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AGENCY SUPPORT COSTS

Note by the Administrator

In response to decision 79/40, 1/ adopted by the Governing Council at its twenty-sixth session, the Administrator appointed Mr. J. I. M. Rhodes as the consultant on support costs. The Administrator is transmitting herewith the report on support costs which was prepared and submitted to him by Mr. Rhodes.

1/ See Official Records of the Economic and Social Council, 1979, Supplement No. 10, (E/1979/40), chap. XXI.

AGENCY SUPPORT COSTS

A study commissioned by the Intergovernmental Working Group on Support Costs of the UNDP Governing Council

ACKNOWLEDGEMENTS

In the course of the study I visited most of the executing agencies and wish first to express my appreciation of the readiness with which they responded to my inquiries. Neither the heads of the agencies nor their staffs showed any of the impatience which might have been their natural reaction to my intrusion into a field which, over the years, has been so thoroughly ploughed.

I am also indebted to the UNDP Administrator and those of his staff who likewise spared no effort to facilitate my work whilst at all times respecting my status as an independent consultant.

As will become apparent, I have drawn on material contained in reports by the Joint Inspection Unit (JIU), the Advisory Committee on Administrative and Budgetary Questions (ACABQ), and the Administrative Committee on Co-ordination (ACC). I gratefully acknowledge these sources.

Above all my thanks are due to my three assistants. Mr. R. Byrnes and Mr. E. W. Herman helped me to glean the facts and separate the wheat from the chaff. They responded unstintingly to all my demands and whilst the views and conclusions contained in the report are my own, they derive from our collective labours. Miss A. B. Bailey organized the office most competently and piloted us through the intricacies of the UNDP administrative machine. She also made a substantive contribution to our internal discussions before devoting her considerable technical skills to the preparation of the report.

New York
March 1980

J. I. M. Rhodes

PROLOGUE

1. Underlying my terms of reference 1/ are two main themes. The first is concerned with the allocation of support costs among the organizations involved in the administration of the technical co-operation programmes of the United Nations system; the second is concerned with ways and means of reducing such costs. Although they are interrelated, I shall deal with these two facets of the question separately.

2. In the process of pursuing these main objectives, I am required to address myself to a wide range of considerations reflecting a variety of interests. Some of these considerations are not easy to reconcile one with another. Whilst

1/ See Official Records of the Economic and Social Council, 1979, Supplement No. 10 (E/1979/40), annex III, Part II, annex.

therefore I have tried to take account of them all, I have necessarily had to place more emphasis on some than on others. I have, for example, attached particular importance to the requirement in the mandate of the Working Group that any system should be "easy to understand and simple to operate". The need to recognize the principle of full partnership between UNDP and the agencies has also been uppermost in my mind.

3. The decision of the Working Group which defined my terms of reference also emphasized the limited nature of the review which I was asked to undertake. This inhibited me from asking the agencies to supply statistics which could only be obtained by the introduction or reintroduction of a cost measurement system. In any event, such a course would have been impracticable within the time scale imposed by the Working Group. I do not think this limitation impeded my work, even though the last authoritative estimate of support costs came from a cost measurement exercise undertaken by several of the major agencies in 1973.

4. As my inquiries progressed, I became increasingly aware of the wealth of facts and figures already available on the subject of support costs. I could only conclude that it is perhaps a surfeit rather than a dearth of information which has retarded a settlement. What I have tried to do, therefore, in my report is to distill the wisdom of those who have trodden the path before me and to relate it to my terms of reference. At the same time I have updated some of the information, incorporated some new material and superimposed my own views and impressions gained from the many interviews held with those intimately concerned with the operation of the technical co-operation system. In so doing, I have tried to maintain a fair balance between the views and interests of all the parties engaged in the joint venture of technical co-operation.

5. A short and admirable resumé of the background of the subject was prepared in December 1977 by the Administrator of UNDP for the Working Group and, for the benefit of any newcomers, I am appending a copy to my report. 2/

6. For convenience I have used the term "agencies" to describe all the organizations which execute technical co-operation projects.

Chapter I

7. In this chapter I shall examine the considerations which bear on the actual level of support costs.

Efficiency

8. That efficiency is a material factor is almost axiomatic. The more efficient an organization, the more cheaply it will deliver a given level of services. It

2/ See DP/WGOC/CRP.1.

would be surprising if all the organizations in the United Nations system were equally efficient at running technical co-operation programmes and my inquiries suggested that differences do indeed exist. In the time at my disposal it was not possible to establish the cause of those differences or to relate the cost effectiveness of the agencies to the quality of their work. Size did not appear to be the dominant factor. It was certainly not self-evident, for example, that the United Nations Department of Technical Co-operation for Development was more cost-effective than some of the smaller and more tightly-knit agencies. In the course of my inquiries I found nothing to suggest individual agencies apply different tests of efficiency to that part of their activities concerned with technical co-operation. The broader question of their over-all efficiency hardly fell within my terms of reference. Machinery for detecting organizational weaknesses and other deficiencies already exists and the reports submitted by such bodies as the auditors, the JIU, and management survey teams provide an opportunity for Governments to exercise broad control and press for remedial action where appropriate. Whether or not more can or should be done to account more consistently for extrabudgetary funds expended on support activities is a matter on which I shall touch when I come to discuss paragraph 4 (c) of my terms of reference.

Project content

9. The three main components of the majority of projects are the provision of project personnel, equipment and training. Whilst proportions vary among agencies, in 1978 the over-all dimensions were approximately as follows:

Project personnel	51%
Equipment	25%
Training	9%

The remaining 15 per cent relates to projects executed by subcontract and to miscellaneous items, none of which is sufficiently large to affect significantly the question at issue. Each of the three main project components listed above requires both technical and administrative support by the agency charged with its provision. In the following paragraphs I shall discuss the main features peculiar to each component.

Recruitment and servicing of project personnel

10. The process involves four main stages:

- (a) Formulation of the job description;
- (b) Selection of suitable candidates;
- (c) Securing the agreement of the host Government to the selected candidate;
- (d) Appointment and servicing of the acceptable candidate.

11. The agency is responsible for the first two and the fourth stages listed above and can to some extent control the cost. Most agencies maintain a roster of prospective candidates but the recruitment of personnel is not like ordering nuts and bolts from a catalogue. Even if the candidates with the right combination of expertise, nationality and language can be identified, they may not, for a variety of reasons, be prepared to accept the appointment or they may not be available at the right time. The increasing emphasis on the need for specialists has compounded these difficulties and last year the Governing Council asked the Administrator to consult with the agencies on how to accelerate the recruitment of experts. 3/ In some agencies a number of experts are retained on a semi-permanent basis and are transferred from project to project. This reduces recruitment and certain other costs which the agencies would otherwise incur but gives rise to the so-called "hiatus payments" which are made to tide experts over between assignments.

12. The duration of an appointment has an important bearing on the ratio of support costs to project cost. More work is entailed in recruiting three experts for a period of one year each than one expert for three years. Yet the amount received by way of support costs would be about the same in each case. This effect may be offset to some extent by the fact that it is easier and therefore less costly to attract consultants for short-term appointments. Their conditions of service are also simpler than those of experts and consequently less costly to administer. My inquiries among the agencies revealed that the demand for short-term consultants has increased in recent years. 4/ For example in UNIDO the average duration of such assignments fell from 6.2 months in 1971 to 4.6 months in 1978. This trend seems likely to be accentuated as technical co-operation among developing countries and government execution feature more prominently in the programme.

13. The agencies have less control over the third stage listed in paragraph 10 - the acceptance of the selected candidate by the host country - which can be a prolonged process and can add considerably to the cost of recruitment. The serious effect on cost of delaying acceptance of candidates was stressed in paragraph 89 of the JIU "Report on some aspects of backstopping of technical co-operation activities in the United Nations System". 5/ The Governing Council has asked Governments to make every effort to facilitate early clearance. 6/ A positive response to that request would reduce costs.

Provision of equipment

14. There is a large measure of agreement amongst the agencies that, on average, it is less costly to provide equipment than it is to recruit and service personnel.

3/ Governing Council decision 79/48 of 10 July 1979.

4/ This trend has been recognized by the Administrator: see DP/392, para. 71.

5/ JIU/REP/77/6.

6/ Governing Council decision 79/48 of 10 July 1979.

But the average conceals wide variations of costs which are dependent upon both the size and nature of the purchases. Nor is size in itself necessarily a true criterion of cost. A big order for equipment may be simple or complex; it may demand original specifications or it may be purely repetitive; it may be satisfied by being virtually bought "off the shelf" or it may require considerable research into availability of supply. Conversely, and for the same reasons, a small order can be easy or difficult to satisfy. Whilst, however, any generalization on the cost of individual purchases would be suspect, there is little doubt that if the administrative costs involved in the purchase of equipment were to be considered in isolation, the current rate of reimbursement of 14 per cent would be over-generous. This view is reinforced by the fact that until it was subsumed in a flat rate in 1965, the rate for equipment purchases from the Special Fund was only 3 per cent. Moreover, several agencies still apply a lower scale of charges for non-UNDP projects containing large equipment components. For example, the FAO scale for Trust Fund projects is as follows. 7/

Nature of component mix

Rates charged for support costs

"Supplies/equipment" component equal to 70 per cent or more of net project value (excluding project servicing costs).

5 per cent for the totality of the project.

"Supplies/equipment" component equal to at least 40 per cent but less than 70 per cent of net project value.

5 per cent for "supplies" and "equipment",
14 per cent for other components.

15. It should not however be assumed that the present arrangement necessarily results in excessive reimbursement to the agencies, since the current rate of 14 per cent must be viewed as an average covering all the components of a project. Whether or not it is appropriate to average such disparate elements is a question which I shall discuss later in this report.

Training

16. Training is an important part of many UNDP-financed projects and in 1978 project expenditure on training approached \$40 million. The agencies also carried out a heavy volume of training activities financed from non-UNDP sources. Training of individuals usually takes the form of fellowships or study tours abroad. Group training requires the preparation and conduct of seminars, symposia, training courses and workshops. In either case the amount of technical and administrative support required is usually considerable, no matter what the source of funding. Candidates have to be sought and screened, places have to be found for them, travel and stipends have to be arranged, and in the case of group training a venue has to be found, teachers or instructors provided, and sometimes equipment made available. 8/ Many of the difficulties that arise are outside the

7/ FAO Manual.

8/ For a review of fellowships in the United Nations system, see JIU/REP/76/1.

control of the agency. I have no reason to suppose that the cost to an agency is very different from that of recruiting and servicing project personnel.

Impact of the over-all size of the technical co-operation
programme administered by an agency

17. Two aspects of this question require separate attention. Firstly, is extra cost involved in administering a small technical co-operation programme? Secondly, can economies of scale be achieved when administering a large technical co-operation programme?

18. The answer to the first question is clearly in the affirmative if only because a minimal establishment must be maintained to administer even the smallest technical co-operation programme. The existing flexibility arrangements recognize that corrective action is necessary at this lower end of the scale to prevent the small agencies being placed at a disadvantage.

19. As one progresses up the scale from the minimum establishment required to support the smallest technical co-operation programme, the advantages which accrue become less easy to identify with precision. Some indirect administrative costs can be more thinly spread and an increase in the workload can for a time be handled by existing staff. When the limit of absorptive capacity has been reached, the work force must be expanded if quality is not to suffer and at that stage the process starts again. If however manpower is properly controlled, the new absorptive capacity generated by the influx of new staff is likely to be more limited. Depicted graphically the progression would not be a straight line but a series of steps decreasing in steepness until they became a virtual plateau. This presentation oversimplifies the matter since it does not allow for the intervention of other events which might be associated with the expansion of the technical co-operation programme. Specific examples of such events are ILO's need to enlarge its computer capacity and FAO's need to acquire rented accommodation to cope with their increasing technical co-operation programmes.

20. The assessment of possible economies of scale cannot be divorced from considerations of efficiency and organization. It is at least conceivable that efficiency and cost effectiveness suffer as the size of a bureaucratic organization increases. Economists have recognized that there may be an optimum size at which point a law of increasing returns gives way to a law of diminishing returns so that if a variable cost curve were drawn, it would be U-shaped. There are however too many variables to permit any generalization about the point at which the downturn might be expected to occur in any organization. Moreover, the over-all size of the organization may be deceptive for the purpose of attributing economies of scale if it is compartmentalized or decentralized.

21. I would make one further point. If the cost of support is dependent upon the size of the programme, it would seem illogical to look only at the UNDP programme in this context. Economies or diseconomies of scale would depend on the total technical co-operation programme.

Variation in delivery

22. One has to look back no further than the UNDP financial crisis of 1976/77 to discern the violent effect which variations in delivery have on the ratio of support costs to project costs. Figures are not available for all agencies but two examples will serve to illustrate the point.

	<u>UNDP project expenditures (\$US million)</u>	<u>Support costs as a percentage of project expenditures</u>
<u>FAO</u>		
1975	117.1	13.8
1976	105.5	13.7
1977	80.1	17.4
1978	105.4	15.8
<u>UPU</u>		
1975	2.2	38.9
1976	1.4	50.6
1977	0.5	107.0
1978	1.4	55.6

23. In the short term there is not much agencies can do to cut their costs when delivery declines sharply. Not only is it difficult and expensive to dismiss staff at short notice but it would also be imprudent to dispense with the services of trained staff if there is a reasonable expectation that they will be needed again in the near future. Some alleviation may be obtained by diverting the superfluous staff to other sectors where work may be expanding although such opportunities are clearly limited and, being fortuitous, cannot be catered for in the reimbursement formula. If severe strains are imposed by variations in delivery they should, in my view, be dealt with on an ad hoc basis.

Decentralization

24. The responses to my inquiries about the impact of decentralization on support costs were inconclusive. Some agencies felt that it reduced costs; others suggested that it might actually increase costs because it added another link in the chain of administrative and financial reporting. I would judge that it is in fact fairly neutral in its over-all impact on costs except where the point of decentralization is in a much higher or lower cost area than the headquarters of the agency. This assessment appears to be consistent with the views, based on

their bilateral experiences, expressed by the Nordic Governments 9/ in their comments on the JIU "Report on the role of experts in development co-operation".

Exchange rates and inflation

25. Both these factors play a significant role in determining the adequacy of the reimbursement for support costs. Project costs are not dependent on the cost of living at the headquarters of the executing agencies but on world-wide costs which on average affect all agencies in like measure. On the other hand, leaving aside the effect of decentralization, the costs incurred by an agency in support of its technical co-operation activities are largely determined by the cost of living prevailing at the seat of the agency. It is, therefore, evident that the cost of administering like projects must be greater for an agency situated in a high cost area than for one in an area where staff can be engaged much more cheaply. Moreover, there is no doubt that this feature has been greatly accentuated in recent years by the fall in the value of the dollar vis-à-vis the local currency used at several agency headquarters. This is illustrated by the table on the following page which compares the amounts of local currencies received by agencies in respect of each \$1 million of programme delivery in 1973 and 1980.

9/ DP/389, para. 39.

Effect of changes in exchange rates a/

January 1973 to January 1980

(Local currency equivalent of support cost
reimbursement on \$1 million of delivery)

Duty station	January 1973 <u>b/</u>		January 1980		Increase/decrease in local currency equivalent (%) <u>c/</u>
	Exchange rate	Local currency equivalent	Exchange rate	Local currency equivalent	
Geneva	3.80	532 000 SF	1.60	224 000 SF	- 57.9 (- 54.7)
Vienna	23.20	3 248 000 Sch	12.50	1 750 000 Sch	- 46.1 (- 42.0)
Paris	5.11	715 400 FF	4.05	567 000 FF	- 20.7 (- 14.6)
New York	1.00	140 000 \$US	1.00	140 000 \$US	- (+ 7.7)
London	.426	59 640 £	.449	62 860 £	+ 5.4 (+ 13.5)
Montreal	1.00	140 000 \$Cdn	1.17	163 800 \$Cdn	+ 17.0 (+ 26.0)
Rome	582.00	81 480 000 Lit	810.00	113 400 000 Lit	+ 39.2 (+ 49.9)

a/ United Nations operational rates.

b/ Calculated at 14 per cent for the purpose of comparison; the reimbursement rate was, in fact, 13 per cent in 1973.

c/ The figures in brackets show the actual increases or decreases taking into account both the currency and the reimbursement rate changes.

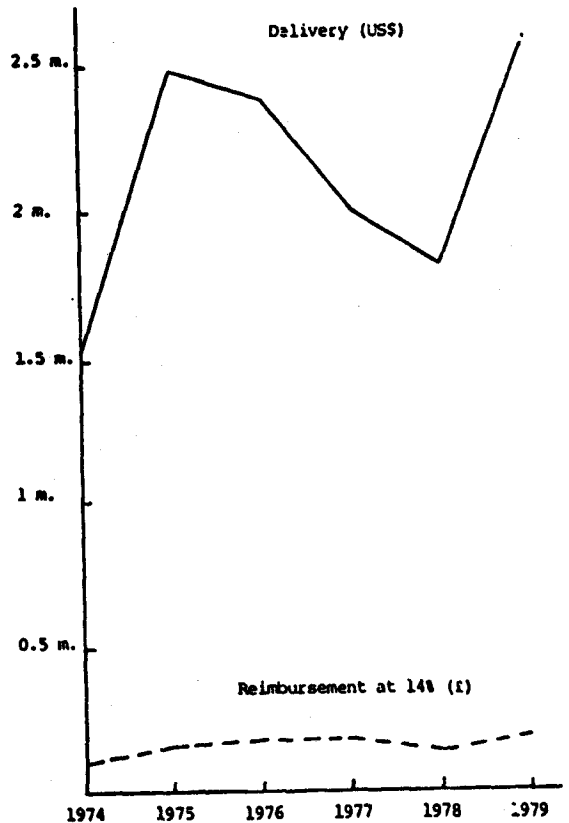
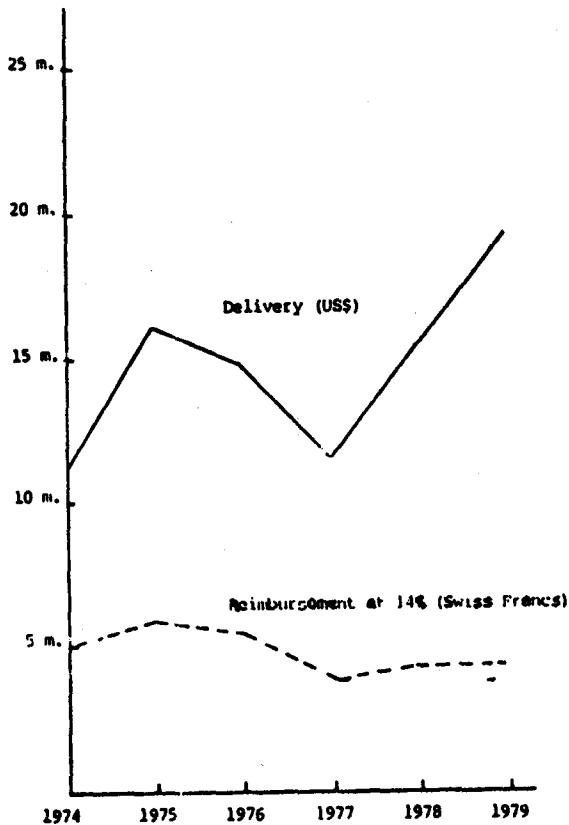
26. The following two actual cases can graphically illustrate how currency fluctuations disturb the relationship between programme delivery expressed in dollars and support cost reimbursement expressed in local currencies. The contrast between delivery and receipts is more marked for ITU because in the case of IMCO the pound sterling has fluctuated in both directions during the chosen period.

UNDP delivery, 1974-1979 and corresponding
Support Cost Reimbursement calculated at
14 per cent in local currency

(United Nations accounting rate at 1 January of each year)

ITU

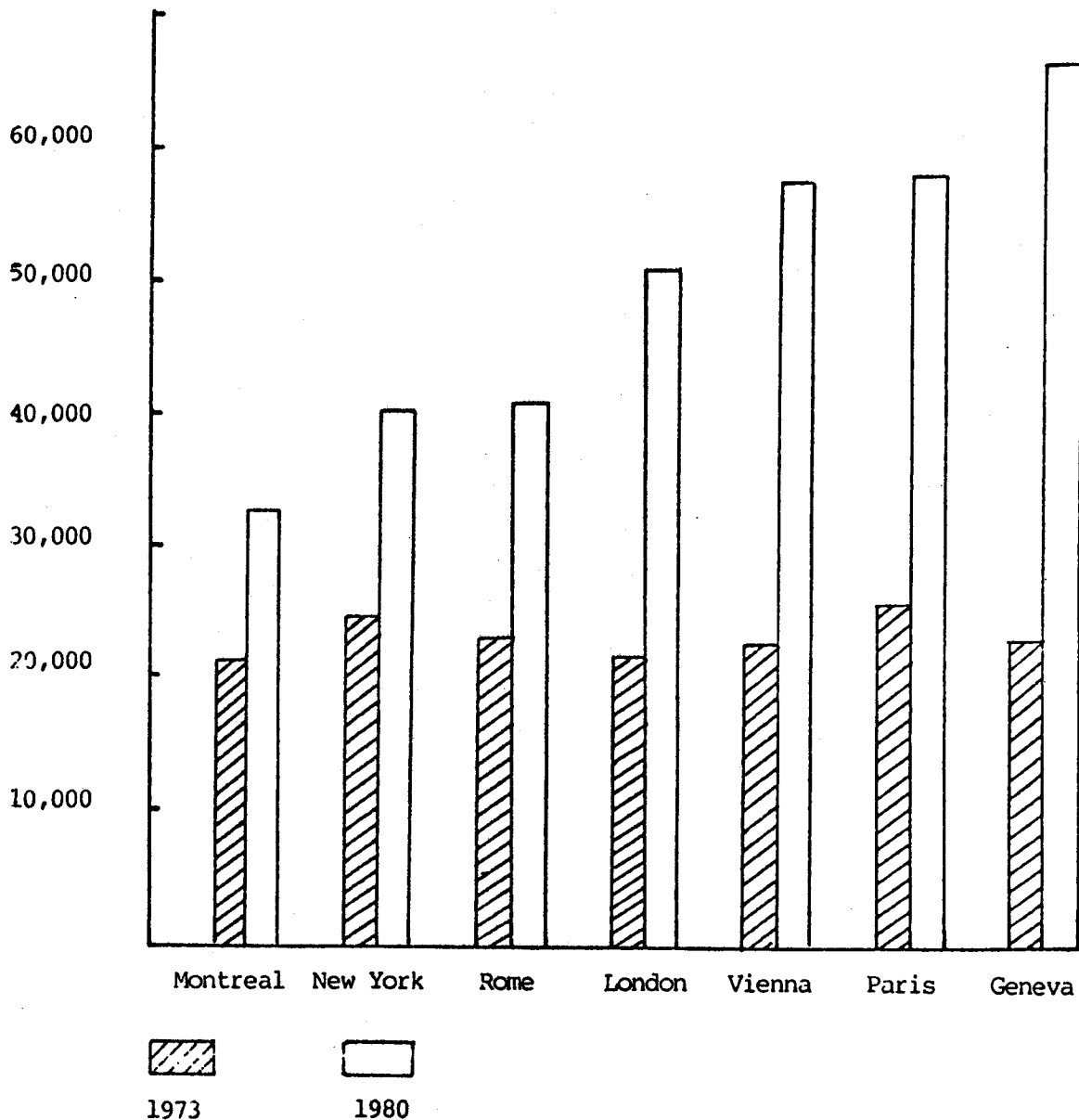
IMCO



27. Weak currencies and inflation, like strong currencies and price stability, tend to go hand in hand. The impact of variations in exchange rates cannot therefore be considered in isolation from the impact of inflation. The post adjustments used in the UN system for regulating salaries in dollar terms at different duty stations take account of both currency fluctuations and variations in the cost of living. It is therefore revealing to look at the current annual net salary in US dollars, including post adjustment, of a P.5 officer serving at the different Agency headquarters and the corresponding levels in 1973.

Total net remuneration of a P.5 Officer at step V with dependants as at 1 January 1973 and 1980

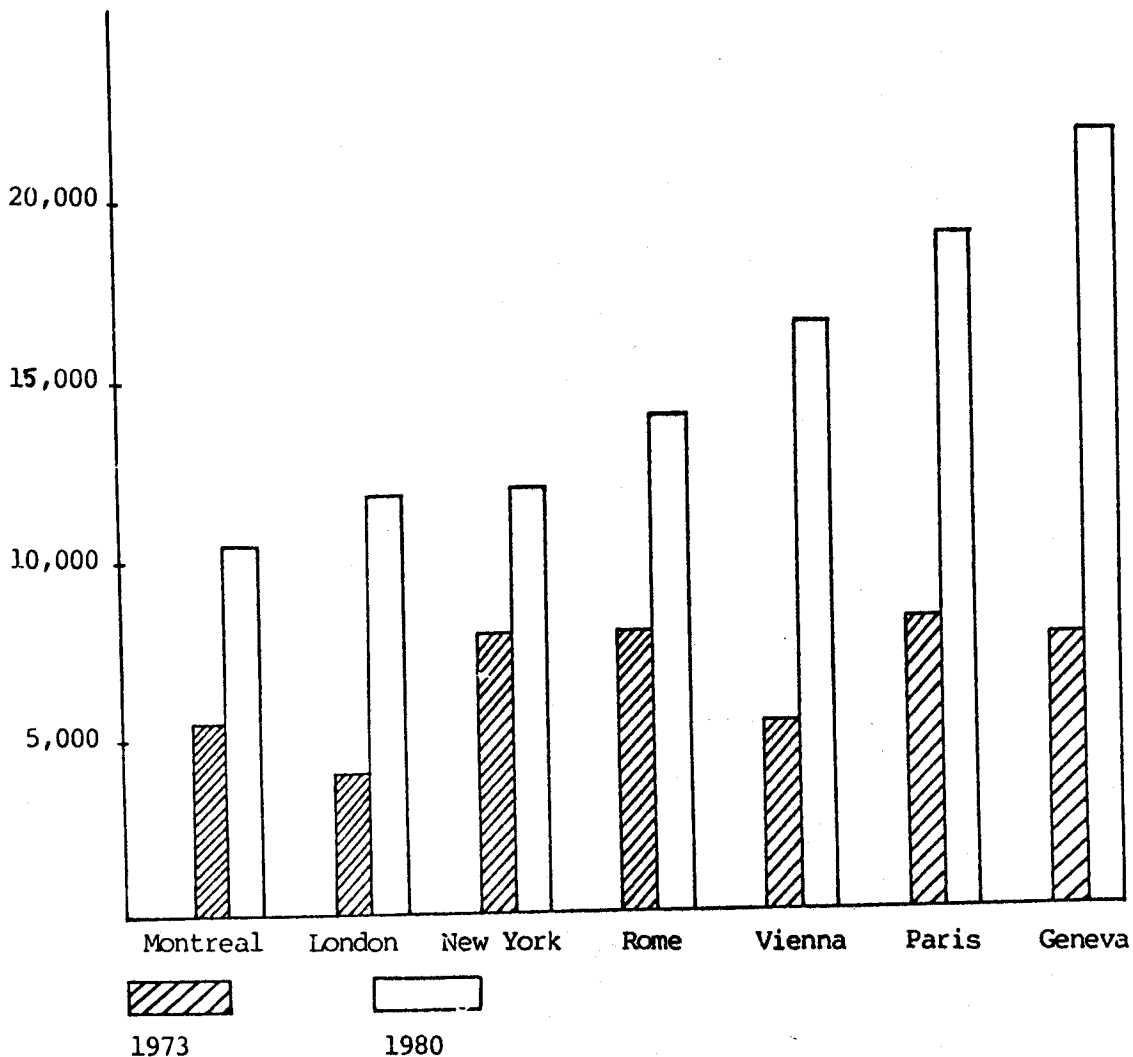
Total
net remuneration
in US dollars



A comparable diagram for a General Service officer a/ would appear as follows.

Total net remuneration of a New York based G-3 Officer
at step V with dependants or the equivalent position
elsewhere as at 1 January 1973 and 1980

Total
net remuneration
in US dollars



It is apparent from the foregoing that whereas there were differences in 1973, particularly in General Service salaries, some Agencies are now at a much greater disadvantage.

a/ This table is based on the salary of a G-3 officer in New York and a broadly equivalent officer at the other duty stations.

/...

28. To complete the picture, account must be taken of the effect of inflation on project costs. Rates of inflation vary widely from country to country and the pitfalls encountered when calculating a global index are legion. The UNDP currently assumes a global inflation rate of 8 per cent for project personnel. I will adhere to that rate and for the sake of simplicity apply it to the project costs as a whole, although world statistics suggest that it may be a conservative estimate. On that basis, if a programme cost \$10 million in 1973, it would cost about \$17 million in 1980. The costs reimbursed by UNDP in support of that programme would therefore have increased correspondingly from \$1.4 million to \$2.4 million. ^{10/} The following table shows the number of P-5 or General Service officers whose salary could be defrayed out of the reimbursements receivable at the two dates at the several locations.

Headquarters	P-5		G.S. ^{a/}	
	1973	1980	1973	1980
New York	57	60	176	198
Geneva	60	36	180	110
Paris	55	41	152	126
Rome	60	59	175	171
Vienna	62	42	259	144
Montreal	65	73	255	229
London	65	47	348	202

^{a/} Because of the difficulty of equating GS grades at the different duty stations, the vertical comparisons may be open to question; the horizontal comparisons are not however affected; they again relate to a G-3 officer in New York.

Subcontracting

29. Of the organizations executing sizable programmes, two, the World Bank and UNDP's own Office of Projects Execution (OPE) rely extensively on subcontracting. The other agencies make only limited use of this method of execution. Its proponents claim that it leads to a speedier execution of projects and that the saving of time compensates for any apparent extra cost. Those less well disposed to the method claim that not only does it involve extra cost but that the project tends to fit less readily into the development programme and does not provide the feedback which is important in the context of an agency's over-all performance. There is no doubt some truth in all these assertions but no one with whom I have discussed the matter denies that there

^{10/} If the rate of reimbursement had been a constant 14 per cent; in 1973 it was actually 13 per cent.

is at least a limited role for subcontracting, more particularly where some very specialized service or innovative work is required. Where this method is adopted the overt cost of support is undoubtedly less than 14 per cent. The World Bank estimates that the cost of providing support for subcontracted projects averages 10 per cent and the special over-all reimbursement rate of 11 per cent which it receives from UNDP takes account of that fact. The OPE estimates its support costs at between 5 and 6 per cent. The discrepancy between the two figures is probably more apparent than real. There are differences in both the nature of the projects and the manner of providing and accounting for administrative services and back-up support. Estimates by other agencies confirm that subcontracted projects cost less to support than directly executed projects.

30. It should not, however, be deduced from these figures that the support costs incurred by agencies which rely on the traditional method of direct execution of projects are too high. Allowance must also be made for the concealed overheads and profit contained in the contract. For obvious reasons exact figures are hard to come by but estimates that these concealed costs may on occasion be as high as 100 per cent appear to be borne out by copies of contract documents which I saw in the course of my inquiries. Such information as is available about the rate of overheads charged by universities and quasi government institutions also points to figures of that order. Comparisons of this kind must be treated cautiously because a contractor's overhead may include items which would be charged to the project were it directly executed. Nevertheless, there is no doubt that the support costs incurred directly by agencies when they resort to subcontracting are only a small proportion of the total support costs.

Chapter II

31. My terms of reference required me to keep in view the mandate given to the Working Group by the Governing Council and in this chapter I shall relate the considerations reviewed in chapter I to that mandate. It was a prerequisite of the mandate that any new system would also take into account relationships with the assessed budgets and programmes of work of the agencies. I have interpreted this as precluding any drastic alteration of the relationships mentioned such as would occur if the present dichotomy were removed by the transfer of all support costs to the assessed budgets or vice versa. For ease of reference I have extracted and underlined in this chapter the several requirements of the mandate to which I shall now address myself in sequence.

32. "Any system should include a clear and detailed enumeration of the expenditures involved in the term support costs, and should reflect clearly the identifiable additional costs of administrative and technical support provided to technical co-operation programmes"

The interpretation of this part of my terms of reference has caused me considerable difficulty for the following reasons. Firstly, it appears to encompass two different concepts of support costs. Secondly, it does not make a clear distinction between the definition and the reimbursement of support

costs. Thus the first reference in the paragraph is to the current concept which envisages the definition and identification of all expenditures which may be incurred in support of technical co-operation programmes. No reference is made to the distribution of those expenditures between UNDP and the agencies although it might be assumed that the question of distribution is covered implicitly since that question is the main *raison d'être* for both the Working Group and my own appointment. It is also reflected in the emphasis placed upon the principle of full partnership between UNDP and the agencies. The second reference in this section of the mandate seems, however, to confound that reasoning since it appears to revert to the original concept which placed the emphasis on clearly identifiable additional costs of administrative and technical support and implied that these should be reimbursed in full. When that concept was propounded, technical co-operation constituted but a small part of the agencies' activities. The agencies could therefore reasonably be expected to absorb some of the small extra costs which arose without any visible impact on their budgets. As the proportion of extrabudgetary to regular budget expenditure rose, this concept became less tenable. Administrative and general services as well as technical services had to be expanded to cope with the growing volume of technical co-operation programmes which became an integral part of the agencies' activities. In consequence, the concept of "additionality" weakened and more emphasis came to be placed on the partnership principle. The course of this transition is sketched in paragraphs 30-35 of a report of the Secretary-General on services provided by the United Nations to activities funded from extrabudgetary resources. 11/

33. Perhaps I have read too much into this part of the mandate but I have stressed the distinction between the two concepts because I believe that a lingering allegiance to the original one may have been a source of confusion in recent years and may have contributed to the failure to reach a settlement. That concept served its purpose when technical assistance programmes were in their infancy but I think it has now outlived its usefulness and should be interred. Attention can then be focused on the main issue which is how much do agencies spend on providing support for technical co-operation programmes financed from extrabudgetary resources and to what extent should they be reimbursed bearing in mind the partnership concept.

34. As to the first of these questions, as the Working Group accepted, the definitions devised by the JIU 12/ or the similar but more detailed headings developed by the CCAQ 13/ provide the basis for a "clear and detailed enumeration of the expenditures involved". 14/ Whether or not it is necessary to assess these expenditures at frequent intervals and the manner of their distribution are matters which I shall discuss later.

11/ A/C.5/31/33 of 26 October 1976.

12/ JIU/NOTE/78/1, paras. 11 and 12.

13/ ACC/1979/R.69, annex VI.

14/ See also para. 3 of my terms of reference (E/1979/40, annex III).

35. "It should be so designed as to provide an incentive to all parties concerned to minimize support costs"

No one could quarrel with this objective. It must, however, be recognized that it will not be obtained by belabouring the agencies or depriving them of all the fruits of any increased efficiency which they may achieve. Incentives are sometimes depicted as carrots and sticks. If one removes the carrots only the sticks remain and these are hardly suitable instruments with which to influence the conduct of transactions between members of a family dedicated to peaceful co-operation. The fact that a reduction in support costs relieves the pressures on the regular budget is in itself something of an incentive to minimize such costs. I did, in fact, find evidence that in a number of agencies where the cost of executing technical co-operation programmes had been increasing and placing a heavier burden on the regular budgets, management had introduced economy measures which had cut costs and increased productivity. This is not however the complete answer and another approach, which is the removal of disincentives, therefore deserves consideration. Of projects completed in 1978 no less than 62 per cent overran the original estimates. Nor were the overruns marginal; compared with initial estimates totalling about \$11 million the final project costs exceed \$17.5 million, an increase of almost 60 per cent. These figures are misleading because it seems that some of the original estimates were in the nature of token estimates for preparatory work. No doubt, too, many of these excesses were unavoidable because of essential modifications to project specifications or because of rising costs. But those factors account only partially for the cost overruns which must have entailed frequent extension of expert appointments since personnel costs figure so largely in the project budgets. I do not suggest that the agencies consciously condoned these excesses. The present cost plus system does not, however, provide them with an incentive to resist pressures for extension of contracts. Such pressures may arise in the field because of the experts' over-enthusiasm for their project or perhaps from their not unnatural desire to preserve their livelihoods until a new appointment presents itself.

36. In this connexion, the following comments contained in the JIU "Report on the role of experts in development co-operation" are pertinent. 15/

"The duration of experts' assignments also has major implications for cost-effectiveness. Inspectors have noted a tendency to provide posts for periods longer than strictly necessary, and in particular to extend the duration of assignments sometimes more to suit the personal requirements of the experts than the needs of projects ... In order to limit the duration of experts' assignments to what is cost-effective JIU believes that a much more stringent approach is required in determining at the planning stage the time periods for which expert posts are provided and, at the execution stage, the duration of experts' contracts."

15/ JIU/REP/78/3, paras. 91 and 92.

37. The JIU returned to this theme more recently in its "Evaluation of technical co-operation activities of the United Nations system in Sri Lanka". 16/ In that report there is repeated reference to the need for better project planning and cost control with a view to reducing cost over-runs and project extensions. The following are a few of the relevant observations contained in the paragraphs indicated.

"The length of expert assignments should be carefully planned to reduce project costs to a minimum and any proposed extensions should be carefully reviewed" (para. 64 (d)).

"Greater emphasis is needed on cost control and realistic budget planning to reduce cost overruns and frequent budgetary revisions during project implementation" (para. 64 (e)).

"Projects which were extended or moved into a new phase not originally planned for still achieved their objectives to only a fair or poor degree even after the additional effort had been made" (para. 66 (d)).

"... Other officials believed that the UN system has been much too soft in managing its technical co-operation activities, acquiescing readily in almost any governmental request for aid (including project extensions) instead of, like many bilateral donors, regarding project proposals with a critical eye and insisting, once project agreements have been reached with the Government, that the projects be carried out according to the implementation schedule" (para. 109).

"There seems to be widespread concern, both in the Government and among UN system representatives, about experts who stay too long and serve too much as traditional 'generalist' advisers. There also appear to have been recent changes away from expert use and toward other assistance forms such as subcontracting, equipment, and training and fellowships. The Inspectors believe that the future use of expertise could be improved through more careful Government and UN system attention at the project planning stage to the number and length of expert contracts, possibilities for short-term consultancies, synchronization of expert posts with other inputs, and an emphasis on thorough justification before extending experts' contracts beyond original plans" (para. 152).

38. Vigilance by host Governments and resident representatives already provides some safeguards against unwarranted extensions. It would, however, be salutary if those safeguards could be buttressed with some kind of financial inducement to the agencies to keep the duration of expert assignments, and hence the costs, more in line with the original intentions and estimates. Such an arrangement would not be without its drawbacks; in particular it would be necessary to ensure that the original estimates were not inflated. Provision would also have to be

16/ JIU/REP/79/16.

made for legitimate revisions of estimates. On the other hand, an arrangement of this kind would discourage any tendency there might be to submit low and unrealistic estimates with a view to evading the more rigorous financial scrutiny which larger projects receive prior to approval. I shall return to this suggestion later in the report.

39. "It should include adequate flexibility to take account of the special situation of the different Agencies"

To meet this requirement allowance would have to be made inter alia for size, location, project content and method of execution. Catering for all the variables in a single formula which is simple to operate and easy to understand obviously presents problems but I shall examine the possibilities and alternatives more closely later in the report. Meantime, it is perhaps salutary to recall the reactions to the formula proposed by the JIU in its "Expanded preliminary note on a new system for agency support costs". That proposal was a genuine and ingenious attempt to cater methodically for all the variables. It failed however to meet the test of simplicity and ease of understanding. Any other all-embracing formula seems likely to suffer the same fate.

40. "It should reflect the fact that support for technical co-operation activities has increasingly become a function of the agencies, as well as the principle of full partnership between UNDP and the Agencies in accordance with the consensus of 1970"

This requirement presents less difficulty. My inquiries confirm that the agencies not only accept the principle of full partnership but recognize that their technical co-operation activities are complementary to and benefit their regular budget programmes. How else indeed can one explain the assiduity with which they compete for business which involves them in a loss. Acceptance of the principle of partnership was also implicit in the adoption of the present reimbursement rate of 14 per cent. Based on the cost measurement exercise undertaken in 1973 that rate purports to represent only the cost, on average, of project formulation (2 per cent) and non-technical backstopping (12 per cent). I would therefore only sound one note of caution. In some agencies there is in theory some constitutional or other restriction on the acceptance of support costs as a charge on the regular budget. In practice, in deference to the principle of partnership, these restrictive conditions are not rigorously enforced. The adoption of a formula which, by precisely quantifying the support costs borne on the regular budget, highlighted this discrepancy between theory and practice, would be counterproductive.

41. "It should be easy to understand, simple to operate and be applicable to all forms of technical co-operation activities in the United Nations system, including all types of cost sharing where necessary support costs of the Executing Agencies as well as UNDP have to be covered"

I have already commented on the difficulty of reconciling this call for simplicity with the need to recognize the impact of the several variables on agency costs.

The desire for a system applicable to all forms of technical co-operation is more easily accommodated. Within the United Nations system the 14 per cent formula at present in effect for UNDP-financed technical co-operation is frequently used as a standard for determining the support costs due to the agencies for activities financed from trust funds and other sources. This is because in most cases the nature and volume of the support work required are roughly comparable. However, the average rate of reimbursement actually received by the agencies from such sources is usually less than 14 per cent, due to the exceptions which they make in order to attract business or for other reasons. ^{17/} My inquiries suggest that both Governments and agencies favour a uniform approach to support cost reimbursement throughout the system regardless of the source of financing. I subscribe to that approach. It would be unrealistic to prohibit exceptions particularly in the case of very large projects to which special considerations, social or otherwise, may apply. Nevertheless, with rather more stringent application I think it should be possible to reduce such exceptions as do exist to a point where they do no more than prove the rule. In this connexion it would be necessary to decide whether the special arrangements made by UNFPA should continue to exist. In most of the larger agencies UNFPA pays for a secretariat infrastructure in lieu of reimbursing the agencies for their support costs on a percentage basis. In the United Nations both methods of defraying project support costs have been used but the infrastructure posts which were associated with non-operational projects are being phased out.

42. There is another exception to the flat rate of 14 per cent which is made by most, if not all, of the agencies. The rate of reimbursement for support costs applicable to associate experts is 12 per cent. Whilst this lower rate appears to be due in part to an historical accident it can be justified on the grounds that governmental participation in recruitment relieves the agencies of some of the costs. No violation would therefore be done to any new formula if this exception were allowed to continue.

Chapter III

43. In this chapter I shall respond to paragraphs 4 (a) and (b) of my terms of reference which required me to address the proposals for assessing the reimbursable support costs which were submitted to the Working Group by the UNDP Administrator and the Canadian delegation respectively.

44. I will consider first the Administrator's proposal together with the associated comments of the agencies. The essence of the proposal was that whilst retaining the basic rate of 14 per cent, lower rates should apply to those projects with a large equipment component and to those which are executed by subcontract. A regressive scale of reimbursement would come into effect at certain levels to reflect economies of scale, and the existing flexibility arrangements, in a modified form, would be retained in recognition of the special circumstances of the smaller agencies. Reimbursement of support costs relating to government-executed projects would be confined to specific inputs delivered by the agencies.

^{17/} See DP/WGOC/25 of 29 November 1978, para. 40.

45. With the exception of FAO and the United Nations, the reaction of the agencies to this proposal can best be described as one of reluctant acceptance. The smaller agencies would not have been affected significantly and some of the larger agencies were prepared to accept a diminution in their rate of reimbursement as the price of disposing of a question which had plagued them for many years. Both FAO and the United Nations objected to the provisions for the recognition of economies of scale and were also opposed to the formula because it would impose a further burden on the regular budget. The United Nations furthermore reiterated its long held view that a single rate of reimbursement with possible minor modifications to meet exceptional circumstances offers the best solution to the question of support costs. The attitude of these two agencies is understandable. As the two largest executors of UNDP projects they stood to lose most by the adoption of the Administrator's proposal and not unnaturally sought to emphasize one of its unavoidable weaknesses - the arbitrary nature of both the regressive rates and of the levels at which they took effect. Other agencies, located in high cost areas, pointed to the fact that the formula did not correct the serious imbalance caused by differences in the cost of living at the various headquarters. Those differences, as I have shown in an earlier chapter, put the agencies located in the high cost areas at a distinct disadvantage but they did not withhold their agreement to the proposed arrangement on that account. Perhaps they were more forthcoming than their colleagues or perhaps these different attitudes are no more than a reflection of the innate tendency to guard one's possessions more jealously than one's potential gains. In any event, as I have shown in chapter I, the provision made for economies of scale can be questioned on broader grounds. Therefore, although the Administrator's proposal was, in my opinion, a commendable attempt to bridge the gap between a simplistic and complicated arrangement, I do not think it should be resurrected in its entirety.

46. I come now to the formula presented in a note submitted to the Working Group by the Canadian delegation and contained in document DP/GC/XXVI/WGOC/CRP.2. It would be repetitious if I were to comment here in detail on the first two paragraphs of that note since my views on the various considerations discussed therein will be found elsewhere in this report. Sufficient to say that whilst I agree with much of what is said in those paragraphs I do have reservations about some of the assertions contained in the second paragraph of the note.

47. Turning now to the formula itself, the basic principle is abundantly clear. It is that the costs which an agency incurs in supporting the totality of its technical co-operation activities should be allocated between the sponsoring organizations in proportion to the cost of the projects executed on their behalf. In recognition of the partnership concept, the cost attributed to UNDP in this way would then be divided between UNDP and the agency according to a predetermined ratio.

48. Like Einstein's theory of relativity, the formula can be expressed very simply in mathematical terms.

$$P = C \times R \left(\frac{T}{D} \right)$$

where

P = UNDP support costs paid to the agency

C = Total support costs of the technical assistance programme of the agency

R = The ratio or "partnership share" of overheads associated with executing UNDP-financed projects (paid either by extrabudgetary or regular budget funds)

T = Total volume of UNDP programme executed by the agency

D = Total technical assistance programme administered by the agency.

49. Whilst I do not suggest that the formula presents the same conceptual difficulty as Einstein's formula, its apparent simplicity does, I fear, conceal some practical difficulties and deficiencies. In fairness, I should add that some of those difficulties and deficiencies are recognized in the list of disadvantages which the Canadian delegation incorporated in the note in order to give a balanced presentation of their proposal. In particular, attention is drawn to the fact that the formula does not take account of the component mix of projects or the method of execution. Neither, of course, does the existing formula and I would not therefore dismiss the Canadian formula merely on that account.

50. There are, however, two features of that formula which weaken its appeal. First, it assumes that the over-all cost to an agency of its technical co-operation activities can be calculated with a fair degree of precision. Although the Canadian delegation asserts that the formula avoids the issue of cost measurement, I fail to see how those over-all costs could be calculated without resort to some kind of cost measurement. This is particularly true in those agencies with fully integrated budgets and programmes. A second, and perhaps even more serious objection to the formula, is that it requires a precise determination of the proportion in which the support costs should be shared between the UNDP and the agencies, i.e. "R" in the equation. That would require an arbitrary decision, the taking of which would be fraught with the kind of difficulties which has bedevilled the question for the last 25 years. The prospect of securing agreement on a percentage of uniform application would in my opinion be remote. Attempts to negotiate different ratios for different agencies would only compound the difficulties, the more so because, as I explained in paragraph 40, some agencies are prohibited from overtly accepting support costs as a charge against their regular budget. For the above reasons I must regretfully withhold my support for the formula. Regretfully, because I sympathize with the underlying motives and recognize its merits as well as its imperfections.

51. I was also asked to comment on the impact of the Canadian formula on the agency budgets. The impact cannot in fact be quantified because it would depend primarily upon the selection of factor "R" in the equation. In the example quoted in the Canadian note, it is shown that one agency would break even if an 80 per cent ratio were used. A higher ratio would obviously increase UNDP's liability; a lower ratio would have the reverse effect. Nor would any one ratio have the same impact on all agencies. For example, using a ratio of 80 per cent,

if an agency's actual support costs exceeded 17.5 per cent of project delivery, it would gain from the application of the Canadian formula. If an agency's actual support costs were less than 17.5 per cent of delivery, it would lose by the application of the formula. The gains or losses of UNDP would be in the reverse order. The formula would therefore do something to redress the balance between agencies in high and low cost areas. It would however weaken such incentive to economy as there is under the present arrangement (see para. 35), since UNDP would have an open-ended liability for a fixed proportion of any support costs which an agency might incur.

Chapter IV

52. Under paragraph 4 (c) of my terms of reference I am required to address myself to "ways and means of instituting adequate arrangements and accounting systems in the executing agencies designed to generate cost data which would give a clear picture of actual support costs in respect of technical co-operation activities".

53. As is recognized by paragraph 3 of my terms of reference, the elements of support costs have been defined by the JIU. I see no reason to question those definitions, which do not differ significantly from the more detailed analysis adopted by the CCAQ when the cost measurement exercise was undertaken in 1973. The distribution of costs between UNDP and the agencies favoured by the two bodies was different but that is another matter. The immediate concern is with the means of segregating and quantifying the elements as defined by the JIU. The ease with which that can be done depends upon the organizational structure of the agency. If, for example, a separate technical co-operation unit exists, there is less of a problem. Such elements as are external to the unit (e.g. administrative and financial services) can either be identified or apportioned on a pro rata basis and a reasonably accurate estimate of the support costs can thus be made. This is the case with many of the smaller agencies which incidentally rely upon this method for the establishment of their claims to additional payments under the flexibility arrangements.

54. At the other extreme there are larger agencies with partially or fully integrated budgets. In these cases special machinery would be needed to generate the cost data needed to give a clear picture of actual support costs. To devise such machinery is not an insuperable problem. The cost measurement exercise mounted in 1973 by five of the larger agencies under the auspices of the CCAQ provides an example. There are, moreover, several possible variants of the method used in that exercise; costs can be classified by function, by source of funds or some combination of the two. The method used in 1973 was designed on the functional basis and confined to support costs attributable to the UNDP programme. A modified system now used by FAO for management information purposes and a simpler system used by UNIDO are designed to establish the over-all cost of supporting technical co-operation activities by source of funds.

55. The real question at issue here is, therefore, not whether a system can be devised but whether the time and money which would have to be expended on its

pursuit is warranted. My inquiries about the cost measurement exercise conducted in 1973 have satisfied me that it was soundly formulated and executed. Since the outcome of any such exercise is dependent upon the judgement and diligence of the individuals completing the time records, discrepancies and inaccuracies undoubtedly arose. These were not however such as to invalidate the exercise and I consider that the figures obtained from the survey gave a reasonably accurate picture of the support costs incurred by the participating agencies at that time. In each case the support costs were shown to be substantially in excess of the amounts reimbursed on the present basis of 14 per cent of project costs. The average for the five agencies was 23.3 per cent which it is interesting to note was not very different from the estimate of 20 per cent made nearly ten years earlier. 18/ Whilst, therefore, some of the more recent estimates and extrapolations may not be so reliable, I am satisfied that, apart from the World Bank, the Inter-American Development Bank and ICAO, none of the agencies currently receive full reimbursement for their costs on the basis of 14 per cent. I am fortified in that view by the fact that exchange rates have gone against many of the agencies since the 1973 cost measurement exercise. Additional support is forthcoming in the following extract from a paper 19/ discussing the experience of the Pan American Health Organization.

"Recognizing that the programmes financed by the regular budget of the Organization would suffer as more and more of its resources were diverted to managing and administering extrabudgetary activities, the Director decided to once again study the question of indirect costs. After extensive negotiations in 1976 with the US Government agency specifically designated to handle such negotiations and staffed with experts in this field, an Indirect Cost Rate for PAHO was approved by that agency and adopted as the PAHO Programme Support Costs Rate. The rate is based upon actual expenditure experience by PAHO, utilizing recognized cost principles and procedures for establishing indirect cost rates. Consequently, PAHO has had a definite advantage in that it established its programme support costs rate in conjunction with highly qualified experts and in accordance with well-defined policies and principles in the field of indirect cost rates. Since PAHO expenditure data formed the base upon which the rate was established, the rate is considered to be a true reflection of PAHO's support costs applicable to any extrabudgetary activities undertaken by PAHO. The approved rates were 31.8 per cent for 1974, 30 per cent for 1975, 31 per cent for 1976, a provisional rate of 31 per cent for 1977 and a proposed rate of 31.5 per cent for 1978."

56. It does not, however, follow from the above that the total support costs are irreducible. Nor does it follow that a higher rate of reimbursement is called for or that a lower rate would be inappropriate. What does follow is that since nearly all agencies incur costs in excess of 14 per cent, it would be unwarranted to ask them to expend their money and energies on cost measurement merely to establish

18/ A/5842 of 4 January 1965, para. 20.

19/ Pan American Sanitary Conference: Regional Committee Meeting, CSP 20.19 dated 7 August 1978.

precisely what part of their support costs is borne on their regular budget. Nevertheless, I recognize that Governments may wish to satisfy themselves periodically that the support costs incurred by the agencies have not decreased to an extent which would invalidate whatever reimbursement arrangements may now be made. For that purpose, the information which the ACABQ provides in its annual co-ordination report 20/ about the excess of each agency's support cost expenditure over reimbursement could be used as an indicator. As the Advisory Committee stresses, the figures in that report only purport, in the absence of cost accounting, to show an order of magnitude. That however should be sufficient to alert Governments to any significant changes in the level of support costs. It would then be for consideration whether another ad hoc cost measurement exercise should be undertaken to establish the facts more precisely and so determine whether corrective action was required.

57. This is not to deny the use of cost measurement as a more general tool of management or for the purpose of budgetary control such as that envisaged in paragraph 3 of the Working Group's decision. As that question has been referred through the Economic and Social Council to the agencies, 21/ it hardly falls within my province. I would say, however, that I agree with the Working Group that there is room for improvement in the budgetary presentations of the totality of agencies' technical co-operation activities. Some agencies because of their organizational structure can more readily provide the information which the Working Group is seeking. For example UPU already provides information on its UNDP programme in a budget annex, and ITU and IMCO devote separate chapters of their budgets to technical co-operation activities. But some agencies, particularly those with integrated programmes and budgets, would be hard put to provide the same sort of information with any precision without introducing fairly elaborate cost measurement systems. Whether the utility of the results would justify the cost of extracting the information can best be judged by the governing bodies responsible for exercising an oversight over the financial affairs of the agencies. In this context it needs to be borne in mind that the extrabudgetary resources likely to be available for technical co-operation activities are known only approximately when budget proposals have to be submitted for approval.

58. If it is possible to introduce an annex to the budgets of the kind proposed by the Working Group it would in my view be more useful if the support costs were expressed in terms of manpower as well as cash. Comparisons between the performance of the agencies would not then be distorted by the large variations in the cost of living at the different headquarters locations. A manpower table of this kind would, however, still have its limitations and could be open to misinterpretation. It would not be a manning table in the normal sense of that term as it would not permit complete identification of posts with personnel. Because many staff engaged on technical co-operation activities divide their time between those activities and other functions of the agency, the manning table would be a composite

20/ See, for example, A/34/684 of 15 November 1979, para. 17 and Table C.

21/ Governing Council decision 79/40 of 2 July 1979; Economic and Social Council decision 1979/55 of 2 August 1979.

of fragmented posts. Whilst therefore artificial compartmentalization of this kind might make for better interagency comparisons, it would not necessarily improve financial and manpower control. Indeed it is at least arguable that an integrated programme and budget provides a more realistic picture and ensures that demands for staff are open to the same scrutiny irrespective of the source of funding.

Chapter V

59. In the foregoing chapters I have concentrated on the specific points covered by my terms of reference. There are, however, a number of other considerations which are germane to the question at issue. Foremost amongst these is whether the size and shape of technical co-operation is changing in such a way as to warrant a complete rethinking of present attitudes and to require a radical alteration of the principles and practices governing the reimbursement of support costs.

60. The programme for which UNDP is responsible has increased about fivefold in nominal dollars since 1965, to an annual level of rather more than \$500 million. The volume of non-UNDP technical co-operation in the United Nations system has grown more rapidly and has now reached about the same level. In the same period the volume of net official development assistance by members of OECD and OPEC has gone from some \$6,000 million to about \$20,000 million. 22/

61. As this growth has occurred, new ideas and techniques have been developed but I think that the present system has stood up reasonably well to the changing nature and size of the technical co-operation programme and that the greater strains have been imposed by external factors such as inflation and currency fluctuations.

62. With some exceptions the arrangements have also been accepted as appropriate to bilateral and multi-bi projects. The lack of responsiveness to changes in programme content and methods of project execution could have presented a more serious challenge to the credibility of the existing system had there been a more dramatic change in those mixes or methods. Even so, as the following figures show, the changes that have occurred in the proportions of the personnel and equipment components are not insignificant.

22/ World Development Report (World Bank, August 1979).

UNDP project expenditures, by category
1972-1978

	<u>1972</u>		<u>1975</u>		<u>1978</u>	
	<u>\$US</u>	<u>%</u>	<u>\$US</u>	<u>%</u>	<u>\$US</u>	<u>%</u>
Project personnel and training	200,362,160	73.1	276,931,222	67.8	243,408,031	60.3
Equipment	34,002,578	12.4	73,862,820	18.1	100,302,347	24.8
Subcontracts	31,575,680	11.5	46,879,887	11.5	49,661,705	12.3
Miscellaneous	<u>8,106,223</u>	<u>3.0</u>	<u>10,791,913</u>	<u>2.6</u>	<u>10,571,510</u>	<u>2.6</u>
<u>TOTAL</u>	<u>274,046,641</u>	<u>100.0</u>	<u>408,465,842</u>	<u>100.0</u>	<u>404,015,593</u>	<u>100.0</u>

63. Given the dynamic nature of the technical co-operation programme, the possibility that even more substantial changes will occur cannot be excluded. I think, therefore, that it would be prudent to guard against that eventuality in any formula intended for lasting application.

64. This might be a convenient time to consider the relationship between the concept of sectoral support, as understood within the UNDP context, and the principle underlying the reimbursement of support costs. It is apparent from the relevant documentation that sectoral support is a hybrid creature which serves the agencies' individual responsibilities as well as their joint development effort with UNDP; and hybrid creatures are notoriously stubborn. Perhaps that is why it has refused to yield to any concise or even precise definition and why, in consequence, there has been little consistency in the manner of financing which appears to have been governed more by expediency than logic. However, bearing in mind the attention devoted to this matter by the Governing Council in recent years, I have not, for the purpose of this study, attempted to determine whether any change might be appropriate in the financing arrangements which it has laid down.

65. Nor have I attempted to devise special arrangements to cater for Government execution of projects. Where an agency is asked by a Government to implement the whole, or part of a project, the normal rules for reimbursement of support costs apply. If the agency contribution is less specific and is in the nature of technical advice or consultation, the UNDP guidelines on the subject appear to envisage that the actual costs incurred by the agency will be charged to the project. I find it difficult to reconcile this provision with the agencies' insistence (see paragraph 68) that support costs cannot be identified by project. Perhaps the guidelines should be revised to indicate that charges for incidental services of this kind will only be raised by the agencies when significant extra costs can be identified.

66. Comparisons are sometimes made to the detriment of the United Nations system between the cost of supporting bilateral programmes and the costs incurred in

support of the UNDP programme. I cannot judge the validity of these comparisons. It may well be that national organizations can, because of their homogeneity, operate more efficiently than international organizations. On the other hand, it may be that the national organizations receive assistance from their national governmental infrastructure which is not reflected in their calculations of support costs. Direct or indirect assistance may also be received without charge from the United Nations agencies whose very existence and day-to-day work may facilitate the nationally executed projects. It is certainly a fact that the UNDP Resident Representatives with access to specialist advice from the agencies spend a considerable part of their time on activities not directly related to UNDP projects. 23/ I cannot quantify these imponderables or discern whether variations in types of project or methods of execution influence the costs which are being compared. Lack of uniformity in the definition of support costs could also invalidate the comparisons. In the time available to me I can do no more than utter a word of caution against too ready an acceptance of such comparisons.

Chapter VI

67. Amongst all those to whom I have talked during the course of this study, I have found an overwhelming desire for a lasting settlement of the support costs issue. There is also a widespread belief that only a political decision can resolve the question and permit that wish to be fulfilled. Fundamental differences of opinion among Governments about the respective roles of assessed and voluntary contributions undoubtedly underlie the question and have impeded its resolution. These differences have been exacerbated by the inconsistent attitudes which some delegations have sometimes adopted when the question is considered in different organs of the United Nations system. Better co-ordination of views at the national level and recognition that the agencies derive benefits from their technical co-operation activities would help to relieve the problem. So too would the removal of misconceptions about the nature of support costs, which in turn have generated an interest in them which seems disproportionate to their impact on the total cost of project execution. In this connexion, I believe the JIU performed a valuable service with its short but pertinent recommendation that the term "overhead costs" should be replaced by "support costs". 24/ Its recognition that support costs "are just as essential to the success of a project as costs which are now charged directly to projects budgets" 25/ is also very relevant in this context. I hope it will not be long therefore before the derogatory connotations associated with the former term are forgotten and administrative and technical support comes to be regarded as a necessary and respectable part of the process of programme and project planning, implementation and evaluation. Incidentally, when viewed in that way a rate of 14 per cent appears less onerous; expressed as a percentage of 114, it is a little over 12 per cent.

23/ See chapter VIII for details.

24/ JIU/NOTE/78/1, para. 11.

25/ JIU/NOTE/78/1, para. 42.1.

68. It is conceivable that the incorporation of support costs or some part of them in the project budgets would hasten acknowledgement of their respectability. I do not however advocate that course which would involve, inter alia, the revision of IPFs. Were it possible to assess the actual support costs incurred on a project basis, I might have reached a different conclusion. All the agencies were, however, adamant that such an assessment would be impractical and I respect their view. The effort required to obtain what at best would be a very rough approximation would not, in my opinion, be justified. This need not, however, prevent a change of attitude to the concept of support costs.

69. If concurrently with that change there comes a realization that there is no ideal formula for allocating support costs, then that too may enhance the prospect of a settlement. That may sound paradoxical but it is possible that a formula which purported to identify, quantify and allocate support costs with absolute precision might exaggerate the political differences and hinder their composition. This is not to decry the efforts made by the Working Group to reach an agreement based on sound financial principles and practices. Political decisions should not be taken in a financial vacuum and it is understandable that Governments should hesitate to adopt an imperfect solution without an assurance that perfection, or near perfection, is unattainable. My own researches will, I hope, help to afford that assurance. I am not however advocating a policy of despair as I believe the present arrangements could be improved without prejudicing political positions.

70. I will now revert therefore to some of the ideas canvassed in the earlier chapters and summarize them in a way that may help the Working Group to reach conclusions, as follows:

(a) A rate in the region of 14 per cent has acquired a certain sanctity by usage and on average has held a reasonable balance between the costs which the agencies incur and the benefits which they receive through participating in the technical co-operation programme. Since those benefits are unquantifiable, the rate is necessarily somewhat arbitrary;

(b) The average conceals significant differences in the cost of executing projects which depends upon both the components of the project and the method of execution. The average also conceals wide differences in the level of costs at the seats of the agencies;

(c) The former differences are not important so long as the project components remain in fairly constant proportions. That has hitherto been the case but there are indications that the proportions are changing as the pattern of technical co-operation adapts to the shifting development scene. A long-term arrangement should therefore cater for that eventuality by establishing appropriate rates of reimbursement for different categories of expenditure;

(d) A strong case can be made for redressing the financial imbalance between the agencies arising from exchange rate fluctuations and differences in the cost of living at their respective headquarters. At the very least, the special flexibility arrangements introduced to meet exceptional cases of hardship due to this cause should be retained. The alternative would be to superimpose upon the normal rate or rates of reimbursement some corrective provision;

(e) Whether or not arrangements should be made to recognize economies of scale is more debatable. No doubt some such economies can be achieved but they are probably not so large as is commonly supposed. Nor would it be easy to devise and apply regressive scales which took account of the factors discussed in chapter I. The need to review the thresholds periodically to take account of inflation 26/ would be an added complication. In short, my researches into this subject have persuaded me that it would be extremely difficult to establish a true correlation between the size of an organization's technical co-operation programme and its cost effectiveness. In my view therefore the attempt to quantify economies of scale should not now be pursued. If, as programmes increase, it should become evident that economies of scale are being achieved to an extent which calls into question the reimbursement arrangements (see paragraph 56), the matter might be reconsidered;

(f) The case for recognizing the special position of agencies which administer small technical co-operation programmes is less open to question;

(g) Cost overruns on project estimates appear to be excessive. The arrangements for reimbursement of support costs should, if possible, include a financial inducement to curb such excesses.

Chapter VII

71. In this chapter I shall discuss how the considerations summarized in the preceding chapter might be translated into concrete terms. For this purpose I shall divide the chapter into three parts. In the first part I shall indicate what I perceive to be the minimum desirable modifications to the present arrangements. In the second part I shall suggest some optional refinements of the basic system which the Working Group may also wish to consider. In the third part I shall indicate the financial implications for UNDP and the agencies. The suggestions contained in parts I and II are complementary. Those contained in part I could be implemented independently and clearly meet the requirement that they be easy to understand and simple to operate. Those contained in part II are more intricate but, on the other hand, they offer a positive response to the requirements that the system of reimbursement should provide an incentive to minimize support costs and should be flexible enough to take account of the special situation of the different agencies. The cost of living adjustment would also counter the erosion of the concept of partnership in the lower cost areas.

Part I

72. The basic system

(a) To make the reimbursement arrangements responsive to the method of project execution a lower rate should be fixed for work done under subcontract. I suggest that 10 per cent would be an appropriate rate;

(b) To make the reimbursement arrangements responsive to project content a lower rate should be fixed for the supplies and equipment component. Assuming that the lower rate would apply to all supplies and equipment rather than being confined to projects containing large equipment components, I suggest that 10 per cent would again be an appropriate rate;

(c) Concurrently with the introduction of the lower rate proposed above, I suggest that the rate for all other project components be raised to 15 per cent to provide some compensation for the disturbance of the average;

(d) The flexibility arrangements applicable to agencies administering small technical co-operation programmes should, I suggest, remain in effect. If entitlement continues to be dependent only on UNDP project expenditure, the eligibility threshold should be raised from the figure of \$10 million at which it was fixed in 1975, to \$15 million as proposed by the Administrator. ^{27/} More logically the threshold would be based on the totality of an agency's technical co-operation activities. In that case, after allowing for the effect of inflation, it might be increased to \$25 million. The threshold level should, in any event, be reviewed periodically. When administering the flexibility scheme UNDP should take account of both the partnership principle and of the fact that part of the shortfall in the agency's receipts may well be attributable to operations financed from sources other than UNDP.

Part II

An incentive scheme

73. If the Working Group wishes to pursue the idea of introducing a financial inducement to more realistic planning and more expeditious completion of projects, the following proposition might be examined. Instead of the rate of 15 per cent proposed in Part I paragraph (c), which refers to personnel, training and miscellaneous expenses a rate of 20 per cent should be applied to the first half of the cost originally estimated, and 10 per cent to the second half and all subsequent expenditure. Under such an arrangement, agencies would receive the full 15 per cent or more on all project expenditures except those relating to supplies and equipment or subcontracted work if the project were completed within the initial estimate. Otherwise, gradually declining rates would apply; for example:

<u>Excess over estimate</u>	<u>Effective over-all rate of reimbursement</u>
10 per cent	14.50 per cent
25 per cent	14.00 per cent
50 per cent	13.33 per cent
100 per cent	12.50 per cent

^{27/} DP/WGOC/25, para. 33.

74. If the foregoing suggestion were adopted, the rate of 15 per cent would, in effect become a hypothetical rate for projects financed through UNDP. The formula would read:

Rate of reimbursement on half the project estimate (excluding supplies/equipment and work which is subcontracted)	20 per cent
Rate of reimbursement on all other project expenditures	10 per cent

Expressed in this way the formula would also conform more closely to the realities of the situation. Support costs relating to the personnel components of projects tend to be front-loaded. In other words costs are higher at the start of a project when the personnel have to be recruited.

75. The formula would obviously meet the requirement that it be easy to understand. Whether such an arrangement would meet the further requirement that it be simple to operate is more debatable. Agency and UNDP officials with whom I have discussed the question do have serious reservations on that score. They pointed to the difficulty of taking account of genuine project revisions which may arise for a variety of reasons and which may be beyond the control of the agency. They also stressed that a revision of the administrative and accounting procedures would be necessary if support cost reimbursements were to be linked with the financial progress of individual projects. I was not able to judge the weight of these objections but I accept that they should not be dismissed lightly. On the other hand official attitudes may have been influenced to some extent by a tendency to rate technical co-operation performance by reference to programme delivery expressed quantitatively rather than qualitatively. Some administrative inconvenience might be a price worth paying for a system which helped to reverse that approach by putting a premium on effective project planning and cost management. Moreover, if that objective were achieved the number of project revisions would decrease and the problem of determining what budget increases could be legitimately added to the original estimate would become less acute.

76. The above arrangement could be applied to projects financed from other extrabudgetary resources if the donors so wished; otherwise the rate of 15 per cent, together with the lower rate of 10 per cent for equipment and subcontracted projects, could be applied without detriment to UNDP.

A cost-of-living adjustment

77. Should the Working Group deem it desirable to do more than continue ad hoc arrangements to redress the financial imbalance between agencies caused by differences in local operating costs, a further refinement could be superimposed upon the basic formula. The adjustment might be made by forging a link with the post adjustment mechanism along the lines of the suggestion contained in paragraphs 27-31 of the JIU "Expanded preliminary note on a new system for agency

support costs". 28/ Since that note was issued the post adjustment system has been changed but the JIU formula could be adapted to the new system in the following way. First, the average of the post adjustment indices at the headquarters of the specialized agencies, weighted by their UNDP project expenditures, would be calculated. Then, for each complete five points that the post adjustment index of a given agency's headquarters was above or below the weighted average, the reimbursement due to the agency concerned would be increased or decreased by 1 per cent.

78. This formula is by no means perfect; in particular the adjustment of 1 per cent for each five points is an arbitrary one and there is no direct recognition of the impact of decentralization on support costs. Moreover, as the JIU recognized and for reasons which it explained and which would still obtain, an arrangement of this kind would provide only partial compensation for the cost differences. Nevertheless, rough justice may be held to be better than no justice, and application of the formula would certainly go some way to restoring the balance between agencies without involving UNDP in any appreciable extra cost. And whilst the pressure on some regular budgets would be increased, it would be relieved on others.

79. In case the Working Group should wish to pursue this possibility, I have revised the figures contained in paragraph 30.3 of the Inspectors' report to take account of the modifications suggested above. I have also updated them by using the post adjustment indices applicable in January 1980 and weighting them by reference to the latest project expenditures available (1978). On that basis the amounts reimbursed to the agencies would be increased or reduced to the following extent.

ILO, WHO, WMO, ITU, UNCTAD, UPU, WIPO	+ 14 per cent
ADB	+ 9 per cent
UNESCO, UNIDO, IAEA	+ 6 per cent
IMCO	+ 1 per cent
FAO	- 6 per cent
UN	- 7 per cent
World Bank, IDB, ASDB	- 9 per cent
ICAO	- 12 per cent

Part III

Financial implications

80. The effect of a change from a flat rate of 14 per cent to the rates of 15 per cent and 10 per cent recommended in paragraph 72 would depend upon the mix of project components and the method of their execution. Had the ratio been in force in 1978 the over-all effect would have been to reduce the amount reimbursed by UNDP by about \$2 million. The financial implication for each of the agencies, based again on 1978 delivery, is shown in the table 29/ at the end of this chapter. In the same table I have shown what the effect would be of applying the cost of living adjustment. That adjustment would not affect the UNDP reimbursements materially.

81. It is not possible to quantify the effect of introducing the incentive scheme. If the practical difficulties could be overcome and it were adopted some reduction in the amounts reimbursed to the agencies might be expected. But the greater gain would come from the more timely execution of projects and consequent saving on project expenditure which the arrangement would encourage.

82. The position would not, of course, remain static; the cost of living adjustment would have to be reviewed periodically and the amounts received by the agencies from the application of the basic rates would depend upon the nature of the projects and their method of execution. It would be wrong therefore to draw long-term conclusions about the relative advantages and disadvantages for the different agencies given the volatile nature of currency exchange rates and the changing economic and development scene.

29/ The table does not take account of the impact of the changes on the flexibility payments made to agencies administering relatively small technical co-operation programmes.

Effect on the agencies of the proposals
contained in chapter VII

(Based on 1978 deliveries and the 15 January 1980 post adjustment index)

(a)	(b)	(c)	(d)	(e)	(f)	(g)
Agency	Delivery	Reimbursement at 14% (11% for the World Bank	Reimbursement at 15%:10%:10%	Col (d) as % of Col (b)	Reimbursement at 15%:10%:10% plus or minus the cost of living adjustment	Col (f) as % of Col (b)
	\$	\$	\$		\$	
UN	71 665 266	10 033 137	9 643 505	13.46	8 968 460	12.51
ILO	38 215 270	5 350 138	5 356 665	14.02	6 106 597	15.98
FAO	113 424 359	15 879 410	15 186 464	13.39	14 275 277	12.59
UNESCO	33 425 585	4 679 582	4 518 352	13.52	4 789 453	14.33
WHO	14 397 743	2 015 684	1 918 052	13.32	2 186 579	15.19
ICAO	26 369 175	3 691 685	3 358 525	12.74	2 955 502	11.21
WMO	7 758 821	1 086 235	1 007 754	12.99	1 148 840	14.81
IAEA	3 204 614	448 646	406 144	12.67	430 513	13.43
IMCO	1 988 073	278 330	265 942	13.38	268 601	13.51
ITU	16 179 729	2 265 162	2 198 759	13.59	2 506 585	15.49
UNIDO	42 466 539	5 945 315	5 384 662	12.68	5 707 742	13.44
UNCTAD	9 458 469	1 324 186	1 384 528	14.64	1 578 362	16.69
UPU	1 503 647	210 511	216 282	14.38	246 561	16.40
WIPO	46 342	6 488	6 501	14.03	7 411	15.99
World Bank	16 393 639	1 803 300	1 973 421	12.04	1 795 813	10.95
IDB	527 411	73 838	63 520	12.04	57 803	10.96
ASDB	850 952	119 133	98 471	11.57	89 608	10.53
AFESD	607 545	85 056	78 951	13.00	86 057	14.16

Chapter VIII

83. A study of the cost of administering technical co-operation activities would be incomplete if it did not include some reference to the administrative costs incurred directly by UNDP. The following table shows how net administrative expenditure has progressed in absolute terms over the years 1973-1978; it also shows the progression expressed as a percentage of programme costs.

<u>Year</u>	<u>Administrative expenditure - net of income</u>	<u>Programme costs - IPF and other supplementary programmes</u>	<u>(A) as percentage of (B)</u>
	<u>\$US millions</u> (A)	<u>\$US millions</u> (B)	
1973	36.4	276.6	13.16
1974	43.8	292.8	14.96
1975	52.4	426.0	12.30
1976	57.2	400.4	14.29
1977	59.0	337.9	17.46
1978	63.6	435.6	14.60

84. To get the above figures into a proper perspective it is necessary to take account of two factors. First, of the total UNDP budget for 1978-1979 some two thirds relates to the provision of field offices. Second, a recent survey by UNDP established that on average the Resident Representatives and their staff spend nearly 40 per cent of their time on non-UNDP work. The possibility of identifying and claiming reimbursement from the beneficiaries for the work performed on their behalf has been discussed in the Governing Council and I am not here concerned with that aspect of the matter. The point I do want to make is that if the cost of this work done for other parties were excluded from the budget total, the percentage shown in the preceding table would be reduced appreciably. The fact that much of the work is performed on behalf of the agencies should also be borne in mind when considering the respective benefits accruing under the partnership principle.

85. In the short time at my disposal, I was unable to gain more than a fleeting impression of the efficiency of the UNDP organization. One suggestion voiced in the course of my visits to the agencies was that UNDP has over-reacted to its financial crisis and that the system of financial reporting is cumbersome and burdensome. The smaller agencies with limited staff resources were most vocal in this respect. Some of the larger agencies were more concerned about, and questioned the need for, the volume of technical reporting required by UNDP.

This, it was alleged, involved duplication of effort. None of this criticism was very widespread. It was always made in a constructive spirit and did not detract from the impression I got of the sound working relationship which exists between UNDP and the agencies. Moreover, the Integrated Systems Improvement Project (ISIP) may remove such grounds for criticism as do exist. If some of the reporting could be eliminated, there would be a double saving as both parties, UNDP and the agencies, would benefit.

Chapter IX

86. My terms of reference envisaged that any arrangements which the Working Group might recommend would bring about an over-all reduction in support costs. It is not clear whether the Group had in mind the totality of support costs or merely that portion reimbursed by UNDP. I have therefore proceeded on the assumption that reductions of both kinds were intended. Indeed, the two cannot be completely divorced. Experience suggests (see for example paragraph 35) that financial stringency is still one of the best inducements to economical management. Stringency should not however be carried to the point at which it affects the quality of the service rendered and I have therefore refrained from suggesting drastic reductions in reimbursements which would either have that effect or inevitably place an additional and substantial burden on the regular budgets of the agencies. If the more modest reductions which I have suggested act as a spur to greater efficiency and higher productivity, they need not, I believe, impose commensurate charges on the regular budgets. The ability of the agencies to absorb support costs will moreover be enhanced if no formal provision is made to take account of possible economies of scale. The standardization of the rate of reimbursement for supportive activities should also generate more income from non-UNDP sources and relieve the pressures on the regular budgets. If the Working Group decided to recommend an adjustment of support cost reimbursements by reference to the level of headquarters costs, the impact on UNDP would be small as the adjustment would be virtually self-balancing and whilst the pressure on some regular budgets would be increased, it would be relieved on others.

87. More specific suggestions for reducing support costs are contained in the JIU "Report on some aspects of backstopping of technical co-operation activities in the United Nations system" 30/ and in the Unit's "Report on the role of experts in development co-operation". 31/ These would, I believe, repay more active attention. In particular Government execution, as the Inspectors suggest, gives to UNDP a valid instrument for reducing administrative and support costs. Judicious use of the Inter-Agency Procurement Services Unit could also help to reduce the work involved in purchasing equipment but care should be taken to ensure that the Unit does not outgrow its utility. I have referred in paragraph 13 to the extra costs caused by delays in response by host Governments when candidates are submitted for their approval. Remedial action here would certainly reduce the

30/ JIU/REP/77/6.

31/ JIU/REP/78/3.

over-all volume of support costs. I believe, too, that savings could be made if the possibility of eliminating some of the reporting required by UNDP were vigorously pursued. Furthermore, the time consumed on discussing support costs could obviously be put to better purpose once the matter has been resolved.

EPILOGUE

88. In the last thirty years tens of millions of dollars must have been spent and countless words have been written in a vain search for an ideal solution to the problem of establishing and apportioning support costs. I shall have failed in my endeavours if the search for that chimera is continued. That is not to press my own suggestions for resolving the issue; better ideas may emerge and other opinions prevail when the Working Group comes to discuss this report. The essential requirement is that the Working Group and the Governing Council now make a firm recommendation which can in turn be remitted to the General Assembly for consideration and discussion. A clear lead by the General Assembly is, I believe, the prerequisite to a long-term settlement. It will then be for the governing bodies of the agencies to endorse or reject that decision; that is their prerogative.

89. I sincerely hope that whatever proposals are favoured by the majority of members of the Working Group will not again be frustrated by what the ACABQ described as the criterion of general acceptability. It would be inexcusable if yet more monies and energies were diverted from the cause of development to which, in all conscience, they should be devoted.
