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EBAP/87/39

March 2, 1987

To: Members of the Executive Board

From: The Secretary

Subject: Cost of Living Allowances for Staff Assigned to the
Office in Europe and the Office in Geneva

There is attached for consideration by Executive Directors a paper dealing with the UN-based cost of living allowances paid to Paris and Geneva staff. Recent changes made in the UN Post Adjustment System and questions regarding the exchange rates used under that system have led to the conclusion that the present system of cost of living allowances for Paris and Geneva staff needs to be revised.

In the absence of a request for discussion by an Executive Director by the close of business on Monday, March 9, 1987, the draft decision that appears on page 5 will be deemed approved by the Executive Board and it will be so recorded in the minutes of the next meeting thereafter.

Mr. Rosseel (ext. 8209) is available to answer technical or factual questions relating to this paper.

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Department Heads



INTERNATIONAL MONETARY FUND

Cost-of-Living Allowances for Staff Assigned
to the Office in Europe and the Office in Geneva

Prepared by the Administration Department
(in consultation with the Legal Department)

February 27, 1987

I. Present System of Cost-of-Living Allowances

The salaries of the 15 staff members assigned from headquarters to the Paris and Geneva offices are based on the headquarters salary scale. To ensure that the local purchasing power of their salaries in Paris and Geneva remains equivalent to the local purchasing power of salaries for staff at headquarters, a cost-of-living (COL) allowance is paid when the cost of living at the duty station is higher than that in Washington. To implement this principle, the UN Post Adjustment (UNPA) system has been used.

The UNPA price index calculated for each post measures the cost-of-living in U.S. dollar terms for UN staff stationed at that post relative to those costs in New York at a specified base date (currently New York, December 1979 = 100). The UNPA price index for a given post in turn determines the UNPA "classification" of that post for UN salary purposes. Normally (as is the case for New York and Washington) a change in the UNPA classification only takes effect when the UNPA price index for the post has increased by a full 5 percent. Thus, the classification of a post moves upward by intervals of 5 percent from 100 to 105, 110, 116, 122, etc., or downward to 95, 90, etc., and corresponding post adjustment allowances varying between 4 percent and 4.5 percent are added to or subtracted from the UN net base salary for each 5 percent interval. 1/

Using the UN system, the COL allowances for Fund staff assigned from headquarters to Paris and Geneva are calculated every month by applying the percentage differential between the UNPA classifications for the duty station and for Washington to the staff member's "disposable" Fund salary (i.e., net salary minus staff contributions for Staff Retirement Plan, Medical Benefits Plan and Group Life Insurance). The disposable salary and COL allowance are paid in French or Swiss francs at the exchange rate that was used by the UN to measure the local cost of living expressed in U.S. dollars. However, the system is not symmetrical; if the UNPA classification for Paris or Geneva is lower than that for Washington, salaries are not adjusted downward for the COL differential with Washington.

1/ The UN post adjustment allowances are equal to only 4 percent to 4.5 percent of net salary because staff contributions to the UN Pension Fund are not affected by local cost of living and because the post adjustment allowances--being net of taxes--reflect the effect of progressive tax rates which are applicable to gross income.

This system was first applied by the Fund in June 1963 on the basis of a 1948 Executive Board decision (Committee on Personnel Policies, Doc. 5, Revision 1, approved at EBM 349, July 30, 1948), which dealt with travel, salary and financial arrangements for staff members temporarily assigned abroad for a period of six months or more, and which contained the following clause:

"In areas where the cost of living is higher than that prevailing in Washington, D.C., the Managing Director may authorize cost-of-living differential in accordance with the schedule established by the United Nations, which will apply to salary and installation allowance payments."

II. Problems with the Present System

The UN-based COL scheme for Paris and Geneva worked reasonably well for many years. However, beginning in August 1984 a number of changes in the UNPA system--described in Attachment I--were introduced in response to specific requirements imposed by the UN General Assembly, designed specifically to limit the growth of salaries of UN staff in New York. The result of these extraneous adaptations of the system was that, between August 1984 and December 1985, the post classification of New York was raised by one class (equivalent to 5 percent). Over the same period, however, the post classification of Washington was raised by three classes (over 15 percent), because the increases for Washington happened on two occasions to become effective before the UN General Assembly took action in 1984 and 1985 to suspend pending increases for New York. The extra increases for Washington have drastically affected the percentage differential between the UNPA classifications for Washington and for Paris/Geneva and have had a major adverse impact on staff assigned to Paris and Geneva.

The decisions adopted by the UN General Assembly in 1984 and 1985, as described in Attachment I, have significantly altered the nature of the UN post adjustment system: while in the past changes in UN post classifications were triggered by changes in the UN price indices, the post classification for New York--which serves as the base of the UN system--is now administratively determined, and the price index for New York is then periodically scaled down so that it remains roughly consistent with the New York post classification. At the same time, the price indices for all other posts are also reduced by a similar percentage as that for New York, but their post classifications are left unchanged.

Effective September 1, 1986 another change was introduced in the UNPA system: the UNPA classifications are increased (decreased) with a "remuneration correction factor" (RCF) to compensate for the fact that, when a local currency appreciation (depreciation) results in a 5 percent increase (decrease) in the UNPA classification, a UN post allowance of only 4 percent to 4.5 percent is added to (subtracted from) net base salary.

This does not apply to the way the Fund has implemented the UN system: the Fund COL allowance expressed as a percentage of disposable salary is equal to the full percentage differential between the UNPA classifications for Washington and for Paris/Geneva. The RCF-adjusted UNPA classifications have thus no validity for the Fund. It should also be noted that, while the RCF has been implemented by the UN for Paris, its implementation for Geneva has been postponed by the Secretary-General until further notice, in view of the United Nations' financial difficulties. This development again illustrates the ad-hoc nature of the present UN system. Potential further changes, also described in Attachment I, may make the present UN system even more unsuited for the Fund's purpose.

These developments mean that the UNPA system no longer accurately reflects the COL differentials between Washington and Paris/Geneva, and they have led to a serious erosion in the purchasing power of salaries for Fund staff in Paris and Geneva relative to their counterparts in Washington. The purchasing power of disposable salaries plus COL allowances received by Paris and Geneva staff has dropped, relative to the purchasing power of disposable salaries of Washington staff, from 100 in July 1984 to 83 and 85 respectively by the end of 1986. Such arbitrary decline in purchasing power is especially harsh at the lower salary levels and has led to increasing dissatisfaction of staff assigned to Paris and Geneva.

This erosion has been exacerbated by the UN operational exchange rate which is used to convert Fund salaries into local currencies. The reason is that the UN exchange rates, since mid-1985, have almost constantly been set below actual market exchange rates as reported in IFS. In theory, the UN operational exchange rate should be the average daily exchange rate of the previous month. However, for the headquarters duty stations in Europe, the UN in New York has given the local headquarters organizations discretion on how to set the operational exchange rate each month. Thus, the UN exchange rate for France is set by the UNESCO and for Switzerland it is set by the UN Office in Geneva in consultation with ILO and WHO. In practice, the UN organizations when setting the monthly exchange rate take into account its effect on the budget of their UN programs.

The strong appreciation of the dollar until early 1985 and the subsequent depreciation have emphasized another flaw in the system currently being applied by the Fund. The 1948 Executive Board decision referred to in Section I above allows payment of COL allowances when the UNPA classification for Paris or Geneva is higher than that for Washington, but there is no provision for downward adjustments in remuneration when the UNPA classification at the post is lower than that of Washington, as may happen for example when the local currency depreciates significantly. The lack of symmetry in not applying downward adjustments can result in wide swings in purchasing power, with fortuitous increases when the local currency depreciates and sudden drops when it appreciates. This is clearly undesirable in principle and practice.

III. Modification of COL Allowances

The recent changes made in the UNPA system to fit the particular objectives of salary administration in the UN, combined with the divergences that have been observed between UN exchange rates and actual market rates, justify the conclusion that the UN system no longer provides a sound and equitable framework for cost-of-living adjustments for Fund staff in Paris and Geneva. A system is needed that maintains equivalence of purchasing power in Paris and Geneva in relation to Washington and does so in a way that is simple to administer and is not influenced by extraneous considerations. As a matter of principle, such a revised system should be symmetrical, giving rise to upward and downward COL adjustments.

The new system proposed below would consist of two main components: (i) a suitable starting period to provide the "base" cost-of-living differential between Paris/Geneva and Washington and (ii) an updating mechanism which reflects current exchange rates and cost-of-living increases at the duty station and in the United States. Since the UNPA system worked reasonably well until major changes were made to it starting in August 1984, it is proposed to use the UN system as it applied prior to August 1984 to determine the starting base. To minimize the effect of any short-term exchange rate fluctuations and changes in the UN price indices, it would be appropriate to adopt the last three calendar years prior to the August 1984 revision of the UNPA system as the reference period. 1/ Accordingly, the "base" cost-of-living differential between Paris/Geneva and Washington would be established by using the 36-month average of the UN price indices for Paris, Geneva and Washington during the period January 1981-December 1983, as shown in Attachment II.

To update the base COL differential, it is proposed to use the monthly exchange rates and national consumer price indices published in IFS. These statistics are readily and quickly available and, unlike the UN exchange rates, they are not subject to administrative decisions. A disadvantage of using national consumer price indices is that these indices may not reflect very closely the consumption patterns of international staff. However, since this applies to Washington as well as to Paris/Geneva, it may be assumed that any deficiencies will be largely offsetting. The updating technique based on these principles is illustrated in Attachment II.

It is proposed to make the new system effective retroactively as of January 1, 1986, when the changes introduced in the UNPA system began to have a serious effect on local currency remuneration. This would involve a retroactive payment of about \$100,000, which represents the amount which the staff of the Paris and Geneva Offices would have received, had their purchasing power relative to Washington been maintained. It can be expected that the new system, because of its symmetry, would tend to be less expensive over time than the present system.

1/ Calendar years rather than 12-month periods were chosen for the reference period for purposes of simplicity.

The World Bank has been informed of this proposal. The Bank uses the UN system not only for their Paris, Geneva, and London Offices, but also for about 200 Bank staff assigned to a large number of other posts. The Bank has studied other cost-of-living systems (in 1984 and again in 1986) and concluded that the UN system is the best available for their purposes. Hence, the Bank has decided to continue with the basic UN system but to make a number of modifications with respect to exchange rates for staff in the field, effective October 1, 1986. Considering that the Bank is retaining the UN system for their staff in the field, the Bank is not contemplating to change the existing UN-based system for their Paris, Geneva and London staff.

It should be noted, however, that there are certain differences in COL allowances and other staff benefits for Fund and Bank staff in Paris and Geneva. With respect to the COL allowances, the Fund has always applied the COL differential between Washington and Paris/Geneva to "disposable" salary (typically about 85 percent of net salary), while the Bank has applied it to 90 percent of net salary until June 1984 (as staff were required to cover their own housing cost in full), and 50 percent thereafter when a rental subsidy arrangement was introduced. The Bank's housing allowance covers the rent in excess of 17.5 percent of net salary up to a ceiling established by the U.S. State Department for each duty station. In the Fund the housing allowance consists of two thirds of any rent in excess of 15 percent, but not exceeding 30 percent, of disposable salary plus cost-of-living allowance. In general, the Bank's formula would lead to a larger housing allowance than in the Fund at higher rent levels, which usually prevail in Paris and Geneva. The Bank's assignment allowance is currently \$5,000 per year for a staff member with a spouse or dependent children and \$2,500 a year for other staff. The settling-in grant, which is a one-time payment in addition to the installation allowance,^{1/} is equal to six weeks' net salary for a staff member relocating with one or more family members and three weeks' net salary for other staff. The Fund does not give assignment allowances or settling-in grants to staff assigned to Paris and Geneva.

IV. Recommended Decision

The following draft decision is proposed for adoption by the Executive Board:

The Managing Director is authorized to establish for staff members assigned to the Office in Europe and the Office in Geneva whose salaries are denominated in U.S. dollars, a system for a cost-of-living differential, to be effective January 1, 1986, which shall be devised, and may be amended from time to time, in accordance with the principles set forth in Section III of EBAP/87/39. This differential shall be applied to the installation allowance and disposable salary paid to such staff members.

Attachments (2)

^{1/} Both the Fund and the Bank provide installation and shipping allowances.

Recent Developments in the UN Post Adjustment System

On August 1, 1984, the UN price indices for New York and Washington were subject to a special corrective increase of 9.6 percent and 10.5 percent respectively on the basis of cost of living surveys carried out in 1982. 1/ This triggered an increase in the post classification by two classes in Washington, but only by one class in New York since post classifications change only after the price index has increased by a full 5 percent. In all other duty stations, including Geneva and Paris, the post classifications remained unchanged except that four extra points---temporarily added to the post classification for Geneva in August 1982 to take account of the substantial appreciation of the Swiss franc---were abolished effective August 1, 1984. 2/

Several major UN member countries strongly contested the upgrading of the New York post adjustment, as they considered this to be an attempt to increase New York UN staff compensation at a time when the General Assembly opposed an increase in the basic salary scale. 3/ Therefore, at the end of 1984, the UN General Assembly decided that the next one-class increase in the post classification for New York---which fell due in December 1984 when the New York price index reached the second 5 percent benchmark---should be suspended pending resolution of the question of what the desirable margin should be between total remuneration of UN staff in New York (salary plus COL allowance) and that of the comparator civil service (U.S. Federal Government salaries). At the same time, the UN General Assembly also decided that similar measures should be taken at other UN duty stations. Consequently, the next one-class increase in the post classification for Washington due in January 1985 was also suspended. No suspension action was needed for Paris or Geneva

1/ The reason given for this revision was that the indices had been updated until 1977 on the basis of prices collected by the U.S. Bureau of Labor Statistics and not on the basis of price surveys of typical UN staff consumption patterns as is done at other UN headquarter cities.

2/ The result was that the COL differential between Geneva and Washington which amounted to 16.9 percent in July 1984 disappeared abruptly the next month. For the Paris staff there was no immediate impact, since no COL allowance had been payable for Paris for some time due to the substantial depreciation of the French franc.

3/ The basic salary scale of the UN has remained unchanged since 1976. Changes in the UNPA system fall within the jurisdiction of the International Civil Service Commission (ICSC) and do not normally require approval of the UN General Assembly, in contrast with increases in the scale itself.

because, under a sliding adjustment for exchange rate movements, the 5 percent threshold was never reached. 1/

In April 1985, the ICSC decided to institutionalize the post classification freeze by scaling the UN price index for New York back by about 4 percent, the amount required to keep the index consistent with the lower frozen post classification. The price indices for all other duty stations were scaled down by a similar percentage, but the post classifications applicable at each duty station were left unchanged.

At the end of 1985, the UN General Assembly decided that the margin of UN remuneration in New York over the U.S. Civil Service should be kept within the range of 10 to 20 percent, with a desirable midpoint over a period of time of 15 percent. In line with this decision, when another one-class increase in the post classification for New York became due in December 1985, it was again suspended and the corresponding UN price index for New York was reduced again by about 4 percent to bring it in line with the suspended UNPA classification. The UN price indices of all other duty stations were similarly reduced as in April 1985 and their post classifications were frozen. However, a one-class increase in the Washington classification, which had been triggered in November 1985 just before the general freeze, was not rescinded.

This new policy of scaling back all indices whenever a change in the New York index would bring UN remuneration in New York over the 20 percent margin will remain in effect indefinitely until the UN General Assembly approves further changes, if any, in the system. Since post classifications are frozen under this policy, the UN system of classifications no longer provides a sound framework to measure cost of living differentials with Washington for Fund staff in Paris and Geneva.

In addition, some other issues are presently under study by the UN:

- (i) the possibility of eliminating post adjustments in New York; and
- (ii) the separation of the effects of inflation and currency fluctuations by either establishing two separate indices or by using a fixed exchange rate until local inflation reaches the 5 percent threshold.

Any of these potential modifications would make it even more impractical for the Fund to retain the existing system of COL allowances for Paris and Geneva staff.

1/ Under special rules for exchange rate variations, the UNPA classifications for Paris and Geneva are gradually adjusted each time the exchange rate movements cause a change in the UNPA classification of two points (without waiting until the normal threshold of a full 5 percent change is reached as for New York and Washington).

Description of New System of Cost-of-Living Allowances

The new system incorporates (i) a suitable starting period which can provide the "base" cost-of-living differential between Paris/Geneva and Washington and (ii) an updating mechanism which reflects current exchange rates and local cost of living increases at the duty station and increases in cost of living in the United States. The resulting cost-of-living factor is applied to the staff member's disposable salary, i.e., net salary minus staff contributions for the Staff Retirement Plan, Medical Benefits Plan and Group Life Insurance.

Taking 1981-1983 as the base period, the average UNPA indices and exchange rates during this 36-month reference period were:

	<u>Average UNPAI</u>	<u>Average Exchange Rate</u>
Geneva	176.0 <u>1/</u>	Sw F 2.0200 <u>2/</u>
Paris	156.0	F 6.4431 <u>2/</u>
Washington	137.8	

The base COL differential between Paris and Washington is therefore 156.0 : 137.8 = 1.132 (or 13.2 percent) based on an average UN exchange rate of F 6.4431 per U.S. dollar.

To update the base COL differential to the present, it is intended to use current monthly exchange rates and national consumer price indices published in IFS. Hence, the base COL differential in terms of the current exchange rate becomes:

$$\frac{156.0}{137.8} \times \frac{6.4431}{\text{Current F}}$$

1/ Excluding the four extra points which were added to the Geneva UNPA classification as a temporary measure effective August 1982.

2/ Average of the UN operational exchange rates used to calculate the UNPA indices.

The formula for updating the COL differential between Paris and Washington for changes in the French cost of living relative to the United States since the period 1981-1983 would be as follows:

$$\frac{156.0}{137.8} \times \frac{6.4431}{\text{Current F}} \times \frac{\text{French CPI}}{\text{U.S. CPI}}$$

where:

French CPI = the current French CPI on the basis 1981-1983 = 100
(or the percentage increase of the current French CPI over the 1981-1983 average) and

U.S. CPI = the current U.S. CPI on the basis 1981-1983 = 100
(or the percentage increase of the current U.S. CPI over the 1981-1983 average).

Similarly, the formula for the Geneva/Washington COL differential becomes:

$$\frac{176.0}{137.8} \times \frac{2.0200}{\text{Current SwF}} \times \frac{\text{Swiss CPI}}{\text{U.S. CPI}}$$

