

**FOR  
AGENDA**

EBAP/06/38

CONFIDENTIAL

March 31, 2006

To: Members of the Executive Board

From: The Secretary

Subject: **Employment, Compensation, and Benefits Review—Proposed Decisions**

Attached for consideration by the Executive Directors is a paper on the proposed revised compensation system and the proposed changes to the home leave policy and the education allowance policy, based on the Executive Board's previous consideration of these issues. This paper is tentatively scheduled for discussion on **Friday, April 14, 2006**. Draft decisions on the proposed new compensation system and on the proposals with respect to the home leave policy and the education allowance policy appear on page 18. In light of the analysis and rationale for the new policies incorporated in the proposed decisions, it is envisaged that there will be no summing up of the April 14 Board discussion of this item.

Questions may be referred to Mr. Márquez-Ruarte (ext. 37180) and Mr. J. Kennedy (ext. 34665) in HRD.

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## INTERNATIONAL MONETARY FUND

**Employment, Compensation, and Benefits Review—Proposed Decisions**

Prepared by the Human Resources Department

In consultation with the Legal Department  
and the Office of Budget and Planning

Approved by Jorge Márquez-Ruarte

March 31, 2006

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## I. INTRODUCTION

1. **This paper sets the stage for concluding the ECB review.** The paper presents formal decisions on two elements of reform: the staff compensation system and expatriate benefits. Building on recent Board consideration of a range of reforms in the Fund's employment framework, compensation, and benefits (ECB), the paper also provides additional information to support decisions on these two elements.<sup>1</sup> Agreed changes in the Fund's employment framework will be implemented by management.
2. **The 2006 compensation review will be conducted following the ECB review.** A separate paper for the 2006 compensation review will be issued for discussion on April 19. On the basis of the proposed rules of the new system, the paper will make formal proposals on all aspects of the compensation system for 2006, including the associated transitional arrangements for affected staff. In particular, these arrangements would ensure that staff have the possibility of receiving some salary increase. These proposals will draw on an assessment of recent recruitment and retention experience, which will be presented in a separate paper.
3. **The rest of the paper is organized into three sections.** Section II presents the main features of the proposed compensation system, with an emphasis on changes to existing rules. Section III brings together the proposed changes in expatriate benefits on the basis of earlier Board discussions, including a revised proposal for home leave travel. Draft decisions giving effect to the new compensation system and expatriate benefits are presented in Section IV.

## II. PRINCIPAL PROVISIONS OF THE REVISED STAFF COMPENSATION SYSTEM

4. This section sets out the proposed provisions of the revised compensation system. Under the revised system, the annual compensation reviews will be conducted, and the annual adjustments to the salary structure will be made, on the basis of a three-year review cycle: (i) in the first year of each cycle, comparator-based reviews will take into account full comparisons of compensation levels in the designated comparator markets for Grades A9–B2 and A1–A8 and other relevant considerations, including, in the case of Grades A9–B2, the assessment of international competitiveness; and (ii) in the intervening years, the structural adjustments will be based on an index of private and public sector salary increases in the

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<sup>1</sup> The key papers are *Employment, Compensation, and Benefits Review—Overview Paper* (EBAP/06/2, 1/6/06), *Employment, Compensation, and Benefits Review—Companion Paper* (EBAP/06/2, Sup. 1, 1/6/06), hereinafter referred to as “overview paper” and “companion paper,” respectively, and *Indexing Staff Compensation* (EBAP/06/22, 2/24/06). Management proposals are contained in the *Statement of the Managing Director on the Review of Employment, Compensation, and Benefits* (BUFF/06/31, 2/22/06, and Sup. 1, 2/28/06, as corrected). See also *The Chairman's Summings Up on Employment, Compensation, and Benefits*, Executive Board Meeting 06/12, February 7, 2006 (BUFF/06/30, 2/17/06) and Meeting 06/21, March 3, 2006 (BUFF/06/47, 3/13/06).

United States. Taking into account each year's approved adjustment to the salary structure, resources will be allocated annually for individual, performance-related merit increases.

5. Although the new compensation system will include features that are similar to the existing system, some of these features require modification given the fact that they will be operating within a different overall framework. For example, there will be new level comparisons between each Fund grade and the corresponding compensation rate in comparator markets and the possibility of grade-by-grade adjustments; and the evaluation of international competitiveness will take place in the context of a broader comparator market review.

6. It is intended that the provisions set out below would become effective upon their approval by the Executive Board. They would govern the 2006 and subsequent annual compensation reviews.

#### **A. Basic Objectives and Principles**

7. The central objectives of the Fund's staff compensation system are derived from Article XII, Section 4 (d) of the Articles of Agreement, which provides that, subject to the paramount importance of securing the highest standards of efficiency and of technical competence, the appointment of staff should "pay due regard to the importance of recruiting personnel on as wide a geographical basis as possible." To give effect to this provision, the Fund's compensation system seeks to be:

- highly competitive in the national markets and market sectors in which the Fund competes for staff, and effective in supporting the recruitment and retention of a diverse, multinational staff meeting the highest standards of quality and professionalism;
- structured and administered in a way that provides effective incentives for high standards of performance;
- internally equitable and consistent; and
- cost effective in its design and operation.

8. In addition to these objectives, two principles will guide the operation of the compensation system:

- **The system is comparator-based.** Periodic reviews of market comparability, based on an established set of relevant comparator markets and designated benchmark levels of compensation in those markets, will provide the basis for ensuring that the Fund's salary structure and staff salaries are maintained at competitive levels in relevant markets.

- **The system is rules-based.** The major provisions of the system, including the definition of the comparator markets and the procedures used to determine the annual salary adjustments, will be clearly defined so that the annual reviews will be conducted in accordance with an established methodology, while still allowing management and the Executive Board to exercise judgment, within defined parameters, in setting salary levels.

## **B. Grades A9–B2: Comparator-Based Reviews**

9. This subsection sets out the provisions of the compensation system governing the setting of the salary structure for Grades A9–B2 in those years in which comparator-based reviews are undertaken.

10. Under the proposed system, these reviews are not designed to reexamine the basic policy parameters of the compensation system, such as: the provisions defining the comparator markets (including, among other elements described below, the sectors and weights, compensation elements, market pitch, and measurement method); the role of the United States as the primary comparator market; or the policy on and procedures for maintaining international competitiveness through reference to the international test market (also described below). However, this does not preclude the Executive Board from amending provisions of the compensation system as needed.

### **Definition of Comparator Markets and Market Paylines**

11. The applicable level of compensation in the comparator markets that will be used in determining the level of the Fund's A9–B2 salary structure will be established as single market paylines developed by aggregating sector and occupational data on comparators' compensation, defined on a basis equivalent to the Fund's net-of-tax, U.S. dollar salary structure. The following provisions will govern the development of the market data, the establishment of the designated level ("pitch") within the markets to which Fund salaries will be linked, and the method for measuring the overall relationship between the Fund and market A9–B2 paylines.

### ***Countries***

12. The primary comparator market, which will serve as the principal basis for setting and adjusting the level of the A9–B2 salary structure, will be the United States market. To ensure that the A9–B2 salary structure is internationally competitive, the competitiveness of the Fund payline, as indicated by the U.S. market, will be tested against an international market. The international test market for the 2006 comparator-based review will comprise the French and German comparator markets. The international market will combine the national data, with each country having an equal weight.

13. Subject to confirmation that the relevant public and private sector data can be secured, the international test market will be expanded by the addition of public and private

sector compensation data on an Asian country (Japan or Singapore) beginning with the 2009 comparator-based review. The market for the additional country will be defined, insofar as possible, on the basis set out in this subsection. A formal proposal on how to incorporate salary information on the additional country into the compensation system will be brought to the Board in advance of the next comparator-based salary review, to be conducted in 2009.

### ***Market Sectors***

14. The selection of specific market sectors and the weight assigned to each in aggregating the sector data in a single market payline are designed to ensure that Fund salaries are maintained at competitive levels that support recruitment and retention from all areas of national employment markets in which the Fund competes for staff. Each national comparator market will include three sectors, which will be assigned the indicated weights:

- **Public sector**, with a 50 percent weight;
- **Private financial sector**, with a 40 percent weight; and
- **Private industrial sector**, with a 10 percent weight.

15. Prior to the 2009 comparator-based review, studies will be carried out to determine the feasibility of adding the academic sector to the U.S. comparator market for Grades A11–A12. The studies will examine whether consistent year-to-year data can be secured on the full-year equivalent of Fund compensation for recent recipients of Ph.D. degrees appointed to economics faculties and business schools of leading universities with which the Fund competes for Economist Program candidates. If the inclusion of the academic sector in the U.S. comparator market proves feasible, the indicated sector weights would be adjusted to accommodate it.

### ***Organizations***

16. With the objective of establishing comparator paylines that are broadly representative of the markets in which the Fund competes for staff, the number and type of organizations to be included in the markets will be determined on the basis of three principles: (i) the organizations should be relevant and appropriate, i.e., the market should require the same types of skills, level of education, and professional training as the Fund; (ii) the market should be composed of organizations from which the Fund might recruit and which, in turn, might seek to recruit Fund staff; and (iii) the market should be reliable and stable in the sense that the organizations comprising it will provide consistent data from cycle to cycle. The specific list of participating private sector organizations can be expected to vary from year to year, however, for example because some firms do not provide data to consultants on a regular annual basis.

17. **United States market organizations.** The compensation surveys in the United States market will normally cover organizations as follows:

- The financial sector will include 40–50 commercial banks, diversified financial organizations, and insurance companies with assets in excess of \$5 billion.
- The industrial sector will include about 100 firms with annual revenues in excess of \$1 billion and in a diverse range of business areas (e.g., petroleum products, chemicals, electrical utilities, telecommunications, airlines, shipping, and pharmaceuticals).
- The public sector will include about 15 federal government departments and agencies whose operations focus on economic and financial issues, together with the Federal Reserve Board in Washington and the Federal Reserve Bank of New York. In compiling the public sector data, the civil service departments/agencies and the Federal Reserve organizations will each have a 50 percent weight.

18. **French and German market organizations.** The compensation surveys in the French and German markets will normally cover the following organizations:

- The financial sector in each country will include about 30 commercial and investment banks and other diversified financial organizations.
- The industrial sector in each country will include 60–70 firms in various lines of business similar to those of the U.S. market.
- The public sector will include at least three representative departments/agencies, including the ministry of finance and central bank, in each country.

***Occupations and function weighting***

19. Compensation data for each national comparator market and market sector will cover occupational groups and positions that are broadly relevant to the staffing requirements of the Fund, including occupations that directly correspond to Fund areas of responsibility, duties, and accountabilities, and/or occupations that are broadly comparable to those of the Fund in terms of their required types of skills, level of education, and professional training. Occupations that are clearly irrelevant to Fund staffing (such as those in retail banking, sales, and food services) and those paid primarily on the basis of commission or profits (such as financial market traders) will be excluded from the market data.

20. Management intends to conduct a review of the methods used to conduct detailed matching of Fund salary grades with positions in other organizations, and how the stock of organizations involved is updated over time. This review will be completed within the next 18 months; any implications such a review might have for the operations of the comparator-based reviews will be brought to the Board well in advance of the 2009 compensation review.



21. To develop a single market payline for Grades A9–B2, the market data for each sector will be aggregated by weighting the data on functional groups approximately in accordance with the occupational structure and distribution of Fund staff. The weighting in Table 1 below will be applied to the extent possible for this purpose.

Table 1. Occupational Weights for Public, Private Financial, and Industrial Sectors  
(In percent)

Occupational Group	Grades A9–A10	Grades A11–A13	Grades A14–B2
Core Operational Occupations	30	70	85
Economics/Financial/Managerial	25	65	80
Legal	5	5	5
Administrative Occupations	70.0	30	15
Finance/Accounting	17.5	7.5	3.75
Information Systems	17.5	7.5	3.75
Human Resources	17.5	7.5	3.75
Other Administration 1/	17.5	7.5	3.75

1/ Includes external relations, language services, editing, facilities management, administrative services, and other administrative functions.

22. Full application of the indicated function weights is subject to data availability; data limitations have not permitted occupational weighting in the French and German industrial and public sectors. The indicated weights may also be adapted to align them with the structure of data in consultants' compensation databases (e.g., Hay Management Associates data on managerial/supervisory positions the U.S. industrial sector, which are maintained separately).

### ***Compensation elements***

23. The compensation taken into account in establishing the level of the market paylines will comprise base salaries and variable-cash performance payments that are paid on a one-year cycle. The variable-cash payments will be smoothed on the basis of a moving five-year average. No long-term incentives or deferred compensation will be included in the market data. Compensation data for the private financial and industrial sectors, which are typically collected by consultants during the third quarter of the year, will be "date-adjusted" forward to April 30 of the compensation review year on the basis of the organizations' reported increases or, when necessary, consultants' estimates of post-survey salary adjustments. Compensation data for the public sector will generally be collected and reported as of the first quarter of the compensation review year.

### ***Tax and exchange rate factors***

24. In order to compare compensation levels in the comparator markets with the level of the Fund's salary structure on a consistent basis, the comparators' gross, pre-tax compensation will be converted to an equivalent net-of-tax basis and, in the case of national markets other than the United States, to U.S. dollars.

25. **Applicable tax rates.** Net-of-tax compensation equivalent to the gross pay of comparators will be determined for applicable income levels on the basis of estimated effective tax rates for married taxpayers with two dependent children.<sup>2</sup> The tax information will be developed by an external tax/accounting firm for each national comparator market on the basis, insofar as possible, of (i) the tax regime (i.e., income brackets, tax rates, and generally applicable statutory exclusions, exemptions, and deductions) that applies as of May 1 of the compensation review year, and (ii) the most recent information released by national tax authorities on the applicable average exemptions and deductions of individual taxpayers.

26. **Applicable exchange rates.** The net-of-tax compensation of national comparator markets other than the United States will be converted to U.S. dollars on the basis of the simple average of (i) the average nominal exchange rate, and (ii) the average purchasing power parity rate, as published by the Organisation for Economic Co-Operation and Development, both calculated on the basis of the 12 months ending in October prior to the compensation review year.

27. **Adjustments for Spouse and Child (Tax Equivalency) Allowances.** The net-of-tax compensation of national comparator markets, expressed in U.S. dollars, will be reduced by the amount of the Fund's Spouse Allowance and, on the basis of two children, Child Allowance.<sup>3</sup>

### ***Market pitch***

28. Compensation in the comparator markets will be measured and the level of the comparator market paylines (i.e., the reference level to which the Fund relates its salaries) will be set at: (i) the 75<sup>th</sup> percentile of the U.S. industrial sector and of each sector in the international (i.e., French and German) comparator market; (ii) a level 10 percent above the mean of the U.S. public sector; and (iii) on the following sliding scale between the 75<sup>th</sup> percentile and the mean of the U.S. financial sector:

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<sup>2</sup> Consistent with the existing practice, the net-of-tax compensation of the comparator market for Grades A1–A8 will be determined for applicable income levels on the basis of estimated effective tax rates for single taxpayers with no dependent children.

<sup>3</sup> Consistent with the existing practice, the net-of-tax compensation of the comparator market for Grades A1–A8 will not be reduced by the amount of the Fund's Spouse and Child Allowances.

Grade	Percent of 75 <sup>th</sup> Percentile	Percent of Mean
A9	100	0
A10	100	0
A11	100	0
A12	80	20
A13	60	40
A14	40	60
A15/B1	20	80
B2	0	100

### ***Market Alignment: Measurement Method***

29. The measurement of overall differences between and the alignment of the Fund's A9–B2 payline and the corresponding comparator market paylines will be determined (i) in the case of the United States market by minimizing the mean squared error of the percentage differences at each grade (MSE);<sup>4</sup> and (ii) in the case of the combined French and German market as the arithmetic average of the percentage differences at each grade. In both cases, the percentage differences at each grade will be weighted by the number of Fund staff in the grade, with the weights determined by the distribution of A9–B2 staff as of January 1 of the compensation review year.

### **Review Process**

30. The comparator-based reviews for Grades A9–B2 will be carried out in year 1 of each three-year cycle in accordance with the following process:

- **As a first step**, the existing A9–B2 salary structure, including the A9–B2 payline as a whole and individual grades, will be compared on a level-to-level basis with the U.S. and the international comparator markets.<sup>5</sup> The review will examine such questions as the relationships between the Fund's overall A9–B2 payline and individual grades and salary ranges and the comparator markets, the slope of the Fund payline, and whether any adjustments are needed in those market relationships. In assessing possible adjustments to the

<sup>4</sup> Prior to the 2009 comparator-based review, management intends to explore whether an alternative measurement method could allow closer linkages between Fund and market salaries, while still maintaining market alignment across Grades A9–B2.

<sup>5</sup> Compensation data for these reviews will be secured from human resources consulting firms, selected on the basis of their ability to provide consistent, high-quality, annual data on organizations meeting the criteria specified below in one or more of the countries and sectors incorporated in the set of Fund comparator markets.

level of individual grades, internal considerations of career progression and the consistency of the salary structure will also be taken into account.<sup>6</sup> This initial step will tentatively establish the level of the new range midpoint for each grade and thereby identify a new provisional Fund payline for Grades A9–B2.

- **The second step** will be to position this provisional Fund payline at the level that, on the basis of the measurement method (MSE) defined in paragraph 29 above, aligns it with the primary U.S. comparator market payline, in order to ensure that the level of Fund’s A9–B2 salary structure as a whole is in line with the designated level of compensation in the U.S. market. This step may call for some adjustment to the midpoints tentatively identified in the proceeding step. The result of the second step will be an adjusted Fund A9–B2 payline that is aligned with the U.S. market (as described in paragraph 29 above) and incorporates any proposed changes in the relative level of individual salary ranges.<sup>7</sup>
- **The third step** is to test the competitiveness of the Fund A9–B2 payline that results from the second step against compensation levels in the international comparator market, measured, as indicated in paragraph 29 above, on the basis of a staff-weighted arithmetic average. The margin of international competitiveness (i.e., a range that is 10–20 percent above the international market) that will be used for this purpose, and the further permissible adjustments to the Fund’s payline in relation to the testing range are described below.

31. Based on the outcome of this review process, the Managing Director will propose for the Executive Board’s consideration and approval a revised salary structure for Grades A9–B2, including the new level of the salary range midpoints and the range maxima and minima based thereon.

32. It is recognized that salary trends reflected in the indexation-based adjustments to the Fund’s payline in years 2 and 3 of the review cycle (see below) may differ from the cumulative three-year increases in compensation levels in the Fund’s designated U.S. and international comparator markets. The adjustments indicated by the level comparisons in the

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<sup>6</sup> The comparator-based reviews may also consider supplementary information on compensation levels among, for example, international organizations, but such information will not be included in the compensation data included in the calculations that determine the level of the Fund payline.

<sup>7</sup> Unlike the existing system, structural increases resulting from comparator-based reviews under the revised system will not be determined as a uniform percentage increase; adjustments to the level of individual grades may vary. Under the revised system, the “average A9–B2 structural increase” will be calculated as the staff-weighted average of the approved change in the level of the range midpoint of each grade.

comparator-based reviews at the start of each review cycle may consequently be larger or smaller than recent general salary developments in particular national or public or private sector markets might suggest. Notwithstanding such differences, the objective of each comparator-based review will be to fully restore the alignment of the Fund's A9–B2 payline with the U.S. comparator market, subject only to relevant considerations of international competitiveness.

**Provisions Governing International Competitiveness and Adjustments to the Level of the Fund Payline Indicated by Alignment with the U.S. Market**

33. In accordance with the rules described in the subsection above, after grade-by-grade adjustments have been made, the result will be a provisional A9–B2 payline that is aligned, on the basis of the MSE measurement method, with the U.S. market. An adjustment to the average level of this provisional A9–B2 payline will be permitted, but is not required, on the basis of an evaluation of international competitiveness in accordance with the rules set forth below.

34. When evaluating international competitiveness, consideration will be given to such factors as recent recruitment and retention experience, the extent to which the margin over the international test market (described below) has been eroded or surpassed, and effects of tax and exchange rate developments on the level of the international market payline.

35. Adjustments based on the above considerations will be subject to the following:

(a) The targeted margin that will be considered an appropriate degree of international competitiveness will be a range that is 10–20 percent above the designated level of salaries in the international comparator market.

(b) When alignment of the Fund's A9–B2 payline with the U.S. market would produce a Fund payline that, on a staff-weighted average, falls outside the target range for international competitiveness, the provisional A9–B2 payline could be adjusted either (i) upward if the Fund payline would otherwise fall below the 10 percent floor of the range or (ii) downward if the Fund payline would otherwise fall above the 20 percent ceiling of the range. An upward adjustment from a position below the 10 percent floor could raise the A9–B2 payline to a level either below or above that threshold. However, a downward adjustment from a position above the 20 percent ceiling that would position the payline below that threshold would be constrained by the rules applicable within the target zone described in (c) below.

(c) When alignment of the A9–B2 payline with the U.S. market, or a discretionary downward adjustment under (b) above, would produce a Fund payline that, on average, falls within the 10–20 target range for international competitiveness, any downward adjustment could not result in a staff-weighted average level of the A9–B2 payline that is less than the higher of (i) a level equal to 10 percent above the level indicated by the international comparator market, and (ii) a level resulting from a

staff-weighted average percentage structural increase at least equal to the percentage increase in the Washington metropolitan area Consumer Price Index for the 12 months ending in January.<sup>8</sup>

36. In the event that adjustments are made as a result of an evaluation of international competitiveness, such adjustments would normally be applied uniformly to the Fund's A9–B2 payline; however, different adjustments could be made to individual grades (with offsetting adjustments to other grades) if this is considered necessary for reasons of international competitiveness.

### **C. Grades A9–B2: Indexation-Based Reviews**

37. In the indexation-based reviews, which will be carried out in years 2 and 3 of each three-year cycle, the structural adjustments (which will be uniform across all grade levels) will be determined in accordance with an index that incorporates annual rates of compensation increases in the public and private sector of the United States. Except as provided below, the international test market would not be taken into account in determining the size of these adjustments.

#### **Indexation formula**

38. The indexation formula will combine the rates of increase in the public and private sectors on a weighted basis in accordance with the sector weights incorporated in the definition of the comparator markets, i.e., a private sector weight of 50 percent and a public sector weight of 50 percent. A technical note on the use of published data on wage developments in the indexation formula is presented in Appendix I.

39. The private sector component of the indexation formula will be established on the basis of reported percentage changes in the wage component of the U.S. Bureau of Labor Statistics Employment Cost Index (ECI) over the 12-month period ending in December immediately prior to the compensation review year. Specifically, the private sector component will consist of the weighted average of the percentage increases in the ECI data on the private sector (i) white-collar goods sector (excluding sales), with a weight of 20 percent, and (ii) finance, insurance, and real estate sector (excluding sales), with a weight of 80 percent.

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<sup>8</sup> The CPI floor would only apply in circumstances where there is a downward adjustment of the Fund payline indicated by alignment with the U.S. market within the target range of international competitiveness. Accordingly, the floor would not apply when (a) the downward adjustment would still place the Fund's payline above the 20 percent floor or (b) the alignment of the Fund's payline with the U.S. market would place the payline within the target range and no downward adjustment is sought. If warranted by considerations of international competitiveness, an upward adjustment from a level within the target range would be permitted.

40. The public sector component of the indexation formula will be the authorized percentage increase for the U.S. Civil Service, including locality pay for the Washington metropolitan area, which normally takes effect in January of each compensation review year.

41. With the ECI data to be re-based in the next few months, staff will conduct further analysis of the rebased series to establish whether it has acceptable properties, and will also explore whether other established/published series could provide a better indicator of the evolution of Fund salaries during the period between comparator reviews. Any proposed changes to the indexation formula will be brought to the Board for approval by end-October 2006.

### **Application of the indexation formula**

42. In years 2 and 3 of the compensation system cycle, the Grade A9–B2 salary structure (range minima, midpoints, and maxima) will be increased uniformly by the amount indicated by the increase in the chosen salary index.

43. Management may propose to the Board an upward adjustment to the salary increase indicated by the index if one or more of the following conditions is met:

- there is compelling evidence to suggest that movements in the index are unrepresentative in a material way of general salary trends in the U.S. comparator market;
- changes in U.S. tax policy make it likely that there will be significant increases in net salaries at the Fund at the time of the next comparator-based review; or
- movements in the euro-dollar exchange rate create significant competitiveness problems for staff recruitment that warrant remedial action prior to the next comparator-based review.

### **D. Grades B3–B5: Provisions Governing Structural Reviews and Adjustments**

44. The level of and adjustments to the salary structure for Grades B3–B5 will be determined separately from, but in relation to, the A9–B2 salary structure on the basis set out in this subsection.

### **Comparator-based reviews**

45. In comparator-based reviews, the midpoints, as well as the range maxima and minima, of Grades B3–B5 will be set at levels that take into account (i) the levels of and structural increases for Grades B1–B2, (ii) the relationship between Grades B3–B5 and management salaries, and (iii) recent developments in the recruitment and retention of senior managerial staff.

### **Indexation-based reviews**

46. In indexation-based reviews, the salary structure for Grades B3–B5 will be adjusted on the basis of the same indexation formula as the salary structure for Grades A9–B2.

### **E. Grades A1–A8: Provisions Governing Structural Reviews and Adjustments**

47. Subject to the development of an appropriate information base, it is intended that, beginning with the 2007 compensation review, the level of and adjustments to the salary structure for Grades A1–A8 will be derived in comparator-based reviews from a comparator market consisting of employees with the requisite qualifications and skills in the Washington-Baltimore metropolitan area. A formal proposal for such a system will be brought to the Board later this year.

48. The 2006 salary structure for Grades A1–A8 will be set by applying a uniform adjustment to the 2005 salary structure, based on the staff-weighted average shift in the A9–B2 salary structure. A specific proposal is contained in the paper for the 2006 compensation review.

49. The A1–A8 salary structure will be adjusted in 2008 on the basis of the same indexation method as the salary structure for Grades A9–B2. Beginning in 2009, the A1–A8 salary structure will be reviewed and adjusted on the same review cycle as that for Grades A9–B2.

### **F. Salary Administration: Merit Pay Resources and Distribution**

50. The Fund will continue its practice of linking the salary increase awarded to individual staff to the performance of the staff member, as reflected in his/her performance rating.

51. Further work is to be undertaken on the determination of merit pay increases, with the objective of strengthening incentives for superior performance.<sup>9</sup> A key principle in setting merit pay increases will be the need to ensure that average salary levels grow broadly in line with the (weighted-average) increase in the salary structure, taking account of actual and projected shifts in staffing across grades. Proposals will be brought to the Board later in the year. An initial step recommended by the Steering Committee—to develop merit guidelines around wider bands than quartiles (EBAP/06/2, paragraph 17)—will be implemented in the 2006 compensation round.

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<sup>9</sup> As recommended by the Steering Committee, this work will examine how the amount of resources devoted to merit increases and promotions should be determined, and how these resources should be allocated across staff members.



52. For the 2006 compensation round, the size of the merit pay envelope will be determined in accordance with transition rules, contained in the Board paper for the 2006 compensation review.

### **III. EXPATRIATE BENEFITS**

53. This section brings together the changes in expatriate benefits that have emerged from Executive Board consideration of the proposals set out in the companion paper and in the most recent statement by the Managing Director (BUFF/06/31, 2/22/06, as corrected). Commentary on these changes is contained in Appendix II.

#### **A. Home Leave**

##### **Class of travel**

54. Subject to the transitional arrangements described in paragraph 58, with respect to travel under the staff member's second entitlement that falls due on or after May 1, 2006, the transportation allowance will be based on the cost of travel to and from the home country destination in full-fare economy class.

##### **Home country expense allowance**

55. The home leave allowance shall be renamed as the "home country expense allowance." The miscellaneous travel allowances will not be provided, and will be replaced by a single home country expense allowance, to be determined as set out in paragraph 56. This policy change will be applied with effect from the first home leave entitlement after the transitional arrangements set forth in paragraph 58.

56. Staff shall have the option of receiving home leave benefits either (i) every 24 months, with the standard amount of home country expense allowances, or (ii) every 18 months, with reduced home country expense allowances. For staff choosing the 24-month home leave option, the standard amount of the allowance per home leave entitlement will be \$5,000 for the staff member and \$2,000 for each eligible dependent. For staff choosing the 18-month home leave option, the amount of the allowance will be \$2,000 for the staff member and \$1,000 for each eligible dependent.

##### **Travel time**

57. The travel leave provided to staff for the purpose of home leave travel shall be set at two days for each home leave entitlement period (18-month or 24-month).

##### **Transitional arrangements**

58. As a transitional arrangement for existing staff, with respect to any home leave entitlement for which the entitlement date has been reached before May 1, 2006 but has not

yet been applied for, as well as one remaining home leave entitlement after May 1, 2006, the transportation allowance and home leave allowances will be based on the cost of travel to and from the home country destination in business class and the other elements of the home leave policy prior to the May 1, 2006 changes. New staff who have already received appointment letters prior to May 1, 2006 but have not yet entered on duty, will be entitled to receive their first home leave benefit under the terms of the policy prior to the May 1, 2006 changes; subsequent entitlements will be based upon the revised policy.

59. New staff whose appointment letters are dated after May 1, 2006 will earn their first home leave entitlement under the revised policy.

## **B. Education Allowance**

### **Tuition-related expenses**

60. Effective for academic year 2006–07, education allowances shall be provided only in respect of tuition, tutoring and, if applicable, room and board (or subsistence), within the limits set out in the policy. The \$1,000 ceiling on reimbursement of tutoring shall not apply to part-time schooling in addition to full-time school attendance during the regular week. Staff members may receive education allowance for a child enrolled in both full-time weekday schooling and weekend schooling, but in no case will the reimbursement be more than the education allowance ceilings.

### **Education travel allowance and education travel certification**

61. Effective for academic year 2006–07, the allowance for travel between the duty station and the school location shall be based on two round-trips per year in restricted economy class. The certification of education travel is deemed to be included in the certification of the child's full-time attendance at the school.

### **Salary-based limitation on education allowance**

62. For staff whose letter of appointment is dated on or after May 1, 2006, the total annual amount of education allowances received for all children in any academic year (including education travel) shall not exceed 50 percent of the staff member's net salary as of the date of the application. Within this limit, the prevailing normal ceiling for the allowance shall apply. This limitation shall not apply to staff whose letter of appointment is dated on or before April 30, 2006 and who are currently eligible for expatriate benefits.<sup>10</sup>

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<sup>10</sup> All staff who enter on duty prior to April 30, 2006 and hold U.S. permanent residency on that date will not be subject to this limitation if they subsequently acquire a G-4 visa and become eligible for expatriate benefits.

### **Education allowance ceilings**

63. Effective for academic year 2006–07 and thereafter, management is authorized to increase the level of the education allowance ceilings at all levels of education in the United States (primary, secondary, tertiary) based on the annual change in the CPI-U expenditure category for “tuition, other school fees, and childcare.” The level of education allowance ceilings for schools outside the United States will continue to be determined by using the U.S. ceilings multiplied by the applicable United Nations Post Adjustment Index.

64. The level of education allowance ceilings for schools outside the U.S. will continue to be determined by using the U.S. ceiling multiplied by the applicable UN Post Adjustment Index. As the annual adjustments will be automatic, they will be approved and implemented under the authority of the Director, Human Resources Department.

65. The level of education allowances will be reviewed by the Executive Board every four years to ensure that the allowances continue to be adequate to meet the policy objective. If any significant deviations from actual costs are found during the four-year review, the Executive Board would be asked to authorize the necessary adjustments to the level of the ceilings for the next academic year.

#### IV. DRAFT DECISIONS

The following draft decisions are proposed for approval by the Executive Board:

1. With respect to the **staff compensation system**:

The Executive Board approves the proposed new staff compensation system as set out in paragraphs 4–52 of EBAP/06/38. This decision supersedes all previous decisions concerning the staff compensation system.

2. With respect to **expatriate benefits**:

a. The Executive Board approves the proposals regarding the **home leave** policy as set out in paragraphs 54–59 of EBAP/06/38.

b. The Executive Board approves the proposals regarding the **education allowance** policy as set out in paragraphs 60–65 of EBAP/06/38.

## **INDEXING STAFF COMPENSATION—TECHNICAL NOTE<sup>11</sup>**

1. This note describes published data on U.S. wage developments and their possible use for indexing Fund salaries during those years in which the Fund would not conduct a comprehensive comparator-based review. Building on an earlier background paper (EBAP/06/22, 2/24/06), this note constructs an indexation formula based on the U.S. Employment Cost Index (ECI) and public-sector wage increases, and compares its evolution to the Fund's comparator payline, as represented by a Market Net (MN) index described in the next section.

### **A. The Fund's Comparator Payline: The Market Net (MN) Index**

2. The Fund's Private Sector Net (PSN) comparator payline was compiled by the Human Resources Department, based on the results of the comprehensive annual Hay/Towers Perrin surveys over the past eleven years. These surveys provide annual comparator salary levels at A9–B2 grade levels, which are then adjusted by the Human Resources Department for changes in the U.S. tax structure and the Fund's child and spouse allowance. On the basis of this information, the Human Resources Department computes the PSN payline as a weighted average of the paylines of different grade levels.

3. A Market Net (MN) index was computed from the PSN comparator payline described above and corresponding survey data provided by Hay on the public sector<sup>12</sup>—in both cases after adjusting for tax and family allowances, and using appropriate weights to the private and public components. In the past, the weights applied on the public and private components have varied over time, but most recently the private sector has been given a 60 percent weight.<sup>13</sup> For the purposes of this note, this MN index represents the Fund's comparator payline.

### **B. Building a Proxy for the Fund's Comparators Using BLS Data**

4. The U.S. Bureau of Labor Statistics (BLS) produces Employment Cost Index (ECI) data quarterly, with a one-month lag, including separate series for wages and salaries and for benefit costs. Wages and salaries are defined to include hourly earnings before payroll

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<sup>11</sup> Prepared by the Research Department in consultation with the Western Hemisphere Department.

<sup>12</sup> The figure for the percentage increase in public sector wages is distorted in 2000 owing to a shift in the definition of the public sector used for the survey.

<sup>13</sup> From 1989 to 1998, the weights were ⅓ for each for the private financial, private industrial, and public sectors. In 1999, the weights were 35 percent for the public sector, 40 percent for the private financial sector, and 25 percent for the private industrial sector. Since then, the weights were 40 percent for the public and private financial sectors, and 20 percent for the private industrial sector. In order to allow comparability, the ECI-2 and PRX1 indices described below used weights that varied to match the weights that were in place each corresponding year. No account was taken of the most recent proposals to amend the weights and salary pitch.

deductions as well as production bonuses, incentive earnings, commission payments, and cost-of-living adjustments. Information is available by industry or by occupational group, and covers the private sector and state and local governments. Data are also available by geographic area (albeit with a greater lag). The reference period for the ECI survey is the week including the 12<sup>th</sup> day of the months of March, June, September, and December, and the data are typically released the last Tuesday of the following month (i.e., in April, July, October, and January).

5. Although there are a host of other sources of U.S. compensation data, this note focuses on the ECI. This reflects the fact that ECI data are widely viewed as a credible benchmark for determining wage and cost escalators in the U.S. private sector, and were offered as basis for a possible index in the Watson Wyatt report.<sup>14</sup> The ECI data are also relatively timely and are available with a long enough time series to permit comparison with the Fund's comparator indices.<sup>15</sup>

6. For the purposes of this exercise, the ECI series also have the advantage of being based on fixed weights. Thus, the ECI reflects genuine developments in wages rather than a mix of wage movements and occupational shifts. It must be noted that these weights were last updated only in 1990, which means that newer and faster growing occupations may have been underweighted in recent years. This in turn may have contributed to the ECI's recent sluggish growth (relative to other surveys). The April 2006 ECI release will be produced using revised weights for March 2006.<sup>16</sup>

7. ECI-based indexation formulas were then calculated to mimic the behavior of the Fund's PSN and MN paylines.

- To proxy the PSN index, ECI-2 was calculated as a weighted average of the percentage increase in the wage component of the ECI for the goods sector (excluding sales) and the wage component of the ECI for the Finance, Insurance, and Real Estate sector (excluding sales), with weights equal to one third and two thirds, respectively.

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<sup>14</sup> The use of the ECI, as well as other data, to index Fund salaries is discussed in Watson Wyatt Worldwide, *Review of Employment Framework and Compensation and Benefits*, Stage I Final Report, July 25, 2005. For a description of the ECI and issues related to its use as an escalator see the BLS publication "Escalation in Employer Costs for Employee Compensation: A guide for Contracting Parties," in *Compensation and Working Conditions* (Spring 1997).

<sup>15</sup> For further details, see *Indexing Staff Compensation*, EBAP/06/22, February 24, 2006. Note, too, that other BLS data were examined and found not to be a more effective proxy for the Fund's comparator payline.

<sup>16</sup> The primary source of the new weights for the ECI is the BLS Occupational Employment Statistics (OES) program. Whenever the data were not available from the OES, the BLS Quarterly Census of Employment and Wages (QCEW) program was used as a secondary source.

- The PRX1 indexation formula was constructed to mimic the MN index, and was calculated from a weighted average of the change in the ECI-2 index and (before tax) U.S. public sector wage increases (i.e., the authorized increases in U.S. civil service salaries and locality pay), with weights allowed to vary in line with the changes that had been applied to the MN index by the Fund over time.

8. Note that in the case of ECI-2, the percentage increase applicable for a particular year is defined as the percentage annual increase during the previous year (i.e., Q4 on Q4), since the Fund's compensation decisions are taken early in a given year and ECI data would only be available through the fourth quarter of the previous calendar year. The PRX1 index is also calculated using the ECI-2 for the previous year, while using the current year's value for public sector wage increases, since these are known early in the year.

### **C. Comparing an ECI-Based Index to the IMF Payline**

9. Table 2 provides the data for the four indices—the percentage increases in the Fund's private and market comparator paylines (PSN and MN) and the corresponding ECI-based proxies (ECI-2 and PRX1). The average of the annual errors is zero, implying that an ECI-based indexing formula would not be biased. The average of the two-year cumulative errors is -0.1, and footnotes 3–5 in Table 2 show that the averages for three hypothetical indexing cycles starting in 1995, 1996 or 1997 range from -0.5 to 0.6.

10. The representative deviation is better approximated by the average of the one-year absolute errors, 0.7, which amounts to 18 percent of the average annual percentage increase in the Fund's comparator payline of 4 percent, although the error rate reaches nearly 40 percent in one or two years. There are no apparent patterns in the sign of the errors.

### **D. Conclusion**

11. The discussion above illustrates that a composite indexation formula—derived from ECI sectoral indices and U.S. federal government salary increases—tracks on average the recent growth in the Fund's comparator payline, as represented by the MN index.

12. Nonetheless, in applying this or similar indexation formulas, care is needed to recognize that the underlying backward-looking index is a simplified and imprecise measure of future developments in the Fund's comparators and that the historical relationship may not hold going forward.

Table 2. ECI-Based Indexation Formula vs. Evolution of the Fund's Comparator Payline  
(In percentage points)

Year	Components of MN		Components of PRX1				Errors = (MN – PRX1)		
	Private Net of Tax & SCA	Public Net of Tax & SCA	MN 1/	ECI-2	Public Sector Gross	PRX1 2/	One Year	Two Years Cumulative	
1995	1.9	3.1	2.2	2.8	3.5	3.0	-0.8		
1996	3.2	1.4	2.6	3.1	1.4	2.6	0.1	-0.7	3/
1997	4.0	3.0	3.7	3.2	3.1	3.2	0.5	0.6	4/
1998	4.3	3.6	4.1	5.3	2.6	4.4	-0.4	0.1	5/
1999	5.2	4.3	4.9	4.2	4.2	4.2	0.7	0.4	3/
2000	4.4	10.0	5.8	5.2	10.9	7.5	-1.7	-1.0	4/
2001	4.4	4.0	4.3	4.1	4.1	4.1	0.2	-1.6	5/
2002	3.5	5.5	4.2	3.2	4.4	3.7	0.5	0.8	3/
2003	2.7	3.9	3.1	4.4	4.2	4.3	-1/2	-0.7	4/
2004	5.5	4.7	5.3	5.9	2.1	4.4	1.0	-0.3	5/
2005	3.3	3.1	3.2	1.9	3.0	2.3	0.8	1.9	3/
Average	3.8	4.2	3.9	3.9	4.0	4.0	0.0	-0.1	
Average of Abs. Val.							0.7	0.8	
Max. of Abs. Val.	5.5	10.0	5.8	5.9	10.9	7.5	-1.7	-1.6	

1/ The combined market net index was computed by HRD. It uses the consultants' analysis and reflects the weights in effect for each year.

2/ PRX1 is a variable-weight average of the rates of change in (i) ECI-2 and (ii) Public Gross Index. The weights reflect those in effect each year. ECI-2 is a lagged composite index using ECI data. ECI-2 is a weighted average of (i) FIRE excluding sales (weight 2/3); and (ii) goods, white-collar excluding sales (weight 1/3) – Source: BLS/Haver

3/ These years would be part of the three-year cycle starting in 1997; their average is 0.6.

4/ These years would be part of the three-year cycle starting in 1998; their average is -0.4.

5/ These years would be part of the three-year cycle starting in 1999; their average is -0.5.



## **COMMENTARY ON CHANGES IN EXPATRIATE BENEFITS**

### **A. Home Leave**

#### **Class of travel**

1. The current airfare cost standard for home leave is business class. The home leave travel entitlement will be changed from business class to full-fare economy class. This change will generate estimated annual savings of \$6.9 million.

#### **Home country expense allowance**

2. Eligible staff are currently entitled to home leave after each two-year period of Fund service and to receive a home leave allowance of \$1,210 for staff and \$605 for each dependent, and a number of miscellaneous travel allowances. Under the new policy, miscellaneous travel allowances will be folded into the home country expense allowance and staff will be offered a choice between a 24-month entitlement with a higher home country expense allowance and an 18-month entitlement with a lower allowance. Staff estimate that the cost of this package to the Fund, at 2005 usage levels and prices, would amount to some \$20.2 million, \$5 million higher than the cost of the original proposal made in EBAP/06/2 and some \$1.9 million less than the cost of the current home leave benefits package.

#### **Travel time**

3. Staff currently receive travel time without charge to annual leave to reach their home leave destinations. The amount of leave is set by the travel schedule for staff business travel, which establishes different amounts of leave (up to 3 days in each direction) depending on the destination. Under the new 18-month option, staff will be able to travel home more frequently, which would increase the cost of travel time to the Fund. In an effort to offset this added cost, and recognizing that air travel schedules permit staff members to reach their destinations faster, the travel time entitlement will be set at a uniform level of two days for each home leave entitlement period. This change will also streamline the administration of the home leave benefit.

#### **Transitional arrangements**

4. The transitional arrangements described above will enable staff to plan for the change in the policy and will provide time for the IT implications of this change to be factored into an ongoing capital project to upgrade the existing HR IT systems. It is expected that the changes can be included in the ongoing IT project without incurring additional costs.

## **B. Education Allowance**

### **Tuition-related expenses**

5. Focusing the education allowance benefit on the costs of tuition, room and board (or subsistence), and eliminating the reimbursement of other miscellaneous fees is expected to reduce education allowance expenses by \$0.7 million (FY 2005).

6. Currently, costs for part-time weekend schooling are covered under tutoring, which is subject to a \$1,000 ceiling per academic year. The cost of academic tuition for weekend schooling will be covered under the education allowance policy (even if the weekend school is not accredited as required by the current policy) to the extent that the staff member is able to certify that the training will facilitate the eventual return of the child to the home country. The cost of including part-time weekend schooling is expected to be minimal.

### **Education travel allowance and education travel certification**

7. The level of the education travel allowance (one round-trip in restricted economy class and one round-trip in unrestricted economy class each academic year) can be reduced and still meet the education travel needs of the children of eligible Fund staff. The savings from this proposal are estimated at \$0.25 million (FY 2005). Eliminating the redundant travel certification will both ease the documentation burden on staff and reduce the administrative costs associated with verifying the certification.

### **Salary-based limitation on education allowance**

8. The impact of the salary-based limitation is expected to be low initially (less than \$20,000 in the first year) but could grow over time with the number of new staff making use of education allowances.