed direction, given the proposed changes in the grossing-up formula and other assumptions, I would like to know how the proposed figures--2.2 percent and

1.8 percent, and the break point--were obtained. I hope that the staff can elaborate on its calculation at some stage of the discussion.

Many of the questions that have been raised focus on the contributions to the Plan. I am pleased to learn that the Fund's Plan has been recording a favorable investment performance. However, I note that, in an answer to one of Mr. Cassell's questions, the staff explains that the difference in some basic conditions and assumptions of the Bank and Fund investment programs also contributes to the difference in investment performances between the institutions. I am interested in learning the real-term difference in the performance--the result of applying common assumptions to the two investment programs. Another answer to Mr. Cassell elaborates the historical background to the initial ratio of the contribution allocation, on which the staff bases its judgment of the appropriateness of the proposed ratio. However, while I would stress that I have an open mind on this issue, "tradition" alone does not seem to be a sufficient reason to maintain the initial 2:1 ratio as the principle to follow over such a long period. The staff may wish to present additional supporting evidence.

I am interested in Mr. Evans's proposal on variable exit benefits. As a lump sum is a more common form of exit compensation in Japanese business, the flexibility in exit benefits proposed by Mr. Evans might be desirable for Japanese employees of the Fund.

Mr. Hogeweg said that the Plan clearly raised highly complex issues that had a long-term impact. Years of preparation had gone into the proposals under consideration. He fully agreed with speakers who had stressed that any revision of the Plan should be undertaken only at long intervals, and that during a review long-term considerations should be taken into account.

The two extreme positions on how to handle the current review of the Plan seemed to be those of Mr. Evans and Mr. Landau, Mr. Hogeweg commented. Mr. Landau, on the one hand, seemed inclined to accept the proposed package as it stood, realizing that, while it might not be ideal, it was the result of considerable effort by many people over a long period, and it seemed the only way to finalize that exercise very soon. For those reasons, he could also accept the proposed package. On the other hand, Mr. Evans had posed some fundamental questions that were highly relevant, and he sympathized with Mr. Evans with respect to many of the questions he had.

Of course, an important consequence of agreeing to move in the direction proposed by Mr. Evans was that, justified as it might be, the review of the Plan would be far from completion, Mr. Hogeweg continued.

Directors might well feel that the time needed to consider Mr. Evans's proposals would be time well spent because of the long-term character of the product they would end up with. The comments of previous speakers and the two extreme positions that he had described, led him to believe that it was unrealistic to assume that the Board would be able at the present stage to agree to the package as it stood. Apparently, thus far only Mr. Landau had said that he was in a position to accept management's package as proposed. If that meant that the Board would indeed wish to consider individual items within the package, then the questions posed by Mr. Evans were highly relevant and should be fully taken into account.

If the discussion on the review of the Plan was to be continued, certain issues would be of special concern to him, Mr. Hogeweg said. The competitiveness of the entire package of salaries and benefits should enable the Fund to attract to the staff high calibre persons on as wide a geographical basis as possible. The same consideration had been crucial during the discussions on the report of the Joint Committee on Staff Compensation.

He agreed with Mr. Grosche that the Plan should be considered on its own merits and in the light of its own long-term prospects, Mr. Hogeweg went on. In that connection, he had been struck by the issue of early retirement. The Plan was one possible instrument with which to achieve greater incentives for early retirement if the Fund wished to do so, but it was not clear to him that the Executive Directors had exhausted the discussion on the appropriateness of pursuing that goal, and whether the Plan was the most desirable instrument to achieve that goal. It was certainly true that the Fund had a problem in that there were many staff members who had been at relatively high levels for a long time. On the other hand, he agreed with those who had pointed to the possibility of employing a more individualized approach to solving that problem; he also agreed with Mr. Grosche's point concerning demographic trends and had noted Mr. Grosche's warning that care should be taken in trying to solve a current personnel management problem with a long-term instrument like the Plan.

There were clear links between the different aspects of the proposed package as it stood, Mr. Hogeweg said. For example, there were obviously links between the grossing-up formula, the accrual rate, the end level, and other factors. In a number of interventions at the present meeting there had clearly been a tendency to look at those aspects in isolation. Of course, any aspect could be looked at--and might be justified to some extent--in isolation, but the links should certainly be kept in mind as the review proceeded.

Several speakers had suggested that further discussion on the review of the Plan should take place in the Committee of the Whole rather than the Pension Committee, Mr. Hogeweg recalled. In his view, it seemed best to continue the discussion in the Pension Committee. The Executive Directors should not hesitate to make full use of that Committee. As had been the case thus far, any Executive Director who wished to attend meetings of the Pension Committee would be welcome to do so and to participate in discussions. An important difference between the Committee of the Whole and the Pension Committee was that the latter included two representatives of the staff; it was important that the staff representatives be fully involved in whatever steps were taken next.

Mr. Feldman stated that he wished to reiterate his support for the proposed changes in the Plan and to broadly associate himself with Mr. Landau's comments. Despite the complexities of management's proposal, it was comprehensive and struck an appropriate balance between improvements in benefits and reductions in pensionable remuneration. The proposals should be evaluated in their entirety; looking at each component separately would be more detrimental than beneficial. If changes were going to be made in management's proposals, the Plan should provide the staff assurance that the value of their pension benefits in real terms would be maintained. A consensus on the modifications of the Plan should be achieved as soon as possible. Both the Fund and the Bank would benefit from prompt agreement on sustainable improvements in the Plan.

Mr. Othman said that he, too, felt that the Plan constituted an integral part of the overall staff compensation package and must be viewed as such. However, to the degree that the Plan was financed to a large extent by employee contributions, its design and administration were qualitatively different from other elements of the compensation package. In that connection, he was pleased to note the high level of consultation that had taken place between management and the staff on the proposed revisions. As the staff had already provided detailed responses to queries by Executive Directors during the Pension Committee meetings, he would make only a few general observations.

First, he sympathized with many of Mr. Evans's observations, particularly those relating to the grossing-up formula, variable contributions, and benefit rates, Mr. Othman continued. Some of the ideas Mr. Evans was advancing might not have been part of the original terms of reference, but, to the extent feasible, and if there was enough support, he would welcome the Committee's consideration of the alternative approach proposed by Mr. Evans.

Second, while the personnel policy objectives behind some of the proposed changes had been outlined by the staff, he would have liked to see a more detailed presentation to the Board of how management and the Administration Department saw long-term staffing trends developing in the Fund and the manner in which retirement benefits fit into staffing needs, Mr. Othman remarked. Third, on parallelism, while he saw some rationale for the need to keep the overall compensation package in line with that of the Bank, he cautioned against too rigid an approach toward parallelism, and particularly in the context of the Plan, because of the different staffing patterns and needs of the two institutions.

Fourth, a study of comparator markets provided a useful basis for determining staff benefits in a less discretionary and less political fashion, Mr. Othman considered. However, comparators should serve to provide broad guidance to management and should not be used as a constraint on the ability to tailor compensation, including retirement benefits, to the needs and character of the Fund and its staff. Finally, he wished to emphasize the need for the rules of the Plan to be simple, easy to interpret, and drafted in such a manner as to avoid the need for further revisions in the near term.

Mr. Fogelholm commented that he had not yet taken a final view on the whole question of the review, which was extremely complex, and his observations were therefore preliminary. Management's proposal seemed to combine different issues. He agreed with those who had said that that proposal should be viewed as an integral part of a whole, and that the Executive Directors should view and weigh the different parts together. Nevertheless, the proposal contained different features. One consisted of purely technical matters, like changing the grossing-up formula to better fit the present situation of taxation in the world. There were other similar technical issues, but there was also a clear policy feature of the package--the promotion of early retirement. He agreed with previous speakers that some of those issues had not been dealt with adequately and properly; the issue of early retirement in particular should be raised in the Board, and management should express its views on the matter.

He agreed with Mr. Hogeweg that the Board seemed to be far from completing the review of the Plan, Mr. Fogelholm said. Apparently Mr. Evans's proposals had much wider support than the staff had anticipated. He, too, felt that those proposals contained a number of interesting features--especially the variable contribution rate--that should be studied further.

He would be fairly flexible as to the final outcome of the review of the Plan, provided that the pension benefits were not allowed to deteriorate, and that the Plan would remain competitive, Mr. Fogelholm stated. He agreed with the basic aims of the reform pronounced by the Staff Association Committee. If those aims were met, he would have no difficulty in accepting a revised Plan. One of the aims should be to arrive at a solution that would not require frequent changes in the Plan in coming years.

He also agreed with Mr. Hogeweg that the next step in the review should not be a discussion in the Committee of the Whole for the reasons that Mr. Hogeweg had mentioned, and particularly because the staff was not represented in the Committee of the Whole, Mr. Fogelholm said. Nevertheless, the Executive Directors should at some stage discuss the question of promoting early retirement--perhaps in the Committee on Administrative Policies or the Pension Committee, if there were no general agreement on holding such a discussion in the Board itself.

The concept of parallelism seemed to be understood somewhat differently in the Fund compared with the World Bank, Mr. Fogelholm remarked. The Bank seemed to be trying to gain all the pension benefits in which the

Bank was lagging behind the Fund, but the Bank did not wish to reduce the particular benefits that exceeded those offered by the Fund. Care should be taken to avoid promoting that kind of lopsided parallelism.

The Plan was one part of the Fund's overall benefits package, but it should be dealt with separately, because of its particular features, Mr. Fogelholm considered. Finally, the different treatment of U.S. and non-U.S. citizens should be further examined.

Miss Napky commented that the proposals under discussion were the product of a long period of discontinuous work and were designed to correct some major deficiencies of the current Plan, namely, the problems arising from the grossing-up formula--which had been unchanged for several years--and the accrual rate and early retirement provisions, which had biased the retirement pattern of the staff in favor of late retirement.

The goal of the proposed revision of the grossing-up formula was to update the calculation base to bring it in line with current taxes in order to make pensions competitive in the market, Miss Napky continued. However, the immediate result of that adjustment would be a reduction in the base of calculation of pension benefits, which would be partially compensated through a modification of the accrual rate and other lesser benefits. Therefore, she agreed with speakers who saw the necessity of considering the various proposals as a whole package.

The revised Plan would reduce the incentives for late retirement through both the change in the accrual rate and the inclusion of early retirement provisions, Miss Napky noted. However, she wondered whether the proposed rule of 85--together with the other new early retirement provisions--would be sufficient to eliminate the back-loading problems in the present Plan; in that connection, she had in mind the penalty for early retirement of 1.5 percent or 3 percent under either the rule of 85 or the age-based reduction that caused a discontinuity in the percentage of benefits in relation to HAGR for early retirees with less than 85 years of combined age and service.

She agreed with the staff representatives that the full cost of living indexation to pensions should be guaranteed, Miss Napky said. Since management had not proposed eliminating the "good cause" provision in Section 4.11 (b) of the Plan, the maintenance of the inflation-adjusted value of the pension benefits should be guaranteed.

In addition, she shared the concern about the equitability of the proposal regarding the benefits of the staff at lower salary levels and the extent to which the ad hoc proposed adjustment fully covered that group, especially as staff benefits had been reduced relative to the August proposal, while staff contributions had been increased, Miss Napky commented. Therefore, the completion of the required additional studies should be expedited in order to see how to fully compensate the staff in lower-salary ranges for the changes in gross remuneration and contributions.

Although the review of the Plan was a very delicate issue, there should be no further delay in concluding it, in order to mitigate the negative impact on the staff of the uncertainties raised by the long process of the review, Miss Napky said. Finally, she wished to associate herself with the comments of Mr. Feldman and Mr. Landau.

Mr. Gurumurthi commented that the Plan had been working fairly satisfactorily, and there was no need to change its basic structure. He supported many of the changes that had been proposed that were in the nature of improvements. At the same time, some of the suggestions made by Mr. Evans were worth examining--for example, variable exit benefits would be attractive to a certain part of the staff. If variable contribution rates were accepted, the Fund's Plan might become more in the nature of a provident fund scheme than a pension scheme, something that the staff might not wish to see happen. Finally, it would be helpful to know the World Bank's views on the proposed changes.

Mr. Al-Jasser said that his preliminary inclination was to agree with the direction of the interim report and proposed changes in the Plan. However, the report raised a number of issues that needed to be clarified and amplified, and, in that connection, Mr. Evans's statement was very useful.

The overriding objective of the proposed changes in the Plan was not fully clear to him, Mr. Al-Jasser continued. Was it simply to take account of changes in taxes on pensions, or was it intended to serve as a vehicle of personnel policy, or to further parallelism with the World Bank, or a combination of those objectives? The Plan had perhaps been overburdened with widely differing objectives.

Given the differences in the structure and characteristics of the staff of the two institutions, parallelism should be interpreted flexibly, Mr. Al-Jasser considered. Moreover, the Plan was hardly the best instrument with which to seek to maintain parallelism; a number of other instruments were available to address parallelism. More important, if the Plan was to serve as an instrument of personnel policy, then the purposes of the relevant proposals would have to be clearly defined; at present, the purposes were still unclear. For example, if the intention was to encourage early retirement, why draw the line at 55 years--rather than an earlier age--as the age at which one could retire without incurring a substantial loss in pension benefits? Assuming that early retirement was a primary objective, perhaps there was reason to reconsider the distinction between the ages of 50 and 55 years for early payment of deferred pensions. It might be more equitable to have a sliding scale of adjustments for benefits between ages 50 and 55 years rather than a fixed adjustment rate of 5 percent, which could in effect be a disincentive to early retirement. He wondered whether the staff or management intended to recommend any supplementary schemes to rationalize staffing in the Fund. Was it in the best interest of the Fund to encourage early retirement, given the changes in the demographics of the staff and the countries from which staff members came to the Fund?

In that context, Mr. Al-Jasser went on, Mr. Evans's alternative approach, based on variable contributions and benefits consistent with each staff member's particular interests, was attractive. The staff should explore the possibility of introducing a plan that considered only years of service--rather than years of service plus age--as a criterion for determining pension benefits. For example, a rule of 75 might be applied to staff with 20 years of service, a rule of 80 to staff with 25 years of service, and a rule of 85 to staff with 30 years of service. Following Mr. Evans's proposal, staff members could be asked to choose among those options.

While he agreed on the need for grandfathering, he was concerned about the consequences of the proposed grandfathering provisions, Mr. Al-Jasser said. Were there assurances that the proposed grandfathering would be only for transitional purposes and would not be repeated in subsequent reviews, and were there other means to achieve the same purpose of grandfathering? Grandfathering might be inconsistent with the implied objective of encouraging early retirement. He wondered whether the suggested period of five years between reviews would be sufficiently long.

Since the Plan was an important element of the staff compensation and benefits package, he hoped that the staff and management had taken that total package into account, Mr. Al-Jasser said. While noting Mr. Grosche's reservation on that point, he himself nonetheless believed that the Plan was important for the competitiveness of the Fund, especially on the recruitment front. He also hoped that the concerns that had been expressed could be met by the time the Executive Directors moved to the final leg of their decision-making process.

Mr. Dai said that his preliminary position was that management's proposals were an acceptable basis for any further discussion on the review of the Plan, as the proposals had been discussed extensively in the Pension Committee, where there seemed to be broad support for them. The main objective of the present discussion should be to agree on some principles or policy guidelines for the review. The staff representatives on the Pension Committee had suggested several sensible principles: pension benefits should be adequate and competitive, at reasonable cost to participants and the Fund; pensions should be equitable among different groups of staff at different salary levels--and, he would add, at different lengths of service; and the Plan should provide a stable framework within which participants could plan for the future. In the latter connection, there was general agreement that any system should be relatively stable in the sense that it should not be subject to frequent change. Furthermore, the Plan should achieve a reasonable balance between the interests of the institutions and those of participants. Those principles were important and sound. Agreement needed to be reached on certain other principles--for example, whether or not early retirement should be encouraged. There seemed to be different views on that particular subject. Once agreement on that subject was reached, it should be easy to agree on the relevant provisions for the Plan. The Executive Directors also needed to consider whether they should try to adhere rigidly to the principle of parallelism with the World Bank. A preliminary consensus on all those matters should be reached first in the Board, leaving to the Pension Committee the technical problem of how to implement the agreed principles.

Mr. Kyriazidis commented that he shared the concerns that Mr. Grosche had expressed with respect to the appropriateness and consequences of using the Plan--rather than some other instrument--for personnel policy purposes. It was also difficult to separate technical adjustments to the Plan under the proposals from substantive changes in the whole conception of the pension scheme. It was also difficult to conclude that the proposed adjustment of the grossing-up formula--which would have important effects on the Plan--was merely a technical matter rather than a major substantive issue. For that reason, and since the grossing-up formula might well be a source of instability in the Plan in the future, he tended to agree with Mr. Evans's proposal to introduce net pensions rather than gross pensions; that idea should be given serious consideration.

As Mr. Warner and Mr. Cassell, as well as Mr. Evans, had raised several important issues, he doubted whether the next step in the review should be a further discussion in the Pension Committee of management's proposals, Mr. Kyriazidis remarked. Before such a Pension Committee discussion, the Executive Board would have to consider principles or guidelines. Therefore, he agreed with Mr. Grosche that the next step should be to hold further discussion in a Committee of the Whole. Without that discussion, the Pension Committee would be at a loss to know how to respond to the various different proposals that had been made.

Mr. Quirós considered that the basic objective of the Plan should be to maintain the excellence of the staff and the Fund. Further consideration should be given to the rationale behind the proposal to change the grossing-up formula. It would be helpful to have additional information in several scenarios on the Fund as Employer and the staff members over the coming 10 years. At present, the Plan had a substantial amount of resources and had enjoyed a good rate of return on its investments. However, in some periods--especially when inflation had been high--the Fund as Employer had contributed much more than the staff, and in other periods the contributions had been roughly equal; but the Fund must also protect the staff in the future. The Fund was a unique institution and might need a unique plan to ensure that it could continue to have a staff of the highest quality. He agreed that further discussion on the Plan and other benefits, including the quadrennial review, should take up all the benefits as a whole, as they were parts of the mosaic of the benefits for each staff member. He would have difficulty in accepting a proposal for full grandfathering. The frequency of future revisions of the Plan would depend on the severity of the circumstances surrounding the Fund and its Plan.

Mr. Kabbaj commented that, as a nonmember of the Pension Committee, his chair, like some others, had some difficulty in expressing at the present early stage firm views on the very complex issues at hand. Hence, he approached with great caution what was after all merely the first consideration by the Executive Board of the proposed changes in the Plan.

He supported the objectives of the proposed changes, and, like Mr. Landau and Mr. Feldman, he found the proposed package to be both comprehensive and balanced, Mr. Kabbaj continued. In addition, the initial reaction to the package by the Staff Association Committee seemed to have been broadly favorable. Further discussion on the proposals, in light of the present discussion, would clearly have to be held, and he wished to reserve his final position for the time being, but he was prepared to support a package that would result in a competitive and cost-effective plan. Another test of an appropriate plan would be its broad acceptability to the staff; in that connection, the current review should be concluded soon to remove the uncertainties facing the staff. To facilitate the discussion, the staff should prepare for the next meeting of the Pension Committee or the Committee of the Whole a paper dealing with Executive Directors' suggestions and remarks at the present meeting.

Mr. Noonan said that his preliminary view of the proposed changes in the Plan was that his authorities would likely share some of the reservations expressed by Mr. Evans and other Directors. Like Mr. Al-Jasser, it was his perception that there was a lack of clarity about the overall direction of the proposed revisions.

He was particularly concerned that the revised scheme could be perceived as being tailored, indeed contrived, to meet special requirements arising at present, Mr. Noonan remarked. At the same time, it was difficult to discern a broad unifying philosophy or principles on which the revised Plan would be based. For example, the Plan was supposed to reflect the social security element of national pension provisions, but he found it difficult to accept the argument that meeting that objective required a juggling of the grossing-up formula, which was a taxation question. Instead, it would be more transparent and straightforward if that element were met by direct means modeled more closely on the social security codes of comparator countries.

The basic approach proposed by Mr. Evans could well provide a more sustainable, long-term basis for the Plan, Mr. Noonan said. Therefore, the various issues that had been raised should be further examined by the Pension Committee and then be brought back to the Executive Board.

Mr. Orleans-Lindsay commented that, in general, the proposed restructuring of the Plan constituted an improved and comprehensive package, with provisions that would serve the needs of the Fund as Employer and the preferences of the staff as outlined by Mr. Landau and Mr. Feldman. While he had no difficulty in supporting the proposed package, as the Pension Committee had recommended, he could go along with speakers who favored a careful consideration of the interesting but controversial suggestions by Mr. Evans, in particular, as well as those by Mr. Grosche. He looked forward to further work on the various issues by the Pension Committee, but bearing in mind that the Staff Association Committee had recently noted that the staff members of the Pension Committee had joined most of the other Committee members in supporting management's proposal as it currently stood, and had emphasized that, in order to retain staff support, it was essential that the integrity of the package be preserved, and that the review be completed in a timely manner. He agreed with Mr. Warner and others who had underscored the need to complete the review in a reasonable period. The pension issues should be considered next by the Committee of the Whole, perhaps over two meetings, before the matter was remanded to the Pension Committee for further work on the technical aspects.

In general, the proposed Plan would provide income adequate enough to enable staff members to maintain an appropriate postcareer retirement, Mr. Orleans-Lindsay said.

Mr. Shrestha stated that he wished to associate himself with the comments by Mr. Landau. At the same time, he agreed with those who favored continuing the discussions in the Pension Committee on the extent to which views expressed by Directors could be accommodated in light of the reactions of the staff representatives.

The Director of Administration remarked that in the coming days the staff would wish to comment in writing on the various points that had been raised during the present discussion. For the time being, he would comment on some of the main themes of the discussion. First, all Executive Directors were clearly concerned about the interests of the staff. After all, the Plan was designed by the institution for the benefit of the staff, and all Directors would certainly agree that results of the current review of the Plan should be seen by the staff members as reasonably reflecting their preoccupations and views, not least because the staff was contributing a substantial proportion of the Plan's resources. While one could of course envisage a number of different possible outcomes that the staff might find attractive, Directors could not yet be certain whether the outcomes would in fact prove to be attractive to the staff. That point underscored the importance of maintaining appropriate contacts with the staff representatives in order to take the staff members' views into account during the course of the review.

Second, the increased emphasis on early retirement under the proposed Plan was not simply an issue of personnel policy, the Director continued. It was important to recognize that, while that emphasis was in the best interests of the Fund, for reasons that had been explained, there was strong evidence that it also reflected the wishes of the great majority of the participants in the Plan. It was very difficult to argue that making it harder for staff to leave the Fund when they wished to do so was in the best interests of the Fund. Mr. Grosche had noted that there were mechanisms other than the Plan that could be used to encourage staff to leave. If the revised Plan, like the current one, was heavily back-loaded, it would be difficult and expensive to encourage early retirement by some staff members; the Fund would have to maintain at considerable expense a pension plan that encouraged staff members to stay and it would have to produce extra money in the form of golden handshakes to compensate for that inducement to stay. The present Plan was not appropriately balanced and it did not appropriately meet the aspirations of many staff members, including some with long service of 25 years or more.

It was difficult to know precisely what conclusions to draw from the various comments on the issue of parallelism, the Director remarked. During discussions on staff compensation in 1989, when it was evident that applying the same compensation principles to the Fund and the Bank would have adversely affected the Fund, the staff had suggested that the Fund should phase in the comparatio of 100 to reduce the adverse impact on the Fund. The Board at that time did not agree with that proposal, on the grounds that parallelism would not justify it. He hoped that the Board would be reasonably consistent in deciding when it was appropriate to depart from the principle of parallelism. In any event, most of the comments on parallelism during the present discussion had been aimed at the Bank rather than the Fund. The Bank had a more serious problem than the Fund in terms of costs of management's proposed package.

As to the issue of timing, reference had been made to the benefits review and the ongoing survey, the Director recalled. The consultants conducting the survey had recently indicated that they had encountered some difficulty in collecting all the required data. The staff expected to receive in early January 1990 data on the U.S. comparators, but the data on the French and German comparators probably would not be available until about the middle of January. Hence, the results of the quadrennial benefits survey might not be available until about February.

He agreed with Mr. Grosche that care should be taken to distinguish between actions taken on the Plan and actions taken on other benefits, the Director said. As a number of speakers had emphasized, the Plan was a permanent feature of the Fund's overall compensation package, and the elements of the Plan should not be adjusted very frequently, as the stability of the Plan was an important consideration. On the other hand, it was much less difficult to adjust other benefits, and to the extent that it seemed necessary to adjust the value of the overall benefits package either by reducing it or by increasing it every few years, it would be much more appropriate to adjust the nonpension benefits. Therefore, once the Board decided on the appropriate plan for the institution, that plan should become a given; there was no strong reason why one needed to have an overview of the full value of benefits before one decided what that given plan should be.

The Board clearly required a while yet to consider further how to revise the Plan, and it was therefore likely that the results of the overall benefits survey would be available before the review of the Plan was completed, the Director continued. A major new exercise to examine a totally different plan with very different objectives from the present Plan would certainly take a good deal of time and would perhaps involve some additional cost, should further work by consultants be required. One of the issues that the Board would have to face fairly soon was whether it wished to continue with the present Plan while engaging in some far-reaching examination of alternative systems, or, instead, reach a decision fairly soon on a plan that was relatively similar to the present one with the kind of adjustments that management had proposed.

Mr. Warner said that he preferred to see the discussion be continued in the Committee of the Whole, rather than in the Pension Committee. The mandate of the Pension Committee clearly was to deal with technical issues raised during the review of the Plan. The Committee of the Whole should deal with the human resource management issues and related substantive issues that had been raised in the course of the current review. Some speakers who preferred to move the discussion to the Pension Committee had said that they were concerned about the absence of staff representatives from the Committee of the Whole. In fact, however, the staff members of the Pension Committee had been present throughout the present meeting, and he saw no reason why they should not continue to attend any further discussion in the Committee of the Whole. No good purpose would be served by excluding the staff members of the Pension Committee from meetings of the Committee of the Whole; on the contrary, keeping them fully knowledgeable of the discussions would contribute to a successful conclusion of the review of the Plan.

The Chairman said that he welcomed speakers' overall positive assessment of management's proposals, their commitment to ensuring the international competitiveness and cost effectiveness of the pension system, and their recognition of the need to keep the system as stable as possible, avoiding frequent revisions. In addition, it was generally agreed that the current review of the Plan should be completed as quickly as possible in order to eliminate staff members' uncertainty about the pension system. He was pleased that Executive Directors generally had an open mind on a number of the issues under discussion, and that their approach toward parallelism was flexible--which certainly seemed reasonable. There seemed to be no major objections to the proposed grandfathering provisions. At the same time, there was interest in the views expressed by Mr. Evans, and the staff would consider how to take them into account.

As to the next step in the review, the staff should be given an opportunity to respond in writing to the views that had been expressed at the present meeting, the Chairman considered. Once that written response had been circulated, the Executive Directors should meet again--say, once or twice--as necessary, in the Committee of the Whole, followed by technical discussions of more precise points in the Pension Committee. Thereafter, the discussions could be continued in the Executive Board.

The Executive Directors concluded for the time being their discussion on the proposed changes in the Staff Retirement Plan.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/89/162 (12/13/89) and EBM/89/163 (12/15/89).

4. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/89/295 (12/12/89) and EBAP/89/297 (12/13/89), by an Advisor to Executive Director as set forth in EBAP/89/297 (12/13/89), and by an Assistant to Executive Director as set forth in EBAP/89/294 (12/11/89) is approved.

APPROVED: August 15, 1990

LEO VAN HOUTVEN
Secretary