Decision No. 1

Louis de Merode,
Frank Lamson-Scribner, Jr.,
David Gene Reese,
Judith Reisman-Toof,
Franco Ruberl,
Nina Shapiro,
Applicants

v.

The World Bank,
Respondent

The World Bank Administrative Tribunal,

Composed of E. Jimenez de Arechaga, President, T. O. Elias, P. Weil, Vice Presidents, A.K. Abul-Magd, R. Gorman, N. Kumarayya** Judge Kumarayya has taken part in all the deliberations in this case. He was prevented for reasons of health from attending the hearing but has since had an opportunity of listening to a tape recording of it. and E. Lauterpacht, Members.

1. The Tribunal is seized of applications dated September 29, 1980 filed by Applicants de Merode, Lamson-Scribner, Reese, Reisman-Toof, Ruberl and Shapiro (hereinafter collectively called “the Applicants”). By a Decision dated September 26, 1980 the Applicants were permitted to add by October 19, 1980 a Memorandum of Law to their applications and the Respondent** For the purposes of this decision, the term "World Bank" means the International Bank for Reconstruction and Development, the International Development Association and the International Finance Corporation. was given until December 10, 1980 (subsequently extended to January 15, 1981) to submit its Answer.

2. The Applicants submitted their observations on the Answer by February 27, 1981, and the Respondent was allowed to submit a supplemental statement by a decision of the Tribunal dated March 16, 1981. The case was listed on March 16, 1981 and was heard on May 28, 1981. At that hearing counsel for the Applicants and the Respondent orally developed certain parts of their respective cases.

I. INTRODUCTION

3. The Tribunal is presented in this, the first case to be decided by it, with the question whether the implementation in relation to the Applicants of the decisions adopted on May 25, 1979 by the Executive Directors of the Bank regarding tax reimbursement and salary adjustment amounts to non-observance by the Bank of the contracts of employment or terms of appointment of the Applicants. The legal issues involved in this question are basic and important. They do not lend themselves to summary treatment.

4. The Tribunal is, by Article II of its Statute, given jurisdiction to hear applications alleging non-observance of the contract of employment or terms of appointment of staff members, and this phrase is stated to include “all pertinent regulations and rules in force at the time of alleged nonobservance including the provisions of the Staff Retirement Plan”. In order to avoid constant repetition of all these terms, the Tribunal will in this Judgment use the phrase “conditions of employment” to describe compendiously the various elements which together determine the content of the legal relationship between the Bank and a member of its staff.

5. The circumstances in which the present case has come before the Tribunal reflect some of the many

changes which the activities and operations of the Bank have undergone since its establishment in 1945 – changes in the purposes of its loans, in the character of the borrower countries, in the magnitude and range of its projects, in its sources of finance and, most relevant of all, in the number of personnel engaged in the pursuit of the Bank's objectives. By reason of the last, the closeness of the relationship between the Bank management and the general body of Bank personnel which marked the earlier years of the Bank has unavoidably been affected. In addition, external economic conditions have understandably given rise to concern on the part of the staff members regarding the maintenance of the real value of their remuneration in the face of inflation and of the increase in the cost of living. At the same time, some of the Bank's Members have found occasion to question some elements of the Bank's compensation policies in comparison with those applied to their own officials and the employees of domestic banking and other similar enterprises.

6. In 1977, the President of the Bank proposed to the Executive Directors that:

> "a Joint Bank and Fund Committee should be established to examine compensation issues and to agree on a set of principles which would provide a more stable framework for the process of determining compensation."

7. The Joint Committee on Staff Compensation Issues (the Kafka Committee, so called because it was chaired by Alexandre Kafka, an Executive Director of the International Monetary Fund), composed of Executive Directors of the World Bank and the International Monetary Fund and outside experts, issued its 516-page Report in January 1979 containing detailed findings as to salaries and benefits at the World Bank and the Fund and making recommendations for the future. After allowing a period for comment the Executive Directors of both the Bank and the Fund decided in May 1979 to adopt, subject to some changes, many of the Committee's recommendations.

8. By Administrative Circular AC/23/79 of May 25, 1979, the staff of the Bank was informed that:

> "The Executive Directors have completed their consideration of the main policy issues stemming from the report of the Joint Committee on Staff Compensation Issues. Among the more important matters, the Executive Directors have agreed that:
> ....
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> "... unless the Governments concerned agree to exempt their nationals from taxes or income derived from the Bank, the present system of tax reimbursement will be replaced, effective January 1, 1980, by a system based on average deductions with a five-year transition period and appropriate safeguards. The details of how this system is to be implemented are yet to be agreed.
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> "The Executive Directors have also approved a 9.5% increase in net salaries effective March 1, 1979 ... This is in line with average real pay increases of the US private sector comparators over the past year."

The methods of implementing the new system of tax reimbursement were set out in Personnel Manual Circular 1/80 of January 21, 1980.

9. These decisions were regarded by members of the staff as affecting them in two respects. The new tax reimbursement system would result, when fully phased in, in a reduction of 23% in tax reimbursements to existing staff of United States nationality. As regards the decision relating to salary increases, staff members considered that this involved the repudiation by the Bank of a decision taken in 1968 to adjust salaries automatically in proportion to the increase in the Consumer Price Index in the Washington Metropolitan Area ("CPI"). As a consequence of this decision the adjustment of 9.5% (effective March 1, 1979) and a subsequent adjustment of 8.3% (effective March 1, 1980) were lower than the increases in the CPI of 11.26% and 11.68% during the two preceding 12-month periods respectively.

10. From these decisions more than 1,300 World Bank staff members appealed to the Appeals Committee of

the Bank alleging violation of their conditions of employment. On January 8, 1980, the Appeals Committee decided that it had no jurisdiction over the matter and expressed regret that there was “no forum in the world in which such decisions can be challenged, reviewed, and possibly overturned if found illegal.” On April 30, 1980 the Board of Governors adopted the Statute of this Tribunal which entered into force on July 1, 1980. Article XVII of the Statute provides that:

> “... the Tribunal shall be competent to hear any application concerning a cause of complaint which arose subsequent to January 1, 1979, provided, however, that the application is filed within 90 days after the entry into force of the present Statute.”

11. On September 29, 1980, that is to say, within the period fixed by Article XVII, the applications of the six named Applicants were filed with the Tribunal. These were identified by counsel for the Applicants as being “representative of the broad spectrum of Bank employees who have been financially harmed by these two changes”. The Bank has agreed that, if and to the extent that the Tribunal renders a decision in favor of an Applicant or Applicants in the representative cases on the basis of general principles rather than on the basis of particular facts relating to the application of a given individual, the Bank will treat all staff members similarly situated in accordance with the Tribunal's decision, whether or not such staff members have made application to or intervened in the proceedings before the Tribunal. As a result, 874 applications have been filed by staff members who believe their cases should be disposed of on the basis of the particular facts of their own individual cases. In addition, the Secretariat of the Tribunal has received 8 applications for intervention which have been joined with the 874 so-called “non-representative” applications.

12. All of the six named Applicants complain of the decisions of the Bank relating to salary adjustments. They contend that, as a result of these decisions, their salaries for the years 1979 and 1980 were respectively 11% and 29% lower than they would have been if the Bank had not unilaterally abandoned its previous policy, established in 1968, of automatically adjusting salaries on the basis of the CPI. In addition, four of the six Applicants, Lamson-Scribner, Reese, Reisman-Toof and Shapiro complain of substantial reductions in their gross income resulting from changes made by the Bank, with effect from January 1, 1980, in the method of calculating tax reimbursement.

13. The Applicants ask the Tribunal:

> 1. To order the rescission of certain administrative circulars, namely, Administrative Circulars 23/79, dated May 25, 1979, and 13/80, dated March 14, 1980, as regards salary adjustment, and the Personnel Manual Circular 1/80, dated January 21, 1980, as regards tax reimbursement;
>
> 2. To order specific performance of their contract of employment;
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> 3. To order the Bank to pay them the difference between their salaries and/or the tax reimbursements which they actually received on the basis of the above-mentioned circulars, and the payments to which they claim they are entitled in law;
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> 4. (a) To order the payment of interest at the prevailing rate on the difference;
>
> (b) To order the Bank to reimburse all their fees, costs and disbursements incurred in the preparation of this case, including reasonable attorney's costs.

14. The competence of the Tribunal to pass judgment upon these Applications has not been contested by the Respondent. As the applications allege non-observance of the contracts of employment or terms of appointment of the Applicants, the Tribunal decides that it is competent to determine these matters.

15. Does the World Bank have the power – and, if so, within what limits – unilaterally to change the conditions of employment of its staff? May Bank personnel invoke the concept of acquired rights to prevent the application to them of changes unilaterally introduced by the Bank? These two questions represent two different formulations of the principal legal issue involved in the present proceedings. The Tribunal will approach its task

of resolving these questions by first identifying the conditions of employment of Bank personnel. It will then examine the issue of the Bank's right to amend these terms. Finally, the Tribunal will consider the specific issues raised by the problems of tax reimbursement and salary adjustment.

II. THE CONDITIONS OF EMPLOYMENT

16. Normally, members of the staff enter the service of the Bank as a result of an exchange of a letter of appointment and a letter of acceptance. The letter of appointment conveys to the prospective staff member "the formal offer of an appointment to the staff of the Bank". It sets out certain specific details of the appointment, such as initial assignment, salary, dependency allowances, entry date, and information about benefits, visas, etc. It also states:

> "Your basic salary and your dependency allowances will be net of income taxes as presently or hereafter provided in the By-Laws and Regulations of the Bank ...
>
> "Your appointment is subject to the conditions of employment of the Bank as at present in effect and as they may be amended from time to time."

In his letter of acceptance the prospective employee states that he accepts appointment to the staff of the Bank

> "... under the terms and conditions set forth in my letter of appointment and the policies and procedures of the Bank as they may be in effect from time to time".

17. Employment by the Bank thus results from an offer followed by an acceptance, that is to say, a contract, and not, as is the case with employment in the civil service of certain individual countries, as a result of a unilateral act of nomination by the administration.

18. However, the fact that the Bank's employees enter its service on the basis of an exchange of letters does not mean that these contractual instruments contain an exhaustive statement of all relevant rights and duties. The two sides are agreed on this point. The contract may be the sine qua non of the relationships, but it remains no more than one of a number of elements which collectively establish the ensemble of conditions of employment operative between the Bank and its staff members. In the case of other organizations one looks for these other elements principally in the constituent instrument of the organization and in its Staff Rules and Regulations. As the Bank has at present no Staff Rules or Regulations one must look to the Articles of Agreement of the Bank and to the By-Laws and, depending on their content, to certain manuals, circulars, notes and statements issued by the management of the Bank as well as to certain other sources which will be examined presently.

19. As regards the Articles of Agreement, Article V, Section 1 prescribes that the Bank shall have, in addition to a Board of Governors, the Executive Directors and a President, such other officers and staff to perform such duties as the Bank may determine.

Article V, Section 2 provides:

> "(f) The Board of Governors, and the Executive Directors to the extent authorized, may adopt such rules and regulations as may be necessary or appropriate to conduct the business of the Bank."

Article V, Section 5 provides:

> "(b) The President shall be chief of the operating staff of the Bank and shall conduct, under the direction of the Executive Directors, the ordinary business of the Bank. Subject to the general control of the Executive Directors, he shall be responsible for the organization, appointment and dismissal of the officers and staff.
>
> "(c) The President, officers and staff of the Bank, in the discharge of their offices, owe their duty entirely to the Bank and to no other authority. Each member of the Bank shall respect the international character of

this duty and shall refrain from all attempts to influence any of them in the discharge of their duties.

"(d) In appointing the officers and staff the President shall, subject to the paramount importance of securing the highest standards of efficiency and technical competence, pay due regard to the importance of recruiting personnel on as wide a geographical basis as possible."

Article VII, Section 9(b) provides:

"No tax shall be levied on or in respect of salaries and emoluments paid by the Bank to executive directors, alternates, officials or employees of the Bank who are not local citizens, local subjects, or other local nationals."

20. The Tribunal turns from the constitutional foundation to the next general instrument which controls the Bank's power to act as an employer. Reference has already been made to the power accorded to the Board of Governors and the Executive Directors by Article V, Section 2(f), to adopt rules and regulations necessary or appropriate to the conduct of the Bank's business. This power has been exercised in a variety of ways of which the most formal in character is the By-Laws. The main provision in these By-laws referring to staff members is that in Section 14(b) which related, in the period prior to 1980, to tax reimbursement.

21. Likewise, the decision of the Board of Governors to establish this Tribunal introduced into the conditions of employment of Bank staff the right of recourse to this Tribunal, in accordance with the conditions laid down in the Statute. This right forms an integral part of the legal relationship between the Bank and its staff members.

22. Further elements of the legal relationship between the Bank and its personnel are also to be found in the Personnel Manual, the Field Office Manual, various administrative circulars and in certain notes and statements of the management. However, it is important to observe that not all the provisions of these manuals, circulars, notes, and statements are included in the conditions of employment. Some of them have the character of simple statements of current policy or lay down certain practical or purely procedural methods of operation. It is, therefore, necessary to decide in each case whether the provision constitutes one of the conditions of employment.

23. The practice of the organization may also, in certain circumstances, become part of the conditions of employment. Obviously, the organization would be discouraged from taking measures favorable to its employees on an ad hoc basis if each time it did so it had to take the risk of initiating a practice which might become legally binding upon it. The integration of practice into the conditions of employment must therefore be limited to that of which there is evidence that it is followed by the organization in the conviction that it reflects a legal obligation, as was recognized by the International Court of Justice in its Advisory Opinion on Judgments of the Administrative Tribunal of the ILO (ICJ Reports 1956, p. 91).

24. The specific circumstances of each case may also have some bearing on the legal relationship between the Bank and an individual member of the staff, particularly the actual conditions in which the appointment has been made.

25. Another source of the rights and duties of the staff of the Bank consists of certain general principles of law, the applicability of which has in fact been acknowledged by the Bank in its written and oral pleadings.

26. The parties have discussed the question whether the conditions of employment incorporate in addition the rights and duties defined in relation to other international organizations by administrative tribunals comparable to this one. Or, to put it another way, do there exist rules common to all international organizations, and which must, therefore, ipso facto apply in the legal relations between the Bank and its employees, in such a way as to determine the rights and duties of the two parties in the present case? Is there a common corpus juris shared by all international officials?

27. The Tribunal, which is an international tribunal, considers that its task is to decide internal disputes between

the Bank and its staff within the organized legal system of the World Bank and that it must apply the internal law of the Bank as the law governing the conditions of employment.

28. The Tribunal does not overlook the fact that each international organization has its own constituent instrument; its own membership; its own institutional structure; its own functions; its own measure of legal personality; its own personnel policy; and that the difference between one organization and another are so obvious that the notion of a common law of international organization must be subject to numerous and sometimes significant qualifications. But the fact that these differences exist does not exclude the possibility that similar conditions may affect the solution of comparable problems. While the various international administrative tribunals do not consider themselves bound by each other's decisions and have worked out a sometimes divergent jurisprudence adapted to each organization, it is equally true that on certain points the solutions reached are not significantly different. It even happens that the judgments of one tribunal may refer to the jurisprudence of another. Some of these judgments even go so far as to speak of general principles of international civil service law or of a body of rules applicable to the international civil service. Whether these similar features amount to a true corpus juris is not a matter on which it is necessary for the Tribunal to express a view. The Tribunal is free to take note of solutions worked out in sufficiently comparable conditions by other administrative tribunals, particularly those of the United Nations family. In this way the Tribunal may take account both of the diversity of international organizations and the special character of the Bank without neglecting the tendency towards a certain rapprochement.

29. It is important to emphasize that the legal basis for the application to each employee of rules outside his own “contract” stricto sensu does not rest on those terms of the letter of appointment and the letter of acceptance which provide that the appointment is “subject to the conditions of employment of the Bank” and which mention specifically the Bank's policy in respect to dependency allowance, benefits, retirement, insurance, etc. True, one might say that, in accepting the appointment “offered” by the Bank, the staff member at the same time “accepted” as a whole the relevant rules and policies. The applicability of these to the employee is, however, the consequence of their objective existence as part of the legal system to which the staff member becomes subject by entering into a contract with the organization. The determination of the law applicable by this Tribunal cannot depend on subjective considerations of a highly individual character which would result, if one were to adopt them, in the application to staff members of different rules of law according to the expectations of each one at the moment he “accepted” his appointment. The Tribunal will revert to this subject later.

III. THE BANK'S POWER OF AMENDMENT

30. The first consequence of the fact that the legal position of Bank employees is in large part fixed by objective rules of a general and impersonal character is that the organization must apply these rules to each member of the staff individually, and that, if it fails to observe them, the latter may turn to this Tribunal and seek the remedies set out in Article XII of the Statute. In other words, because every authority is bound by its own rules for so long as such rules have not been amended or abrogated individual decisions must conform to the general rules.

31. A second and no less important consequence of the dominantly objective nature of the legal situation of the staff of the Bank is that the Bank possesses, in common with other international organizations, an inherent power to change – subject to conditions which the Tribunal will examine later – the general and impersonal rules establishing the rights and duties of the staff. It is a well-established legal principle that the power to make rules implies in principle the right to amend them. This power flows from the responsibilities of the competent authorities of the Bank.

32. While the power of the Bank to change the general rules defining the rights and obligations of the staff cannot be denied – and indeed is not denied by the Applicants – the question whether the changes introduced by the Bank may be applied to staff members employed before their adoption is a matter on which the parties express divergent views.

33. The Applicants rely principally on what they call the doctrine of acquired rights, under which “the employer organization may not unilaterally make substantial adverse changes in the essential terms of an employee's appointment”. They maintain that, even if the staff member has accepted in advance in his contract of employment, without any reservation or limitation, the organization's power to amend the contract – which is the case in the letters of appointment and acceptance of the Bank – this power cannot go so far as to authorize the organization unilaterally to prejudice the acquired rights of the staff members. The Respondent rejects the Applicants’ contention in regard to acquired rights as unreasonable and unrealistic: acceptance of such a theory, the Respondent argues, would prevent the Bank from adjusting its personnel policies to changing circumstances and would place it in an administrative straitjacket. Moreover, adds the Respondent, the doctrine of acquired rights could not be applied here without disregarding the clear language of the Applicants' letters of appointment.

34. However, once these strongly contrasting and at first sight irreconcilable positions are studied at closer range, they appear to have been put forward by the parties with some nuances. The Applicants qualify their theory of acquired rights by two limitations. First, acquired rights stand in the way only of “substantial adverse changes in the essential terms of the employee's appointment”. This implies a contrario that the Bank may make (i) favorable changes; (ii) insubstantial changes; and (iii) changes in nonessential terms. Moreover, Applicants admit that there may be instances of “exigent circumstances” or “overwhelming contingencies” under which the acquired rights doctrine gives way to the Bank's need to act. The Respondent, on the other hand, though denying the existence of any so-called “doctrine of acquired rights” as invoked by the Applicants, acknowledges that the Bank cannot act in an unfettered manner. Its power of unilateral amendment, in Respondent's own view as elaborated during the oral pleadings, is subject to general principles of law such as the principle of non-retroactivity, the principle of nondiscrimination and the principle of reasonable relationship between aims and means.

35. The Tribunal is of the view that the Bank has the power unilaterally to change conditions of employment of the staff. At the same time, significant limitations exist upon the exercise of such power.

36. The existence of the Bank's power unilaterally to change conditions of employment rests on its implied power to pursue fully and efficiently the purposes and objectives for which it was created. As the legal relationship between the Bank and its staff does not rest on any national legal system, it is in the Bank's own internal law that the basis for the Bank's power must be found. To deny the existence of any power unilaterally to amend the conditions of employment of existing staff would lead to a situation in which there are as many rules as there are employees who entered the service of the Bank at different dates. This would create unjustifiable inequalities between the various staff members and would be contrary to the elementary requirements of good administration. The existence of objective rules of a general and impersonal character implies not only the power of the organization to change these rules, but also a power to decide that the new rules should apply immediately to personnel already employed.

37. The Applicants advance the idea that the elements of the conditions of employment must remain at least as favorable to the staff member during the whole period of his employment as they were at the date of the commencement of his service to the Bank. It is on those conditions of employment, so the Applicants maintain, that the staff member placed his “reliance” and his “expectations”; without them he would not have agreed to become an employee or would not subsequently have remained in the service of the Bank.

38. In the opinion of the Tribunal the conditions of employment can not be frozen at the date the staff member joins the Bank. It is relevant to note that Article II, paragraph 1, of the Statute, after defining the jurisdiction of the Tribunal by reference to “non-observance of the contract of employment or terms of appointment”, provides:

> “The words 'contract of employment' and 'terms of appointment' include all pertinent regulations and rules in force at the time of alleged non- observance....”

This provision clearly establishes that the conditions of employment for which the Tribunal must assure respect

are not those which existed at the date of appointment of the claimant but those which exist at the date of the alleged non-observance; it implies, by its very words, possible changes in the conditions of employment.

39. The same considerations which underlie the existence of a power of unilateral amendment, namely, the internal law of the Bank and its implied powers, lead the Tribunal to reject the idea that this power should be totally unlimited. Such an idea would run counter to “the paramount importance of securing the highest standards of efficiency and of technical competence” (Article V, Section 5(d) of the Articles of Agreement). No one would wish to be employed in an organization in which there were no limits at all to the power of the employer.

40. How then is a distinction to be drawn between those unilateral amendments which are permissible and those which are not? The Tribunal notes, first, that such distinction cannot rest on the extent to which a staff member accepted such power of amendment in his letter of appointment. Even if no reservation of the power of amendment were expressly included in the letters of appointment, such a power would be implied from the internal law of the Bank. Likewise, even in those cases where a power of amendment is reserved in terms which impose no limitation upon its exercise, this cannot be construed to accord to the organization an unrestricted power of amendment. The scope of the words as used in the exchange of letters must be read against the background of the Bank's internal law, and it is not on the strength and extent of any individual's acceptance that the power of amendment and its limitations may be defined.

41. Nor can the distinction between what is permissible and what is impermissible rest on the state of mind or the intentions of staff members at the time of taking their employment, on their “expectations” or “reliance” or on the motivating factors which might have induced them to accept or remain in employment with the Bank. Subjective considerations are at best difficult to identify and the difficulty increases with time. The possibility exists that different considerations may prevail with different individuals, thus occasioning a diversity of governing rules where uniformity is necessary. Moreover, there are at least two subjective intentions in any contract. There is no more reason to attach greater weight to the intention of the staff member than to that of the Bank, Furthermore, staff members are entitled to the observance of their conditions of employment as they may exist from time to time, and not only of those terms of appointment which induced them to accept service with the Bank and on the maintenance of which they have placed their “expectations” and their “reliance”. In entering the service of the Bank, the staff member expects, or should expect, that these elements may be altered in the future to take account of changing circumstances.

42. The Tribunal considers that in examining the numerous and varied elements of the conditions of employment, a major distinction must be drawn. Certain elements are fundamental and essential in the balance of rights and duties of the staff member; they are not open to any change without the consent of the staff member affected. Others are less fundamental and less essential in this balance; they may be unilaterally changed by the Bank in the exercise of its power, subject to the limits and conditions which will be examined later. In various forms and with differing terminology this distinction is found in the Jurisprudence of other international administrative tribunals.

43. The Tribunal recognizes that it is not possible to describe in abstract terms the line between essential and non-essential elements any more than it is in abstract terms possible to discern the line between what is reasonable and unreasonable, fair and unfair, equitable and inequitable. Each distinction turns upon the circumstances of the particular case, and ultimately upon the possibility of recourse to impartial determination. However, this difficulty has not prevented distinctions of this kind playing a central role in the application of the law generally and the Tribunal sees no reason for rejecting the relevance of such a distinction in the internal law of the Bank. Sometimes it will be the principle itself of a condition of employment which possesses an essential and fundamental character, while its implementation will possess a less fundamental and less essential character. In other cases, one or another element in the legal status of a staff member will belong entirely – both principle and implementation – to one or another of these categories. In some cases the distinction will rest upon a quantitative criterion; in others, it will rest on qualitative considerations. Sometimes it is the inclusion of a specific and well-defined undertaking in the letters of appointment and acceptance that may endow such an undertaking with the quality of being essential.

44. In describing the distinction between essential and non-essential elements, the Tribunal prefers not to use such terminology as “contractual rights” as opposed to “statutory rights”. Some of the conditions contained in the “contract,” that is, in the letters of appointment and acceptance, may be non-fundamental and non-essential, while some of the conditions lying outside the “contract”, and therefore called “statutory”, may be fundamental and essential. Likewise, the Tribunal prefers not to invoke the phrase “acquired rights” in order to describe essential rights. The content of this phrase is difficult to identify. It is not because there is an acquired right that there is no power of unilateral amendment. It is rather because certain conditions of employment are so essential and fundamental and, by reason thereof, unchangeable without the consent of the staff member, that one can speak of acquired rights. In other words, what one calls “the doctrine of acquired rights” does not constitute the cause or justification of the unchangeable character of certain conditions of employment. It is simply a handy expression of this unchangeable character, of which the cause and the justification are to be found in the fundamental and essential character of the relevant conditions of employment.

45. As has been stated, while the fundamental and essential elements of the conditions of employment may not be amended unilaterally, the non-fundamental and non-essential elements are subject to unilateral amendment. This power is discretionary and it is not for this Tribunal to substitute its own judgment for that of the competent organs of the Bank in exercising that discretion. However, the Bank's power to amend non-essential terms may be exercised subject only to certain limitations. Discretionary power is not absolute power.

46. First, no retroactive effect may be given to any amendments adopted by the Bank. The Bank cannot deprive staff members of accrued rights for services already rendered. This well-established principle has been applied in many judgments of other international administrative tribunals.

47. The principle of non-retroactivity is not the only limitation upon the power to amend the non-fundamental elements of the conditions of employment. The Bank would abuse its discretion if it were to adopt such changes for reasons alien to the proper functioning of the organization and to its duty to ensure that it has a staff possessing “the highest standards of efficiency and of technical competence”. Changes must be based on a proper consideration of relevant facts. They must be reasonably related to the objective which they are intended to achieve. They must be made in good faith and must not be prompted by improper motives. They must not discriminate in an unjustifiable manner between individuals or groups within the staff. Amendments must be made in a reasonable manner seeking to avoid excessive and unnecessary harm to the staff. In this respect, the care with which a reform has been studied and the conditions attached to a change are to be taken into account by the Tribunal.

48. The Tribunal must satisfy itself in each case that the Bank's power to change the non-fundamental elements in the conditions of employment of its employees has not been exercised either retroactively or in an arbitrary or otherwise improper manner.

IV. TAX REIMBURSEMENT

49. In the light of the principles and rules of law which have just been stated, the Tribunal now intends to examine whether the introduction in relation to the Applicants Lamson-Scribner, Reese, Reisman-Toof and Shapiro, of a new system of tax reimbursement with affect from January 1, 1980 constituted a non-observance of their contracts of employment or terms of appointment.

50. The origins of the system of tax reimbursement go back to 1945. As already pointed out, Article VII, Section 9(b) of the Articles of Agreement of the Bank provides: “No tax shall be levied on or in respect of salaries and emoluments paid by the Bank to Executive Directors, alternates, officials or employees of the Bank who are not local citizens, local subjects, or other local nationals.” At its inaugural meeting, the Board of Governors adopted on 16 March 1946 a resolution recommending to the Members of the Bank that they take necessary action to exempt from national taxation salaries and allowances paid to the staff of the Bank. The resolution stated:

> “Appropriate measures for the elimination or equalization of the burden of national taxes upon salaries and

> allowances paid by (the Bank) are indispensable to the achievement of equity among its members and equality among its personnel."

However, as the solution of relevant legal and other problems to achieve this aim would take time, the Board of Governors, at its first Annual Meeting in the autumn of 1946, adopted By-Laws containing the following provision (Section 14(b)):

> "Pending the necessary action being taken by members to exempt from national taxation salaries and allowances paid out of the budget of the Bank, the Governors and the Executive Directors, and their Alternates, the President, and the staff members shall be reimbursed by the Bank for the taxes which they are required to pay on such salaries and allowances.
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> "In computing the amount of tax adjustment to be made with respect to any individual, it shall be presumed for the purposes of the computation that the income received from the bank is his total income. All salaries and allowances prescribed by or pursuant to this section are stated as net on the above basis."

51. In the early years of the Bank, it was expected that its Members, including especially the United States, would become Parties to the Convention on the Privileges and Immunities of the Specialized Agencies with respect to the Bank, with the effect that each such member would have exempted its own nationals from income taxes on compensation for World Bank employment. The United States Government among others did not accede to the Convention, so that all of the more than 1,500 United States nationals employed by the Bank, whether in the United States or elsewhere, have remained subject to United States federal, state and local income taxes on their Bank salaries while all other staff members (except for a few French nationals working in the Bank's Paris office and a few British nationals working in its London office) are entirely exempt from national taxation of their Bank compensation. The Bank was therefore left with a system under which it has to reimburse all its United States staff for the taxes which they are required to pay on the Bank's salaries and allowances.

52. While the principle of reimbursement of the taxes that United States staff members "are required to pay" was easy to state, the method of calculating the amount gave rise to complex questions. One of the reasons for this complexity lies in the United States tax system. On this subject the Respondent has provided the Tribunal with the following information, which has not been contested by the Applicants:

> "The federal government of the United States imposes income taxes at rates which increase progressively as the amount of taxable income rises. The increment of income to which a given rate applies is commonly referred to as a 'tax bracket'. Most states of the United States (including Virginia and Maryland), the District of Columbia, and, in some cases, county or city governments within States also impose income taxes upon persons subject to their taxing jurisdiction.
>
> "The U.S. federal income tax system requires that the taxpayer report his gross income to the U.S. Internal Revenue Service at least annually. From gross income, the taxpayer may make certain deductions (for example, 60% of certain capital gains, unreimbursed travel expenses incurred as an employee, and certain moving expenses) to reach 'adjusted gross income'. From adjusted gross income, he may make additional deductions for personal exemptions (a specific dollar amount for each taxpayer and each of the taxpayer's dependents), for the zero bracket amount and for itemized deductions insofar as their total amount exceeds the zero bracket amount. The zero bracket amount is a flat dollar amount deductible from adjusted gross income on each taxpayer's federal income tax return.
>
> "There are numerous itemized deductions provided for. They include, among others, the dollar amount paid during the taxable year for interest, state and local income taxes, real estate taxes, charitable contributions, and certain medical expenses. The result of subtracting deductions for personal exemptions, the zero bracket amount, and itemized deductions in excess of the zero bracket amount from adjusted gross income is 'taxable income'.
>
> "From the time the Bank was organized until 1977, however, the U.S. Internal Revenue Code did not contain provision for a zero bracket amount, but rather it provided for a 'standard deduction'. The taxpayer

> was allowed to deduct from his adjusted gross income the greater of his total itemized deductions or the standard deduction, but not both. The standard deduction during most of this time was the lesser of a flat dollar amount or of a specified percentage of adjusted gross income."

Thus, when today one uses the term "standard deduction", it is no longer, as it was from 1946 to 1977, a "standard deduction" stricto sensu (that is the lesser of a flat dollar amount or of a specified percentage of adjusted gross income), but, more exactly, a zero bracket amount. The term "standard deduction", in contrast with "itemized deductions", continues to be used for reasons of convenience.

53. In this context, two basic problems had to be resolved in the formulation of any system of tax reimbursement.

54. The first problem was that of determining whether outside income should be taken into account and, if so, by what method. As the Kafka Report noted, since the United States tax system is progressive, it makes a difference to the amount to be reimbursed if outside income is regarded as top or bottom income, or if it is given equal weight with organization income. As has been seen, the By-Laws adopted the principle that "it shall be presumed for the purposes of the computation that the income received from the Bank is his (the employee's) total income". Special problems were to arise, however, regarding the effect of a spouse's income.

55. The second problem related to deductions. It has been explained in the following terms in the memorandum of the General Counsel and of the Treasurer, dated December 5, 1946:

> "The taxpayer may, at his option, in making his tax return take as deductions the actual amounts of his expenditures for the allowable items [interest, real estate taxes, charitable gifts, etc.], in which case he must be prepared to justify the deductions taken, or he may take what are called standard deductions, that is, a lump sum which covers all such deductions and which he does not have to justify.... Obviously as among individual employees of the Bank there will be a great diversity as to whether they take the standard deductions or actual deductions, and, in the latter case, as to the kinds and amounts of the deductions which are taken. If the Bank should undertake to compute the amount of deductions taken by the particular employee in computing his income tax, that would mean that the Bank would have to make an inquiry into each employee's tax return. Furthermore, in the case of employees having income other than their salaries from the Bank, it would mean that the Bank would have to determine how the deductions should be allocated between the employee's salary and his other income, because in many cases it would be highly inequitable to allocate all such deductions to the employee's salary. The amount of accounting and investigating work involved would be considerable, not to mention the annoyance to employees of such a scrutiny of their personal affairs."

56. The Tribunal does not consider it necessary to examine the problem of the treatment of outside income as only the problem relating to deductions arises in the present case.

57. Other international organizations were also affected by the problem. That is why a "Steering Committee on Tax Problems of International Organizations Respecting Methods of Tax Reimbursement by International Organizations" was established. In a Report issued in October 1946, the Committee spoke of "the problems and issues respecting various methods of tax reimbursement of employees by international organizations", and indicated that "the current reimbursement systems adopted by international organizations need not be uniform as to the treatment of exemptions and deductions". The Report of the Technical Sub-Committee annexed to the Report of the Steering Committee emphasized that "None of the tax reimbursement methods analyzed would achieve complete equality between nationals of different countries .... Only substantial equality of salaries after taxes is practical". The Sub-Committee added that the method to be adopted should satisfy equally the conditions of "simplicity in the administration of tax reimbursement and understandability by the employees". The Sub-Committee proceeded to a detailed comparison of the "advantages and disadvantages of three plans for tax reimbursement by international organizations" and proposed one which "on balance, meets the requirements set forth above". It added that "the Committee is strongly of the opinion.... that a system of

standard deductions will prove necessary under any method of tax reimbursement to avoid difficult administrative and policy problems".

58. As a result of the Steering Committee's Report, the General Counsel and the Treasurer of the Bank recommended to the President on December 5, 1946 that, for the reasons of simplicity mentioned by the Committee, the Bank adopt a tax reimbursement system based on the standard deduction. They also recommended that the reimbursement be in an amount that, "when added to .... net salary, will yield a net income for the year, after deducting U.S. income taxes, at least equal to such net salary".

59. On December 10, 1946, the Executive Directors adopted the recommendations of Bank Management. They decided inter alia that:

> "In computing the amount of such tax reimbursement, there should be deducted from the amount of the salary of the particular employee .... (b) the amount of the standard deductions from such salary which are allowable under the U.S. Federal income tax law and regulations."

60. The system thus adopted by the Bank presented one peculiarity to which it is necessary to draw attention. As has been said, the United States tax system permits a taxpayer to deduct from his "adjusted gross income", with a view to the calculation of his "taxable income", at his option, either a "standard deduction" or "itemized deductions" (interest, charitable contributions, state and local taxes, etc.) Obviously each taxpayer will make the choice which assures him the largest deduction; that is, a choice which produces the smallest taxable income and taxes. Since the Bank decided in 1946 to calculate tax reimbursement on the basis of the standard deduction, even in cases where the employees in fact claimed itemized deductions in a greater amount, it followed inevitably that in the latter cases the employees were reimbursed sums in excess of the taxes actually paid by them – in short they were "over-reimbursed". On the other hand, there was no possibility of "under-reimbursement". With the standard deduction system a staff member would always receive a reimbursement at least equal to his actual federal tax liability on his Bank salary because every taxpayer was entitled to the standard deduction under United States tax law; by virtue of the standard deduction, his after-tax income could not fall below his stated net-of-tax salary.

61. The fact that there could be cases of reimbursement in excess of taxes was taken into consideration at the time of the recommendation and decision in 1946. The Steering Committee expressly mentioned this possibility: "All taxpayers... with deductions larger than standard would receive net salaries higher than stipulated", but the Committee immediately added: "However, these additional amounts are generally not relatively large and in our opinion would constitute tolerable differences". Likewise the General Counsel and the Treasurer drew attention to this possible consequence of the standard deduction system and to the cost that it would involve for the Bank; but, they added: "It is not believed that the saving to the Bank which would result from a more exact method of computation would be sufficient to offset the disadvantage to the Bank in having to make a special investigation and computation in each case".

62. Over the years the system established in 1946 underwent a number of changes. Most of the changes are not relevant to the present problem, either because they did no more than make necessary adjustments in consequence of changes in United States tax legislation, or because they were concerned with aspects of reimbursement other than that of deductions. Only one amendment requires special consideration. Large increases in the amounts of state and local taxes levied on employees resulted in payment by some employees of state and local taxes that exceeded, sometimes by a considerable sum, the amount of the standard deduction. These state and local taxes were reimbursed by the Bank. Since an employee could claim the amount of his state and local taxes as a deduction on his federal tax return, it became clear that some employees had deductions exceeding the standard deduction used as the basis for the Bank's calculations, and therefore were reimbursed in excess of their actual federal income taxes. In 1963, in recognition of the changed circumstances, the Bank modified its policy so that reimbursements would henceforth be calculated using the standard deduction or the amount of state and local taxes, whichever was greater. Although this modification produced an adverse impact on employees who were already working for the Bank, since they would receive a lower reimbursement than under the former policy and thus would have a lower gross salary,

the change was applied across the board and without protest from the staff.

63. The tax reimbursement system was codified in the Personnel Manual Statement No. 3.05 issued December 1973, paragraph 10 of which reads:

> "The Bank Group will reimburse taxes on net-of-tax salaries and on allowances and other non-salary payments which are required to be included in taxable income, and with respect to which no expenses are deductible. Taxes will not be reimbursed on allowances or non-salary payments which are not required to be included in taxable income or with respect to which expenses are deductible. Tax reimbursements will be computed on the basis of normal filing of tax returns at the applicable tax rates and the exemptions and the standard deduction which a staff member is entitled to claim on his tax returns, except that in any case in which the state or local tax reimbursements made to a staff member during a year exceeded his standard deduction for federal tax purposes his state or local tax reimbursements will be used in lieu of the standard deduction in computing his federal tax reimbursement. In computing reimbursement for a state or local tax when no standard deduction is provided for by law the Bank Group will use a deduction of 10 per cent of compensation up to $5,000 or $500, whichever is less." (emphasis added)

64. Gradually, doubts arose as to the adequacy of this system in new economic conditions. Inflation had led to increased salary payments, which placed their recipients in constantly higher brackets. The standard deduction, on the other hand, had not been significantly increased. Also it appeared that an increasing number of staff members had come to use itemized deductions, thus obtaining more by way of reimbursement than they had paid by way of tax. The possibility of reimbursement in excess of taxes paid, which in 1946 had been thought of as remaining infrequent and unimportant, in fact had become increasingly frequent and more important. Correspondingly, the cost of the system became constantly heavier for the Bank.

65. In order to assess the exact size of these changes, the Bank and the Fund in 1977 commissioned a survey of tax reimbursement by a specialized firm. Based on the income tax returns for 1976 of 1,147 Bank and Fund United States staff members, this survey led to the following conclusions:

- About 74% of staff members entitled to reimbursement claimed itemized deductions; only 26% used the standard deduction on which the tax reimbursement system was based. Of those claiming itemized deductions, most were in the middle or higher income levels; only 36% had a net organization income of less than $20,000. Virtually all (98%) of those claiming the standard deduction had net organization incomes of less than $25,000.

- Nearly 50% of those entitled to reimbursement received reimbursement in excess of the actual tax paid on their total family income, that is not merely in respect of organization compensation, but in respect of all sources of income.

- The overall average excess reimbursement was over $2,300 per staff member. This excess ranged from $150 at the low income levels to a maximum of more than $4,000 at the highest income levels.

- More than 68% of all staff surveyed who had income above the $20,000 level received a reimbursement in excess of tax paid on total family income.

- Slightly more than 50% paid some tax on total family income in excess of their tax reimbursement. However, the authors of the survey did not feel able to draw any conclusion from this fact, since whenever a staff member had non-organization income it would be reasonable that some tax in excess of the reimbursement would be payable.

66. In 1977, the problem of tax reimbursement was submitted, together with other aspects of compensation policy, to the Joint Committee on Staff Compensation Issues (the Kafka Committee). Chapter 6 of the Kafka Report identified the following factors as profoundly altering the reasons which had led to the adoption of the 1946 system:

> "Over time, inflation and changes within the United States tax structure have widened the difference between standard deductions and those which may be claimed by itemizing deductions. The tax brackets and absolute amounts of standard deductions under the U.S. Tax Code have not been fully adjusted to reflect price level changes, but itemized deductions, such as mortgage interest payments and real estate taxes, have generally kept pace with these changes. This has led to a considerable increase in the practice of itemizing."

The Report added that the cost to the Bank of tax reimbursement had mounted from $300,000 in 1946 to $18,902,000 in 1978, representing an increase from 2.4% of the total administrative budget to 7.2% and stated:

> "In the light of these results, we concluded that the present system is indefensible and should be changed."

67. In order to replace this system and to find a solution which was appropriate "in terms of internal equity and economy for the institutions", the Report stated that there were a variety of systems available, none of which was by itself entirely satisfactory:

> "There is clearly scope for disagreement, not merely about the objectives of a tax reimbursement system, but about their relative importance. Even a cursory examination of possible alternative systems reveals that no single one fully meets all the objectives."

The principal objective of the system should, according to the Report, be the achievement of equity. However, the Report added, this was a difficult notion to define, for various kinds of equity might be identified – as between United States nationals and expatriate staff ("internal equity"); as between United States nationals employed by the organizations and those employed outside ("external equity"); and among United States nationals at different income levels and with or without outside income. Other objectives had, according to the Report, also to be borne in mind: ease of administration – "some systems are far more complicated than others"; cost – "the cost to the institutions is certainly a factor to be taken into account but cannot be the sole criterion for choosing one system as against another"; comprehensibility; and, as a subsidiary consideration, confidentiality.

68. The Report considered several possible alternatives, including the system used in the United Nations, and set out their respective advantages and disadvantages. It expressed a preference for an average deductions system under which the tax reimbursed would not exceed the average tax paid by persons throughout the United States at the same income level as the staff member. This system implied that it would still be open to the individual staff member to claim a standard deduction or to itemize his deductions but in no case would his reimbursement exceed the average paid by his counterpart in outside employment. The Report saw various advantages for this system, particularly in view of "the perception of Americans outside the Bank and Fund of how their compatriots inside the two institutions are treated". However, while expressing their preference for this system over others, the authors of the Report took care to emphasize that there was no single characteristic of any one scheme which conclusively indicated that that scheme should be favoured before all others.

69. On the basis of this Report, the Executive Directors decided on May 24, 1979 to introduce the average deductions system, with effect from January 1, 1980, subject to two conditions which had not been proposed by the Kafka Committee, namely, a five-year transition period and other appropriate safeguards.

70. The Personnel Manual Circular 1/80, dated January 21, 1980, which informed staff of the new system stated:

> "... the arrangements for the reimbursement of taxes on salaries and allowances paid by the World Bank, as described in Personnel Manual Statement 3.05, should be replaced, effective January 1, 1980, by a system of tax allowances based on average deductions ... This circular, therefore, amends and supersedes in fact the provisions of PMS 3.05 ... PMS 3.05 will be revised in due course. In the meantime, its provisions will continue to apply except to the extent necessary to reflect the changes announced in this Manual Circular."

The Circular recalled that “the basic concept of the new system is to provide for U.S. staff members a tax allowance equivalent to the average taxes paid by the generality of U.S. taxpayers at the same income level”. Consequently, according to the Circular, the Executive Directors recommended to the Board of Governors that Section 14(b) of the Bank's By-Laws be amended effective January 1, 1980 to read:

> “Pending the necessary action being taken by members to exempt from national taxation salaries and allowances paid out of the budget of the Bank, the Governors and the Executive Directors, their Alternates, the President, and staff members and other employees of the Bank, except those whose employment contracts state otherwise, shall receive from the Bank a tax allowance that the Executive Directors determine to be reasonably related to the taxes paid by them on such salaries and allowances.
>
> “In computing the amount of tax adjustment to be made with respect to any individual, it shall be presumed for the purposes of the computation that the income received from the Bank is his total income. All salaries and allowances prescribed by or pursuant to this section are stated as net on the above basis.” (emphasis added)

This recommendation was subsequently adopted by the Board of Governors and now forms Section 13(b) of the By-Laws.

71. The Executive Directors decided, so the Circular stated, that the new system should apply immediately and fully only to those staff members “who accept offers of appointment on or after January 1, 1980”. As regards the “existing staff”, that is, the staff who were on duty prior to January 1, 1980 or who had formally accepted offers of appointment before that date, two special provisions were laid down. First, “in order to alleviate the impact of the change, for existing staff the new system of tax allowances will be introduced progressively over a five-year period”. Second, the Executive Directors wished to take into account the fact that the tax allowances under the new system would only be “reasonably related” to the taxes effectively paid by each staff member in such a way that, in the terms of the Circular, “the tax allowances will rarely exactly equal the taxes payable – it may be more, it may be less”. That is why it was decided, said the Circular,

> “... that the Bank will continue to apply to existing staff, for the duration of their service with the Bank, a safeguard consistent with the provisions of section 14(b) of the former By-Laws of the Bank so as to ensure that, as a minimum, such staff are reimbursed for the taxes they are required to pay on their income from the Bank” (emphasis in the original text).

The Circular stated that in consequence “any existing staff member who … considers that the total amount of the tax allowance received ... is less than the taxes due on Bank income may choose to apply for a supplementary payment”. This provision is commonly referred to as the “safety-net”.

72. The Tribunal must now assess whether in adopting the new tax reimbursement system the Bank has made an unlawful unilateral change in the conditions of employment of the four Applicants affected.

73. The Respondent contended that the standard deduction system was not included in the conditions of employment of the Applicants prior to 1979 but instead amounted to no more than a mere procedure not forming part of the legal relationship between the Bank and the Applicants. The Tribunal cannot accept this view. The Bank ruled in 1946, and subsequently confirmed this ruling on various occasions, particularly by issuing P.M.S. 3.05 in December 1973, that the amount of reimbursement should be calculated on the basis of the presumption that all United States staff members had benefited from the standard deduction, without taking account of the individual positions in which this or that staff member had in fact claimed larger itemized deductions. The Bank ruled in 1963 that the standard deduction should be replaced by a deduction corresponding to state and local tax payable in cases where those payments exceeded the amount of the standard deduction. Such rulings, by which the competent authorities of the Bank established legal norms, were undeniably part of the conditions of employment of the staff members. The Tribunal considers therefore that the provisions of P.M.S. 3.05 providing for tax reimbursement on the basis of the standard deduction

established by United States legislation formed part of the conditions of employment of the Applicants Lamson-Scribner, Reese, Reisman-Toof and Shapiro at the date when the Bank took the decision to “replace”, “amend” and “supersede” them by the terms of Circular 1/80.

74. Having reached this conclusion, the Tribunal must now consider whether the introduction of the new provisions in relation to the four Applicants changes the fundamental and essential elements of their conditions of employment.

75. The conditions in which the tax reimbursement system were established from the origin of the Bank show that this system rested on two inherently fundamental principles, designed to ensure the equality among staff members of the Bank as an international organization, regardless of their nationality. The first is that all employees of the Bank should receive a salary free of national taxes, as was expressly stated in Article VII, Section 9(b) of the Articles of Agreement. That is why the letters of appointment from the very beginning fixed salaries in net terms, and all included the following statement: “Your salary will be at the rate of .... per annum and will be net of income taxes as presently and hereafter provided in the By-Laws and Regulations of the Bank”. The second principle, a logical corollary of the first, is that those staff members of the Bank who were subject to tax by their State would have the right to be reimbursed by the Bank for the taxes which they were required to pay. This principle was set out in By-Law 14(b), by which the Board of Governors decided in 1946 that “pending necessary action taken by member governments to exempt ...” the Bank would reimburse those affected and, more particularly, the U.S. staff members “for the taxes which they are required to pay”. Such are the fundamental and essential elements of the conditions of employment of staff recruited before January 1, 1980. The character of the safety-net mechanism added by the Bank to the recommendations of the Kafka Report constitutes in the circumstances of the present case an implicit recognition of the fundamental character of these elements.

76. The principle of “reimbursement for the taxes which they are required to pay” may be implemented in a variety of ways, especially as regards the deductions which are to be taken into account. Various methods of calculation are possible. It is possible, for example, to examine the individual situation of each staff member and take account of itemized deductions actually claimed; it is possible also to adopt the presumption of a standard deduction or of average deductions. A balance has to be struck among various factors (equity, simplicity, cost) which sometimes contradict one another: rigorous exactness cannot be achieved save at the price of complications; a simple solution can only be achieved at the cost of approximation. On all these questions it was by a reasoned judgment and after a balance of considerations that the competent authorities of the Bank preferred one formula to another, being conscious that none could be perfect in all respects.

77. This distinction between the principles of tax reimbursement and the method of implementation was expressed as early as in the Report of the Steering Committee of October 1946. The Memorandum addressed to the President some weeks later, on December 5, 1946, dealt at length with what it called the “Methods of Computing the amount of tax reimbursement” and recommended “that the tax reimbursement be computed on the basis of ... standard deductions” rather than on “a more exact method of computation” which would be more complex. The decision of the Executive Directors of December 10, 1946 chose the method of standard deduction “in computing the amount of such tax reimbursement”. Nearly twenty years later, the reform of 1963 was presented by the President as a modification of “the Bank's calculation method” or of “the standard deduction method”. The relevant paragraph of P.M.S. No. 3.05, issued in December 1973, is placed under the double heading: “IV. Procedure. A. Computation”. It thus appears clearly from the relevant documents submitted to the Tribunal that if the right to a salary net of taxes and the right to be “reimbursed for the taxes they are required to pay” constituted at the time of alleged nonobservance – and in fact since 1946 – a fundamental and essential element of the terms of appointment of the four United States Applicants, the same is not true of the standard deduction, simple method of calculation or procedure of computation.

78. It may be recalled that several aspects of the method of calculation of tax reimbursement were indeed unilaterally changed by the Bank before 1979. The 1963 amendment which – in a particular situation referred to in paragraph 62 – replaced the standard deduction by an itemized deduction constitutes a significant precedent showing that the method of computation of reimbursement established in 1946 on the basis of the standard

deduction was not sacrosanct and could be modified from time to time.

79. The Applicants insist both in their written and their oral pleadings on the weight which they attached to their gross income when they decided to accept the Bank's offer of employment or to remain with the Bank rather than to seek more remunerative positions elsewhere. They maintain that the possibility of reimbursement in excess of taxes paid constituted an integral part of their gross remuneration: “The amount of reimbursement, whatever its relationship to the taxes actually paid, was an integral part of the United States staff members compensation … the standard deduction tax reimbursement formula was an established and significant part of the United States staff members' compensation package and contributed a substantial inducement for many of them to accept employment at the net salaries set forth in their letters of appointment”.

80. As the Tribunal has concluded that the standard deduction method is not a fundamental element of the conditions of employment of Applicants, it follows that the determination of the gross income and the possibility of reimbursement in excess of taxes, which are but corollaries of this method, are equally non-essential elements of the conditions of employment of the Applicants. In any event, any information given to Applicants before their employment with the Bank about any approximate gross income figures must be deemed superseded by the explicit provisions referring to net salary in the letters of appointment.

81. The preceding observations are reinforced by the statements made in the brochure of the Young Professionals Program to which attention was drawn by Applicant Shapiro. The relevant text of the brochure is as follows:

> “At the present time, Young Professional salaries range between … and … dollars a year, net of income taxes. In cases where salaries are taxable, the amount paid in taxation by the staff member on his Bank salary is reimbursed by the Bank”.

This is a restatement of the two fundamental principles of net salary for all and of reimbursement of taxes for the United States staff members. The brochure does not indicate any particular method of calculation, it does not speak of a standard deduction formula, and it does not mention gross income, let alone reimbursement in excess of taxes.

82. Accordingly, the Tribunal concludes that the Bank does not have the power unilaterally to abolish the tax reimbursement system or to repay a lesser amount than the taxes which each of the Applicants is required to pay (on the assumption that Bank income is his or her only income). Indeed, the Bank has not done so. The Applicants continue after the decisions of 1979/80 as before to receive a net salary in the same way as non-United States staff members. The principle of reimbursement “for the taxes they are required to pay” is fully respected by virtue of the safety net. In no case does any United States staff member receive a net salary lower than that which he would have received if he had not been subject to United States taxes. All taxes which he is “required to pay” are reimbursed by the Bank. The only change effected is in the replacement of the standard deduction method with another method. The Bank was entitled to do this even if the gross income of certain United States staff members has been reduced as a result, and even if the reimbursement in excess of taxes which they previously received is diminished or altogether disappears. All these non-essential elements in the conditions of employment were subject to unilateral amendment by the Bank.

83. Although the Bank's power to substitute one method of computation for another is discretionary, this discretion is not an unfettered one. It remains therefore for the Tribunal to ascertain whether in making the contested decisions the Bank has, or has not, committed an abuse of discretion.

84. The Tribunal notes, first, that the change in the tax reimbursement method had no retroactive effect and that no complaint of this kind has been brought forward by the Applicants.

85. Second, as the Tribunal has shown above (paragraphs 64 et seq), the ever-increasing discrepancy between the taxes which staff members were required to pay and the amount of reimbursement which they received on the basis of the standard deduction method rendered the operation of this method inequitable. The

Staff Association itself, in its Memorandum of April 11, 1979, “Staff Association Comments on Staff Compensation Matters,” acknowledged that “the ability of individual U.S. staff to take advantage of the provisions of the U.S. tax code under the present system has enabled those U.S. staff members in a position to do so, to achieve net incomes above their official net pay”. This Memorandum from the Staff Association further recognizes that under the standard deduction system “the objective of equal net pay for equal work on an individual basis is not achieved.” Thus, the Bank could reasonably conclude that the system did not work properly and had to be changed. The Tribunal is satisfied that the objective of the Bank was not to reduce the income of a particular category of staff members by reason of their nationality but to ensure a better functioning of the institution by a more equitable personnel policy. This did not involve an abuse of discretion or a misuse of powers on the part of the Bank.

86. It is not for the Tribunal to substitute its judgment for that of the Bank in choosing the average deduction system, rather than some other system, to replace the previous system. That the average deduction system also presents some inconveniences is certain. As the Kafka Report brought them into the open, the Executive Directors were fully aware of them. As was the case in 1946, the 1979 decision represented a considered choice taking into account the various relevant factors. The Applicants concede that “it is plainly not the function of the Tribunal to determine the best compensation policy for the Bank to adopt... nor is it the Tribunal's function to decide which among the various possible tax reimbursement systems is the ‘best’ or ‘fairest.’” The Tribunal fully shares this view.

87. Nevertheless, the Applicants express regret that once the Bank decided to change the method, it did not adopt the United Nations systems. According to them, this would have better achieved the objective of internal equity. The Applicants maintain that if the Executive Directors did not choose this system it was only because such a choice would have cost the Bank more. The choice of a particular method of tax reimbursement may properly be determined by several factors: equity, ease of administration, cost, comprehensibility, confidentiality. Thus, the cost of any particular system is one of several factors which the organization may take into account. The United Nations system presents, as do all the others, both advantages, for instance, in achieving a significant degree of internal equity, and disadvantages, particularly in the cost to the organization. The Kafka Report analyzed them as it did the other systems which it examined. It observed inter alia that, unlike organizations such as the United Nations, the Bank's Member governments do not refund to it the amount of taxes reimbursed. As a result, as the Respondent says “the costs of the tax reimbursement system are real costs to the Bank which must be deducted from its income, which is generated in large part from interest and fees paid by its borrowers in less developed countries”. The Tribunal sees no abuse of discretion in the fact that the Executive Directors took into account the cost of the various systems and, after having assessed the advantages and disadvantages of each, decided to adopt the average deductions system.

88. As has been said (paragraph 47) the manner in which a change in the non-fundamental elements of the terms of appointment are prepared or applied is also to be taken into account by the Tribunal when it seeks to ascertain whether the amendment has an arbitrary or unreasonable character. The long and detailed studies which preceded the 1979 decisions show that this was not a hastily adopted reform, but a change studied at length and most carefully prepared. The establishment of the new system included measures showing moderation and concern for staff. The Executive Directors did not follow the Kafka recommendations blindly, but introduced into them two important changes: the safety net and a transitional period of five years “in order to alleviate the impact of the change.”

89. The preceding considerations lead the Tribunal to conclude that in applying the decisions in Manual Circular Pers. 1/80 dated January 21, 1980 to the Applicants Lamson-Scribner, Reese, Reisman-Toof and Shapiro the Bank did not commit any non-observance of their contracts of employment or terms of appointment.

V. SALARY ADJUSTMENT

90. The six Applicants contend that their conditions of employment include a right to the protection of the real value of their salaries against erosion by inflation and that in granting increases markedly lower than the

increases in the Washington CPI the Bank has violated those conditions. The Respondent denies that the conditions of employment of the Applicants include a right to an automatic adjustment of their salaries to meet an increase in the cost of living and adds that, even if such a right had been part of the conditions of employment before 1979, the Bank retained the right, in the letters of appointment accepted by the Applicants, to change its salary policy.

91. The Tribunal first notes that no provision for periodic adjustment of salary and still less for an automatic adjustment to meet the increase in the cost of living appears in any of the letters of appointment and acceptance. The Tribunal also notes that there is no provision to this effect in the Personnel Manual. On these points, both parties agree.

92. The Applicants maintain, however, that a policy of automatic adjustment of salaries to meet increases in the CPI was recommended by the President to the Executive Directors in Report R. 68-140 dated June 30, 1968 and was adopted by the Executive Directors at their meeting of August 13, 1968. Since then, so the Applicants claim, this policy has been applied, has become a firmly established practice and has therefore become part of their conditions of employment. The Tribunal will first examine whether in 1968 a decision in this regard was made and, second, whether a practice of automatic cost-of-living adjustment was followed between 1968 and 1978.

93. Report No. R. 68-140 is entitled: “Proposed General Salary Increase.” After recalling that the Bank has not “since 1962 provided general salary increases uniformly applied to meet cost-of-living changes” the President said:

> “For these reasons I propose to modify our system and adopt a policy of periodic across-the-board salary increases for professional staff to match rises in the ‘cost-of-living’ in the area in which we work and live. We will, of course, continue our policy of granting merit raises to professional staff based on individual performance and ability in the light of personal reviews... However, these increases will be separate from adjustments to meet advances in the ‘cost-of-living.’ The basic objective will continue to be to attract and retain a highly competent international staff and to motivate and stimulate the highest level of performance by all staff members.”

The President then provided information on price increases in Washington since 1968, on the increases in salaries granted by the Fund, the Inter-American Development Bank, the United Nations and the United States Government, on comparable practices in the public service of Canada and various European countries, as well as on increases in academic salaries in the United States. He concluded with a proposal to “grant an across-the-board salary increase effective at 1 September, 1968... amounting to 8 per cent.”

94. The Executive Directors examined the problem on August 13, 1968. The Minutes of the Meeting recorded the following:

> “General Salary, Increase. The Executive Directors approved the recommendation (R 68-140) for a general salary increase, with the modification adopted at the meeting.”

The content of the discussions and of the decisions taken by the Executive Directors on the recommendation of the President is stated in an agreed summary of the meeting prepared by the parties. It appears that a decision was taken to place a ceiling on the general increase of 8% recommended by the President in such a way that the higher salaries would not benefit from the increase. Further:

> “In response to questions raised at the meeting about paragraph 4 of document R. 68-140, which stated that the President proposed to adopt a policy of periodic across-the-board salary increases for professional staff, the President explained that he proposed to follow such policy and he planned to have periodic reviews and make recommendations to the Executive Directors where it was necessary to have their approval of across-the-board increases. He considered it absolutely essential that there be a clear-cut established policy in the administration of the Bank's salaries and that was the policy that he proposed to

> have the salary administrative department follow. Where the application of such policy required approval of the Executive Directors, a decision would be brought to them for approval."

The same day the staff were informed by Administrative Circular that:

> "In the face of the continued rise in the cost of living in the Washington area, a general increase in salaries has been approved for the staff of the Bank and Corporation. Present salary rates of professional staff members, because they have not reflected cost-of-living increases since September 1966, will be raised by approximately 8%..."

95. The foregoing shows that the President recommended an increase of a certain percentage effective September 1, 1968, adding, first, that he intended to make periodic recommendations to the Executive Directors for across-the-board salary increases and, second, that he would recommend to the Executive Directors to follow in their periodic decisions a clear-cut and established policy. The Report (as clarified by the explanations of the President during the meeting of the Executive Directors) thus amounted only to a statement of the President's intentions and of the policy that he recommended the Executive Directors to follow in the future. The Tribunal cannot attribute the effect of a decision creating rights and obligations as between the Bank and its staff to a statement of policy by which the President informed the Executive Directors of his intentions. The President's recommendation of June 30, 1968 cannot, therefore, be considered as having modified, and become part of, the conditions of employment of the Applicants.

96. As regards the Executive Directors' decision of August 13, 1968, it is clear from the parties' agreed summary that this decision neither repeated the President's recommendation nor stated a general policy that the Executive Directors intended to follow in the future. The Executive Directors merely decided to give the staff an increase of a fixed amount on September 1, 1968. Should the President subsequently recommend further increases, as he said he would, the Executive Directors would decide on such recommendations within the framework of their powers: "a decision would be brought to them for approval." The Executive Directors thus retained their full freedom to approve or not in each future case any salary increase which the President might propose to them. The Circular announcing the increase to the staff did not contain any commitment to compensate automatically for future increases in the cost of living.

97. The Applicants maintain, secondly, that the implementation by the Bank of a policy to adjust the salaries of its staff to match cost-of-living increases has given rise to a consistent and established practice, which has become an integral part of their conditions of employment. The Respondent denies that such a practice was established.

98. If the practice alleged by the Applicants exists it cannot be regarded as the implementation of a decision taken in 1968, since, as the Tribunal has just shown, no decision was taken in 1968 to maintain salaries at a level intended to eliminate completely the effects of inflation. As indicated in paragraph 23, the practice of an international organization may under certain conditions be an independent source of rights and duties in the legal relationship between an organization and its staff. The Tribunal must therefore consider whether or not the practice invoked by the Applicants exists, and if it does, whether it has become a condition of employment.

99. Between 1968 and 1978 the Bank increased salaries each year and sometimes twice in a year. In conformity with the intention which he had expressed to the Executive Directors, the President submitted to them each year a recommendation to this effect. Each year the Executive Directors reached a conclusion on this recommendation and a circular was issued to inform the staff of the decision adopted. Close examination of the recommendations and circulars relating to each of the years 1969 to 1979 leads the Tribunal to several observations.

100. The first is that the rise in the cost of living was indeed mentioned in some cases as being the decisive reason for the increase. The circular of May 9, 1973, for example, said that "these increases are designed to maintain the real level of salaries in the face of rising prices..." On October 17 of the same year the President

proposed a further increase stating that “the key factor determining the need for a general salary increase is, of course, the movement in price levels in the Washington area,” and the circular of November 7, 1973 explained that a new increase had been decided because of the “especially sharp rise in local price levels since February.” Five years later, in 1978, the President explained that “the rise in the cost of living in the Washington area has for several years been a customary and important factor in our consideration of staff compensation.”

101. But the Tribunal also notes a second point of even greater significance: several factors other than cost of living were taken into account in formulating one or another salary increase.

102. One of those most frequently mentioned was the need to maintain the competitiveness of the Bank in the recruitment of highly qualified personnel and, consequently, the necessity of maintaining Bank salaries at a level comparable at least to those of its principal competitors: the United States Government, other international organizations such as the United Nations, O.E.C.D., the European Common Market, United States financial institutions and industrial corporations, and academic institutions. The 1969 circular, for example, told the staff that there were two reasons for the increase, namely that “other employers, both public and private, have adjusted their salary structures upward, and the cost of living in the Washington area has continued to rise.” In 1971 the President in his recommendation examined in detail the factors “which have further eroded our competitive margin.” The recommendation of the President for 1973 spoke of “a balance between sometimes conflicting factors: (a) the erosion of the real income of the staff due to the rise in the Washington cost of living and the currency realignments... (b) the competitiveness of present Bank group compensation…” The 1977 Circular also invoked these two factors, being based on a study of the compensation of twenty-seven “analogous organizations.” The “practice of analogous organizations” was invoked also in the 1975 circular. In 1979 the Kafka Report noted that “the comparison of Bank jobs with certain outside jobs has always been part of the process of determining pay...” The Applicants have recognized that the cost-of-living element was not the sole criterion governing the increases adopted during this decade: “Rather, the objective was to prevent the real value of Bank salaries from being eroded by inflation and to keep those salaries competitive”.

103. Several other factors were also taken into consideration by the President and the Executive Directors. Thus the recommendation of the President for 1973 mentioned that as a consequence of a study carried out by a consulting firm “we believe that the Bank group professional salary structure should be designed to take account of: (a) the competitive situation; (b) the need to provide reasonable differentials between grades...; (c) the need to provide reasonable scope for the reward of performance.” The recommendation of the President for 1974 noted that “many member governments and most other organizations do not adjust salaries solely on the basis of price level changes” and said that “salary changes may be induced as well by (a) advances in standard of living ... ; (b) changes in pay relationships with other organizations.” The 1976 Circular explaining “the underlying philosophy” of the salary changes cited the following factors: cost of living, competitiveness, real income growth and staff morale. The preceding shows that, in reality, a wide range of factors were taken into account by the Bank in deciding year after year on the level of increase to grant to the staff.

104. The Tribunal observes, third, that in each of the years under consideration the President and the Executive Directors made a balanced choice among these factors according to the conditions prevailing in each year. Thus, the Memorandum of the President for 1973 said: “We have sought to achieve a balance between sometimes conflicting factors.” The circular of 1976, after referring to the various factors taken into consideration, stated: “The extent of response to these qualitative aspects is very much a matter of judgement in the context of economic, financial and social considerations.” It is certain that amongst the factors taken into consideration by the Bank was the evolution of the cost of living and that this was a “key factor” “or customary and important factor”. But it is equally certain that this was only one amongst several, sometimes “conflicting” factors.

105. The Tribunal observes, fourth, that the exercise by the President and the Executive Directors of their judgment did not lead in the years 1969 to 1978 to systematic increases equal to those of the Washington CPI. The Chart submitted by the Applicants in their Consolidated Memorandum shows that only in 1974 and 1976 was there an exact coincidence between the rise in the CPI and the salary increase. In the other nine years there were differences, sometimes of importance, with salary increases exceeding the CPI index when the

surveys found that the pay of certain staff levels was not competitive with that of other employers. The Circular of 1973, for example, said that the increases "designed to maintain the real level of salaries in the face of rising prices" had been adopted "with adjustments of varying amounts to take into account the market conditions for the types of skills employed in the Bank Group."

106. The Applicants do not deny that sometimes there was a difference between the CPI increase and the salary increase. They assert, however, that in all these cases the salary increase was at least the equivalent of that in the cost of living and that "maintenance of the real value of Bank compensation was the minimum essential". This interpretation is contradicted by the fact that in 1969, 1970, 1971 and 1973 – according to the same Chart in the Consolidated Memorandum – the increases were tapered for the staff at higher levels, who consequently received increases below the CPI index. This practice of "tapering" – the existence of which the Applicants recognized – is by itself a sufficient basis for discarding the thesis of "the minimum essential."

107. On occasion, the President and the Executive Directors even expressly opposed a salary adjustment corresponding exactly to the increase in the CPI. In October 1974, the President informed the staff that he would not be following up the request of the Staff Association for a supplementary mid-year increase although such an increase had been given in the preceding year because of a particularly steep rise in inflation. The President recognized that there had again been a "sharp rise in price levels" in 1974, but, he added, "there has been a dramatic change in the political climate of the world," and it was practically impossible to obtain the agreement of the Executive Directors for a salary adjustment at that time. Even more pertinent is the Memorandum of the President of May 1, 1975. In this memorandum the Staff Association is described as concerned "with the perceived differences in approaches to periodic salary adjustments: in recent years both EEC and OECD have granted at least biannual adjustments which fully compensate for price level changes in net terms and at all levels, together with further periodic adjustments intended to provide real income growth." The memorandum adds that the staff is also disturbed by the differences between the Bank practices and the United Nations system. The latter "provides for automatically-triggered cost of living adjustments for professional staff which compensate in net terms for 80-90% of price level changes as they occur." The memorandum also states that "the Staff Association has pressed repeatedly and strongly for the indexation of salaries with some form of automatic triggering related either to the passage of time or to a given percentage rise in the cost of living." The President turned down this demand for an automatic adjustment of salaries to meet the rise in prices, stating:

> "There is no simple formula by which the degree of competitiveness of a compensation package can be measured with precision... There can be no substitute for the exercise of judgement in determining a compensation package at any given time in relation to all the factors involved."

108. The considerations set out above lead the Tribunal to conclude that between 1968 and 1979 there did not exist any established and consistent practice of increasing salaries across the board to a degree at least equal to the increase in the CPI. The Staff Association had, indeed, demanded such a policy but the Bank expressly refused it. Each increase was decided in the light of the circumstances of the time and having regard to various factors among which the increase in the cost of living played an important, but in no way a decisive and certainly not an exclusive, role. The increases were sometimes equal to the increase in the CPI, sometimes greater, sometimes lower. Applying by way of analogy the approach of the International Court of Justice one may note that the facts "disclose so much uncertainty and contradiction, so much fluctuation and discrepancy ... that it is not possible to discern in all this any constant and uniform usage, accepted as law..." (Asylum case, ICJ Reports 1950, p. 277).

109. The Tribunal therefore concludes that there did not exist in 1979, at the time of alleged non-observance of the contracts of employment or terms of appointment, any decision or practice to automatically increase salaries to at least equal the rise in the cost of living so as to form part of the conditions of employment. From this it follows that the Tribunal need not consider another argument advanced by the Applicants, namely, that they had agreed to enter the service of the Bank in the expectation of a guaranteed maintenance of the real value of their remuneration, and that the Bank did not have the right to disappoint this expectation. As already stated, no particular importance can be attached to such subjective considerations. In any event, there could

have been no reasonable expectation of the maintenance of a decision or practice which did not exist.

110. Accordingly the Bank was free in 1979, as it had been at any time, to choose the method which appeared to it the most appropriate for achieving the objectives of its personnel policy as defined by the Articles of Agreement. The Kafka Report recommended recourse to a “comparator” method consisting of a mixture, in equal parts, of the public and private sectors in the United States. In order to ensure that the Bank would be able to attract high quality personnel including candidates from countries with high pay levels, the Report suggested adding a premium of 10% to the levels of remuneration produced by this method. On the basis of these recommendations the Executive Directors decided on May 25, 1979 to give a 9.5% increase in net salaries effective March 1, 1979, explaining that “this is in line with average real pay increases of the U.S. private sector comparators over the past year”. By a circular of March 14, 1980, the staff was informed that, pending the outcome of the survey commissioned from a consulting firm it had been decided to award an increase of 8.3%, effective March 1, 1980, which could be revised retroactively taking account of the results of the survey. This increase was granted “in the light of compensation pay movements and the continuing high rate of inflation.” In taking this decision, the Circular added, “a number of factors were taken into account ... General information on pay trends in Germany and France was made available to Executive Directors. The change in the Washington CPI from February 1979 to February 1980 was also presented.”

111. In holding that the conditions of employment of staff members did not in 1979 contain any rule of law relating to the method of adjustment of salaries or to the taking into consideration of certain factors in preference to others, the Tribunal is not asserting that the conditions of employment contain no rules whatsoever regarding salary adjustment. True, neither the letters of appointment and acceptance nor the Articles of Agreement, nor any written rule or regulation, include any provision requiring the Bank as a matter of law to make periodic adjustments of salaries. However, the Tribunal considers that a consistent practice of periodic adjustment has been established, and that the Bank makes these adjustments out of the conviction that it is legally obliged to do so. In his Memorandum to the Executive Directors dated April 19, 1972, the President wrote:

> “It is by now our established practice to review the staff compensation programme annually in early spring with a view to introducing whatever changes may be appropriate effective May 1.”

Since then, this practice has been affirmed year by year, and the increases adopted in 1979 and 1980, as well as those decided upon since the filing of proceedings in the present case, have confirmed it. The circumstances within which certain Applicants have been recruited and, in particular, certain information provided to them at the time of their appointment further confirm the existence of this obligation.

112. The Tribunal considers in consequence that the Bank is obliged to carry out periodic reviews of salaries, taking into account various relevant factors. The Bank is under no duty to adjust salaries automatically to increases in the cost of living and it retains a measure of discretion in this regard. This does not mean that the rises in the cost of living in a period of inflation constitute a factor that can be ignored or disregarded in the exercise of that discretion. On the contrary, the established practice, and statements confirming that practice, have created a legal obligation to make periodic adjustments reflecting changes in the cost of living and other factors. In the opinion of the Tribunal such an obligation is a fundamental element in the Applicants' conditions of employment which the Bank does not have the right to change unilaterally. In this respect, the Tribunal takes particular note of the statement made in the Respondent's Joint Memorandum to the effect that:

> “It is still the intention of the Bank to adjust salaries periodically to reflect changes in various factors, including cost of living.”

113. The decisions now contested before the Tribunal are fully in accordance with the obligation of the Bank. The Tribunal concludes that, in adopting the decisions which the six Applicants contest, the Bank has not failed to observe the contracts of employment or terms of appointment of the Applicants.

DECISION:

For these reasons, the Tribunal unanimously decides to reject the applications.

E. Jimenez de Arechaga

/S/ Eduardo Jimenez de Arechaga
President

B.M. de Vuyst

/S/ Bruno M. de Vuyst
Executive Secretary

At Washington, D.C., June 5, 1981