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**Statement by Mr. Mirakhor on Statement by the Managing Director on the Review of
Employment, Compensation and Benefits
(Preliminary)
Executive Board Meeting 06/21
March 3, 2006**

We thank the Managing Director for his efforts toward a compromise on the key issues of the ECBR, and welcome the valuable feedback from the Staff Association.

For the record, this chair did not support the present review, believing that the system put in place in 1989 was well-suited to this institution and has served it well since then. We also believed that its problems were exaggerated and the objections, raised by a minority of chairs, were marginal and could have been addressed without the need for a costly and divisive review. Now the Board is to consider a set of proposals that purport to serve the goal of maintaining the highest quality international staff with a view to enhancing diversity, while rationalizing the Fund's employment practices and allowing greater flexibility to management in its future employment-related decisions. This goal is commendable, but the proposals under deliberation will not promote it and are likely to have deleterious effects on staff quality. A clearer evaluation of the long-term impact of the proposals is necessary. There are many remaining ambiguities about the details of exactly what the new employment and compensation policies will be, much to the consternation of the staff and this chair. Nevertheless, it is hoped that once the key principles are clear and agreed upon, the details of the changes will be clearly explained to the staff at every step.

The goal of achieving budgetary efficiency gains is praiseworthy on its own merits, as are the goals of attaining a strong foundation for medium-term income position and designing a well-defined, medium-term strategic vision. Nevertheless, it is neither appropriate nor advisable to directly link these with changes in compensation and benefits. High quality work by the Fund will continue to be an international public good for the benefit of members into the foreseeable future, and should be considered by the membership on its own merits.

Compensation

The compensation system lies at the heart of our ability to maintain an internationally diverse staff of the highest quality and, therefore, needs to receive our full and careful attention. Some of the new proposals on staff compensation, which are set out in the management's

two Buffs, are both surprising and troubling. They are surprising because the proposals are very different from those that were brought to the Board in January and were supported by Directors. The alternative proposal that is now before the Board as a compromise was already proposed by some Directors in the last Board discussion on ECBR but failed to receive the support of the Board. We are, therefore, surprised to see it now as the management's proposal. They are troubling because they seem to conflict with some of the objectives that management and Executive Directors have supported throughout the ECBR process—namely to maintain internationally competitive salaries and a firmly rules-based system for our decisions on compensation—"seem to conflict" because too little information is provided on some of the new proposals for us to understand their implications or to reach an informed decision. There are three particularly troubling aspects of the new proposals on which I will focus:

First, the new proposals on the comparator markets for Grades A9-B2 would lower the Fund's salary structure by at least 3.2 percent plus another 1.5 percent when the revision of the Spouse Allowance is eventually implemented. This is a much larger salary reduction than was originally proposed and it is difficult to understand the reasons for it. Neither Watson Wyatt nor the Steering Committee found any need for reductions of this amount, and Directors did not call for such changes in the January discussion or earlier informal meetings. There is a real risk that such reductions will harm our competitiveness, particularly at the higher grades where the largest reductions—up to 7 percent or more—would occur, even though these are the grades where we need to strengthen our competitiveness for mid-career appointees, financial sector specialists, and diverse staff from higher-paying countries, including Japan and Europe. We would also ask for more information on how these changes will be implemented. The assurances that no staff member's salary will be reduced and that there will be scope for some increases are welcome, but it will be important for those increases to be sufficient to continue to motivate and reward staff during the transition.

Second, the new proposals on indexation would appear to offer some simplification for annual reviews, but they open the door to departures from the rules-based and comparator-based approach that will turn out to lead to more complexity and contention. It is important to bear in mind that our general policy is to base Fund salaries on a specific set of comparators that is representative of the markets in which we actually compete for staff. It is not our policy, as Ms. Jacklin's and Mr. Lynch's statement would suggest they prefer, to base our salaries on general trends in national labor markets as covered in government-reported statistics. These statistics should not replace the comparator system. Also, to maintain a rules-based system, we need to ensure that the comprehensive salary reviews—whether they are every two years, as the Steering Committee recommended or every three years, as now proposed—are designed to restore the full alignment with the specific comparator markets that this Board has adopted. Some safeguards are needed to firewall the system against the temptation to significantly overhaul the system every three years.

The proposed three-year cycle of compensation review may well be workable, provided that the adjustments in years between comparator-based reviews are based on a reliable index, which is applied in a transparent manner (and with the above assurances regarding the comprehensive reviews). We have noted, however, that the *Indexation* note (EBAP/06/22)

has acknowledged some pitfalls concerning the Bureau of Labor Statistics index—e.g., the salary level on which it is based, the lack of differentiation among grades, and lack of knowledge about the U.S. data incorporated in it. These problems will need to be overcome if indexation is to have credibility with the staff and to avoid excessive errors and corrections. In this connection, we would be interested to learn about alternative indexes, such as those proposed by Watson Wyatt in their report (pp. 87-88), which may be more representative of the Fund's particular employment markets. In addition, we would urge that the staff do not lose sight of salary developments in other countries in the years that salary adjustments are based on only a U.S. index. Reliance on the U.S. market alone for two consecutive years may be problematic; if other salaries rise more rapidly, we could face recruitment and retention problems and reduced diversity by discouraging prospective employees from high-wage countries. Like Mr. Shaalan and Ms. Choueiri, we wonder what the impact on the salary structure would have been, had the three-year cycle methodology been applied during the last salary review.

Third, we are surprised by the decision to revert to the amendment that was adopted last January to provide discretion for the Board to reduce the indicated salary adjustment within the 10-20 percent testing range. For the record, I opposed that amendment at the time, and some colleagues who supported it did so only as a temporary measure pending the completion of the ECBR. It is not a satisfactory way to meet the desire of Directors for some limited flexibility in applying the results indicated by the salary reviews. Moreover, as the staff pointed out in the January "companion paper" (EBAP/06/2, Supplement 1, para 180), this approach "... would not, in practice, always allow such an adjustment to be made. The constraint would rule out any downward adjustment in years when the applicable CPI increase is equal to or greater than the increase indicated by the U.S. market..." does not even provide flexibility. We believe that these arrangements require further consideration.

Among the new proposals, we welcome the Managing Director's proposal to incorporate an Asian country to expand the non-US markets used to evaluate competitiveness for the next comprehensive salary review.

In sum, we believe that the initial Steering Committee's proposal is far superior and should form the basis for a compromise with the suggested modifications by SAC.

Apart from the new proposals, we would reiterate our continuing concerns about some of the original measures in the January paper. The proposed extension of the probationary period for new staff—whether to four years as originally proposed, or to three years—should be reconsidered. We continue to support the view that the existing two-year probationary period is serving the Fund well and should be maintained.

Like Mr. Misra and Mr. Bennarji our preference continues to be an integrated pay line, and believe that bringing the A1-A8 salaries in line with the local markets and limiting recruitment to local markets, create potential long-run problems that may undermine the ECBR goal of maintaining highest quality staff and job standards. The Fund has certainly been blessed with highly qualified staff assistants with immense dedication to the institution, willingness to cope with the necessary workload, and language skills. By using the

Washington-Baltimore area international staff salaries as comparator, the Fund may be facing the peril of settling the institution with a job standard that may well be below the standards we are all accustomed to at the Fund. We also support the compromise offered by Mr. Misra and Mr. Bannerji that, where recruiting well-qualified staff at B3-B5 is difficult at prevailing salary scales, the Board can decide on a case-by-case basis on management's recommendations.

Expatriate Benefits

There is broad agreement that expatriate benefits are not over competitive. We welcome the proposal that third-country education allowance be maintained. The proposal that there should be a cap on such benefits as a percentage of salary would discriminate against staff at lower grades, and we cannot support it. We concur with the compromise proposal of Messrs. Kiekens and Prader to convert home leave travel to two home leaves in a period of three years on full fare economy class. We also agree with Messrs. Kiekens and Prader and Mr. Shaalan and Ms. Choueiri that the Board should decide on all aspects of the ECBR together, without deferring the expatriate benefits review until FY 2007, since as these colleagues argue, all elements of ECBR have budgetary implications. Extension of at least some of the expatriate benefits to a relatively small number of green card holders should be further considered.