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Programme budget for the biennium 2002-2003

Additional expenditures deriving from inflation and currency fluctuations

Report of the Secretary-General*

Summary

The present report has been prepared pursuant to paragraph 44 of General Assembly resolution 56/253, which requested the Secretary-General to submit an updated study on a comprehensive solution to the problem of additional expenditures deriving from inflation and currency fluctuations, taking into account General Assembly resolution 41/213. The report provides an update to earlier reviews, the conclusions of which have proven to be still currently relevant to dealing with this issue. Information previously recommended by the ACABQ for inclusion in subsequent reports on this subject has been taken into account in this report.

* The document was submitted late to the conference services without the explanation required under paragraph 8 of General Assembly resolution 53/208 B, by which the Assembly decided that, if a report is submitted late, the reason should be included in a footnote to the document.

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I. Introduction

1. The General Assembly in paragraph 44 of its resolution 56/253 of 24 December 2001, requested the Secretary-General to submit to the Assembly at its fifty-seventh session an updated study on a comprehensive solution to the problem of additional expenditures deriving from inflation and currency fluctuations, taking into account its resolution 41/213 of 19 December 1986.

2. Paragraphs 10 and 11 of annex I to Assembly resolution 41/213, concerning the contingency fund and additional expenditures, read as follows:

> "10. A comprehensive solution to the problem of all additional expenditures, including those deriving from inflation and currency fluctuation, is also necessary. It is desirable to accommodate these expenditures within the overall level of the budget, either as a reserve or as a separate part of the contingency fund set up in paragraph 8 [of annex I to the resolution]. The Secretary-General should examine all aspects related to the question and report, through the Advisory Committee on Administrative and Budgetary Questions and the Committee for Programme and Coordination, to the General Assembly at its forty-second session.
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> "11. Pending a decision by the General Assembly on the question dealt with in paragraph 10 above, the revised estimates arising from the impact of extraordinary expenses, including those relating to the maintenance of peace and security, as well as fluctuations in rates of exchange and inflation, shall not be covered by the contingency fund and shall continue to be treated in accordance with established procedures and under the relevant provisions of the Financial Regulations and Rules. The Secretary-General should nevertheless make efforts to absorb these expenditures, to the extent possible, through savings from the programme budget, without causing in any way a negative effect on programme delivery and without prejudice to the utilization of the contingency fund."

II. Updated review of the problem

3. The most recent comprehensive report on additional expenditures deriving from inflation and currency fluctuations was presented to the General Assembly at its fifty-first session (A/C.5/51/57). It was noted that this issue had been on the agenda of the General Assembly more than once, and had been the subject of extensive reviews and studies over the years. It was acknowledged that the problem was complex, and that no easy solutions existed. The present report recalls much of the earlier reviews, and provides an updated study taking into account the fluctuations in exchange rates and inflation experienced in recent years. In addition, information previously recommended by the Advisory Committee on Administrative and Budgetary Questions for inclusion in subsequent reports on this subject has also been taken into account.

4. Notable reviews of this issue date as far back as the early 1970s, when the Advisory Committee on Administrative and Budgetary Questions, the Administrative Committee on Coordination and the Working Group on Currency Instability reported on the subject. The Working Group, composed of 13 Member States designated by the President of the General Assembly, was to consider alternative solutions to

difficulties resulting from the effect of continuing currency instability and inflation on the budgets of the United Nations system. The General Assembly reviewed the alternatives outlined in the report of the Working Group (A/9773) and noted that it had found no generally agreed alternatives to the policies already utilized. More recent reports covering this issue include the reports of the Secretary-General to the General Assembly at its forty-second session (A/42/225 and Add.1), forty-fourth session (A/44/665) and the above-mentioned (A/C.5/51/57). Related reports were made by the Advisory Committee to the General Assembly at its forty-second session,[1] forty-third session (A/43/929), forty-fourth session (A/44/729) and fifty-second session.[2]

5. In the report submitted to the Assembly at its fifty-first session (A/42/225 and Add.1), the Secretary-General highlighted a number of relevant points. First, the magnitude of adjustments due to changes in rates of inflation and exchange and standard cost adjustments is such as to make it virtually impossible to foresee from the outset the level of expenditures in a biennium. Further, the magnitude of such changes can be such as to make any savings effected in the course of the implementation of the budget totally inadequate. Even if it were agreed that additional requirements arising from changes in rates of inflation and exchange and standard cost adjustments should be met through the reduction of programme activities, the level of savings that might be required and the inability of the Organization to effect such savings at short notice would force the adoption, on a continuing basis, of economy measures such as those in place at times of severe financial crisis. In the report, the Secretary-General noted that, while the continuation of the current methods of dealing with such adjustments appeared to be the least inconvenient approach, a reserve could be utilized to handle such adjustments and, on the basis of experience of the past few bienniums (1980-1981, 1982-1983 and 1984-1985), a provision of $125 million would not appear unreasonable.

6. In its related report,[1] the Advisory Committee expressed the view that the question merited further study and indicated its intention to look at the matter closely with a view to formulating specific recommendations to the Assembly at its forty-third session. In its report to the Assembly at that session (A/43/929), the Committee reviewed the practices of specialized agencies in this respect and outlined the variety of methods that were in use. The Committee concluded that there was an unavoidable cost to mitigating the effects of inflation and currency fluctuation and, faced with the situation, the Assembly might wish to consider the continuation of the current system, whereby the estimate of requirements is adjusted annually on the basis of the most recent forecast by the Secretary-General of inflation and exchange rates.

7. On the other hand, the Committee pointed out that, if the Assembly decided to proceed with seeking a comprehensive solution to the problem, a mechanism to achieve a greater degree of certainty than then existed could be explored. Such a mechanism could be the establishment of a reserve that would cover additional requirements due to currency fluctuation, non-staff cost inflation and statutory cost increases for staff. The Assembly, in its resolution 43/214 of 21 December 1988, agreed to the concept of a reserve that would cover additional requirements due to currency fluctuation, inflation in non-staff costs and statutory cost increases for staff; requested the Secretary-General to formulate a set of procedures for the operation of the reserve fund to be submitted through the Advisory Committee to the Assembly at its forty-fourth session; and agreed to address further at that time the question of setting up such a reserve for the biennium 1990-1991.

8. In response to that request, the Secretary-General prepared the report on the establishment and operation of a reserve fund (A/44/665), in which he stated that the purpose of the reserve fund would seem to be to minimize, during any given biennium, and to the extent possible, changes in the level of the programme budget resulting from variations in the forecast included in the programme budget in respect of currency fluctuation, inflation in non-staff costs and statutory cost increases for staff or, as stated by the Advisory Committee in its report (A/43/929), to achieve a greater degree of certainty than then existed. The report identified two possible ways to establish and fund a reserve: either as a separate fund outside the programme budget or as a section within the programme budget. In either case, the reserve would be funded through assessed contributions. The annex to the present document outlines the detailed procedures for the operation of such a reserve, as initially set out in A/44/665.

9. The Advisory Committee, in its related report (A/44/729), expressed a number of difficulties with the concept put forward by the Secretary-General, pointing out, for example, that the idea of financing the reserve fund from the outset through assessment would not allow Member States a more precise idea of the final total amount to be paid than was currently the case and, in addition, would result in advance payment for requirements that might or might not materialize.

10. The Committee recommended that consideration of a reserve fund should be deferred until the forty-sixth session of the Assembly, at which time it should be taken up again on the basis of a further report by the Secretary-General. The Assembly, in its resolution 44/200 B of 21 December 1989, decided to keep under review the question of a comprehensive solution to the problem of all additional expenditures, including those deriving from inflation and currency fluctuation, and to consider it again at its forty-sixth session. The Assembly did not, however, revert to the question at its forty-sixth session.

11. In its resolution 51/220 of 18 December 1996, the General Assembly requested the Secretary-General to prepare a comprehensive policy paper which would examine all issues related to the question of all additional expenditures referred to in paragraphs 10 and 11 of annex I to Assembly resolution 41/213. In the report prepared in response to that request (A/C.5/51/57), the Secretary-General noted that the adjustments of this nature required during the bienniums 1994-1995 and 1996-1997 confirmed the significance and volatility of such fluctuations. It was noted that the establishment of an outline of the programme budget and a contingency fund under General Assembly resolution 41/213 reflected the desire of Member States to know at the outset of a biennium the level of resources that would be required during that biennium. It was also noted that this goal had been partially achieved, and that the Secretary-General, through the outline, was given a guideline on which to proceed. It was further noted that while the initial level of the budget and the potential addition through the mechanism of the contingency fund were known in advance, subsequent changes due to inflation and currency fluctuation had given rise to automatic adjustment in the budget.

12. In order to ensure greater predictability and to minimize changes in the level of the programme budget resulting from these fluctuations, two possible alternative courses of action were envisaged in the report:

(a) The first would be to absorb the costs of increases resulting from inflation and currency fluctuation. In view of the amounts involved, the absorption of such costs would lead to a significant erosion in the real volume of resources available in the programme budget. The issue was compounded by the nature of currency fluctuations. Since these could not be foreseen in advance, and since the Organization was unable to effect savings of a significant magnitude at short notice, it would be necessary to initiate at the outset of a biennium savings measures such as those that had been required to comply with resolution 50/214 of 23 December 1995 in the current biennium. This alternative did not appear desirable;

(b) The second possible course would be the establishment of a reserve fund as initially envisaged by the Secretary-General in his report to the Assembly at its forty-fourth session (A/44/665). The reserve could be funded from assessed contributions and replenished through savings due to variations in the forecast included in the programme budget in respect of currency fluctuation, inflation in non-staff costs and statutory cost increases for staff or through further assessed contributions, as necessary.

The annex to the present document outlines the detailed procedures for the operation of such a reserve as set out in A/44/665.

13. It was acknowledged that the disadvantage of such a system would be that Member States could be presented with an unnecessary financial burden, having to pay in advance assessments that might prove to be unnecessary. It was noted that, under the circumstances, the existing mechanism for dealing with inflation and currency fluctuation might still be the most appropriate.

14. The Advisory Committee on Administrative and Budgetary Questions, in its related report,[2] shared the Secretary-General's view that the absorption of such costs would lead to an erosion in the real volume of resources available, and therefore did not appear to be a desirable alternative. At the same time, it recalled its difficulty with the idea of financing a reserve from the outset through assessment, even before the need for recourse to it had been identified. The Advisory Committee concurred with the Secretary-General's conclusion that under the circumstances, the current mechanism for dealing with inflation and currency fluctuation might still be the most appropriate. In its decision 54/481 of 15 June 2000, the General Assembly took note of the report of the Secretary-General (A/C.5/51/57) and of the related report of the Advisory Committee,[2] and requested the Secretary-General to keep the Assembly informed of issues pertaining to inflation and currency fluctuation in the context of the budget performance reports.

15. In reporting on the subject to the General Assembly at its fifty-second session, the Advisory Committee noted that a breakdown of the increases and decreases attributable in recent bienniums to currency fluctuations, inflation in non-staff costs and statutory increases for staff should be considered important and relevant information. It recommended that this information be included in future reports on the subject. This information is summarized in table 1 below in the recommended format, covering the bienniums 1996-1997, 1998-1999, 2000-2001, and 2002-2003.

Table 1
Adjustments for currency, inflation and standard costs fluctuations
(Millions of United States dollars)

Biennium	*Currency fluctuation*	*Non-staff costs inflation*	*Staff costs inflation*	*Total*
1996-1997	(0.28)	38.42	54.34	92.48
1998-1999	(127.49)	(24.56)	(49.48)	(201.53)
2000-2001	(143.63)	40.54	74.69	(28.40)
2002-2003[a]	(11.80)	39.97	112.53	140.70

[a] As reflected in the initial programme budget.

16. The information outlined above reconfirms the outcome of earlier reviews on the experience of previous periods — required adjustments are unpredictable and can be quite significant. Net adjustments for these factors over recent periods range from an adjustment downwards of $201 million in the biennium 1998-1999 to an adjustment upwards of $140 million in the initial budget for the biennium 2002-2003. The table shows that, apart from highly volatile currency fluctuations, inflation can also be a significant factor in required adjustments. Further, previous studies have shown that apparent trends can be easily reversed from one appropriations stage to the next for a given biennium (i.e. from the proposed budget, to the initial budget, to the first performance report and to the final appropriations).

17. The Advisory Committee also requested[2] that subsequent reports on the subject provide information on the share of the United Nations budget disbursed in the principal currencies. Table 2 below provides the share by currency of disbursal as budgeted over the bienniums 2000-2001 and 2002-2003.

Table 2
Estimated share of the regular budget by currency of disbursal

	2000-2001	*2002-2003*
Currency	*(percentage)*	
United States dollar	56.87	60.22
Swiss franc	21.75	20.13
Euro[a]	4.57	4.04
Thai baht	2.62	2.31
Chilean peso	2.92	1.96
Mexican peso	0.53	0.42
Ethiopian birr	3.14	3.11
Kenyan shilling	1.48	1.48
Lebanese pound	2.23	2.12
Trinidad and Tobago dollar	0.18	0.18
New shekel	2.97	3.07
Indian rupee	0.73	0.97
Total	**100.00**	**100.00**

[a] Euro share for the biennium 2000-2001 reflects the combined share of the Austrian schilling and Netherlands guilder.

18. From the information above, it can be seen that resources are budgeted for disbursal in two main currencies, the United States dollar and Swiss franc, which together make up about 80 per cent of the regular budget. A number of other currencies listed above make up the remaining 20 per cent. The Advisory Committee on Administrative and Budgetary Questions reviewed a variety of methods used by the agencies to deal with the effects of fluctuations in the rates of exchange and inflation (see A/43/929). One such method, split assessments, involves the collection of contributions in more than one currency. The Advisory Committee pointed out that requiring part of assessments to be paid in currencies other than the United States dollar, while mitigating losses in times of a falling United States dollar, would work the other way in times of a strengthening dollar. The Advisory Committee noted that there were many practical difficulties associated with mixed currency or split assessments including, in the absence of large reserves, problems associated with cash flow (e.g. not receiving currencies in the right mix for current cash needs).

19. The information outlined above does not give rise to any new solutions to the problem of additional expenditures deriving from inflation and currency fluctuations. Much of the earlier reviews and analysis, available to the General Assembly prior to its most recent decision on the subject (54/481), remain relevant to this issue. In reporting to the General Assembly at its forty-third session (see A/43/929), the Advisory Committee noted that the operations of the United Nations are global, and that no way had yet been found to control inflation or currency movements on a global basis or to predict those factors with absolute certainty. In revisiting the issue of a comprehensive solution to these additional expenditures, it must be noted that this observation still holds true.

20. The absorption of such expenditures, as previously concluded by the Secretary-General and concurred with by the Advisory Committee, is not an alternative that can be practically implemented. Any attempt to absorb such expenditures would severely impact programme implementation. Using the current approved budget as an example, the calculation in table 3 below shows that absorption of an adjustment of $125 million, at the time of the first performance report, would require a reduction of about one third of activities which utilize non-staff costs and are programmed for the second year of the biennium.

Table 3
Example calculation of adjustment in case of absorption[a]

	United States dollars
Initial budget (for 2002-2003)	2 625 178 700
less requirements for 2002	1 365 000 000
Balance of approved budget	**1 260 178 700**
less staff costs for 2003[b]	917 080 900
Balance of approved budget	**343 097 800**
Adjustment to be absorbed	125 000 000
Adjustment as a percentage of the balance of the approved budget	36.43

[a] Amounts are based on the initial budget for the biennium 2002-2003 solely as an example and do not reflect required adjustments related to that period.
[b] Staff costs represent the most significant obligation of the Organization which cannot be terminated at short notice. Amount includes staff assessment.

21. The example above outlines the calculations which would relate to the absorption of an amount of $125 million to account for required currency and inflation adjustments at the stage of consideration of a first performance report. The example shows a balance of the approved budget amounting to $1.26 billion after accounting for first-year requirements. Where absorption of an adjustment amount of $125 million is required, the reduction in programmed activities would likely be implemented in a phased manner. While the amount of $1.26 billion would be available for second-year requirements, this amount would largely cover staff-related contractual obligations which cannot be terminated at short notice. After accounting for contractual obligations (such as staff costs), the required absorption of $125 million could only be implemented during the remainder of the biennium through, at least, a one-third reduction in objects of expenditure (and related activities) for which no contractual obligations exist and which can be terminated at relatively short notice. These calculations show that the impact on programmed activities would be considerable, and that the absorption of adjustment amounts for currency and exchange rates cannot be viewed as a practical solution in dealing with this issue.

22. Consequently, the use of a reserve fund remains the only practical alternative of the previously recommended methods. While the establishment of a reserve fund would not provide greater predictability, it would allow a mechanism to budget for potential costs of this nature at the outset of a biennium. Should the General Assembly wish to utilize this method, the procedures outlined in the annex to the present report may be implemented. These procedures, as envisaged in A/44/665, are still appropriate for the operation of such a reserve. At the same time, the overall stability gained through the operation of a reserve would still have one main disadvantage: Member States would have to pay in advance for requirements that might or might not materialize. Rather than incurring such a cost at the outset of each biennium, the continuation of the current system, whereby the estimate of requirements is adjusted annually on the basis of the most recent forecast by the Secretary-General of inflation and exchange rates, could be considered. Inherent to the continuation of the current system would be a commitment on the part of Member States to the implementation of the real level of budgeted activities. While the utilization of the gains received in periods of strengthening of the United States dollar does not normally present a difficulty, there must be a willingness to meet, through additional appropriations, the additional requirements that arise in some periods if damaging programme cuts under the heading of absorption are to be avoided.

III. Recommendation

23. **The General Assembly may wish to take note of the present report**.

Notes

[1] See *Official Records of the General Assembly, Forty-second Session, Supplement No. 7* (A/42/7).

[2] See ibid., *Fifty-second Session, Supplement No. 7* (A/52/7/Rev.1).

Annex

Guidelines for the operation of a reserve fund for adjustments resulting from variations in the forecast included in the programme budget in respect of currency fluctuation, inflation in non-staff costs and statutory increases for staff[a]

1. The programme budget shall contain a section that will include provisions for adjustments that may be required as a result of variations in the forecast included in the programme budget in respect of currency fluctuation, inflation in non-staff costs and statutory cost increases for staff. This section shall be entitled the "Reserve Fund".

2. In off-budget years, the General Assembly shall decide on the level of the Reserve Fund, which will be included in the proposed programme budget for the next biennium.

3. The Secretary-General shall, prior to each appropriation stage, submit to the General Assembly for its approval the adjustments required as a result of variations in the forecast included in the programme budget in respect of currency fluctuation, inflation in non-staff costs and statutory cost increases for staff.

4. The adjustments approved by the General Assembly will be reflected in the appropriations. When such adjustments result in additional requirements, these will be reflected under the relevant sections of the programme budget concerned and will be accompanied by a commensurate reduction in the Reserve Fund section of the programme budget. When such adjustments result in reductions, these will be reflected under the relevant sections concerned and will be accompanied by a commensurate increase in the Reserve Fund section up to the level initially approved for the section. Any surplus would be classed as miscellaneous income.

5. If the amount of funds in the Reserve Fund section of the programme budget is insufficient to provide for the additional requirements resulting from variations in the forecast included in the programme budget in respect of currency fluctuation, inflation in non-staff costs and statutory increases for staff, the Secretary-General, in submitting the proposed adjustments to the General Assembly, shall make proposals regarding the manner in which the shortfall should be covered.

6. At the end of the biennium, any residual amount in the Reserve Fund section shall be surrendered in the context of the final appropriations for the biennium.

[a] As proposed in the report of the Secretary-General to the General Assembly at its forty-fourth session (A/44/665, para. 19).