Bridging The Gap: Important Questions About Global Cost Of Living Allowances

Relocation costs can be very expensive for both the relocating employee and the employer. This is especially true when it comes to global assignments. One aspect of global assignment management that is truly vexing to even the most experienced mobility professional is how best to address the complexities of providing compensation packages that preserve an equitable standard of living between the home and host location.

When an employee takes on an assignment, the cost of living in the destination is rarely the same as in their home country and city. In most cases, the assignee will end up paying either more or less for basic essentials, such as housing, transportation, food, and entertainment, than they would have if they had not accepted the assignment. In the interest of upholding a philosophy of equitable programme administration, any unintentional benefit or deficit for the employee on assignment needs to be addressed.

It is common practice for companies to adopt a Cost of Living Allowance (COLA) or Goods and Services Allowance (GSA) to bridge the gap between home and host country cost differences. One of the most misunderstood concepts in mobility, we tackle some basic questions about Cost of Living and the allowances intended to address these differences.

1. What Is A COLA Or GSA and What Is The Intent?

A COLA or GSA is an allowance designed to address the differences between how much it costs to live at the home and host location.

When an assignment is considered temporary, assignees tend to remain on home country compensation packages. Since assignees remain on home country payroll and all merit increase cycles, pay scales and increases, are based on the home country standard, spending patterns and standards of living variances in the host country are a given.

Scaling an assignee's salary to meet the cost of living difference can be complicated, particularly when the employee is moving to a lower cost location on assignment. No one wants to see their salary lowered. Likewise, a move to a higher cost country would require a salary boost, and it's then difficult to reduce the assignee's salary back to home country levels upon repatriation. Therefore, COLA is utilised to build in an adjustment to local standards of living, without adjusting the employee's base salary.

2. When And Why Is It Appropriate To Provide A COLA?

When an employee experiences a loss of purchasing power due to the cost of living for basic essentials at the host location exceeding the cost of living at home, a COLA is provided. Bridging the gap is not as simple as providing an allowance since allowances may only address specific expenditures. The objective of providing a COLA is to (a) maintain the employee's purchasing power over the course of the assignment and (b) do this in the most cost-effective and equitable manner for all employees on assignments.

3. What Data Is Used To Determine The COLA Calculation?

The best-in-class mobility programmes will leverage data from several sources, not just one. The most critical components are the international COLA index and local market price data, which can be purchased from an independent third party data provider. This data is available for various levels of living standards and is updated on a regular basis. Most companies will look to validate this information with input from their local Human Resources managers based on their unique company culture and practices that might slightly impact the way the data is used. And finally, at Weichert, we often tap into our destination services providers, who are excellent local resources and subject matter experts in all things hyper-local – where to shop, dine, live, and how to get around cost effectively.

4. What Is A COLA Index?

To calculate each city's COLA index (also called a 'price index value'), a central reference city is selected (Prague, as an example) and assigned a value of 100. Once the reference point has been established, the price index value of every other city in the database is calculated by comparing their cost of living to the cost of living in the central reference city (Prague).

Therefore, if a city has a price index of 134, that means that living there is 34% more expensive than living in the central reference city (Prague in this example).

5. How Are The Indexes Calculated?

Third party data providers calculate cost-of-living differentials for a given family size and level of income. The provider develops a standard "basket of goods" that represents average expenditures for a typical household. They will then compare the cost of purchasing this same basket of goods in each location. This represents the percentage of income needed to purchase the same items in each location relative to the cost for the same basket of goods in a "standard city".

6. What Is Included In The "Basket Of Goods"

A typical market basket of goods includes transportation, goods and services (which includes food at home, food away from home, tobacco, alcohol, furnishings and household operations, clothing, domestic service, medical care, personal care, and recreation), and sales taxes.

Some items may be considered variable, such as transportation (if transportation is provided) and schooling (if local schools are deemed adequate) and therefore those may be pulled out of the calculation.

Note: the typical COLA programme covers non-housing expenses. Items such as housing rental, rental insurance, and utilities are covered under the basic allowance specific to housing.

7. Are Transportation Costs, Such As Insurance Or Taxes On A Private Vehicle, Considered Part Of COLA?

Yes, these are included along with maintenance costs, financing costs, cost of gasoline, and all other major costs of owning and driving a private vehicle.

8. If Public Transportation Is Available, Is It Considered In Determining Transportation Costs?

Yes, and this is why transportation is often considered a variable cost. Public transportation is considered in locations where it is normal and customary for assignees to use public transportation. In some locations, where it is not customary nor recommended to drive, the cost of taxis or car and driver services are considered. Depending on specific circumstances, car and driver may be shared between assignee and spouse/partner or the accompanying spouse/partner may also be provided with car and driver.

9. Is COLA Ever Paid As A Daily Rate In Lieu Of A Per Diem?

COLA can replace a per diem, but COLA is generally a monthly entitlement based on a 30-day month and usually meant for long-term assignments or "short"-term assignments that exceed 6 months. Usually COLA is associated with an assignment to bridge the spendable gaps between a home and host location as discussed above.

Alternatively, a per diem is usually associated with a short-term or business trip for only one person with duplicate expenses and is limited to meet the basic needs of the assignee. In other words, a per diem is better suited as a temporary support for an employee who is buying items for personal consumption for a limited time period (such as a business traveller).

10. How Does The Data Provider Adjust For Significant Local Changes Such As Currency And Exchange Rate Fluctuations?

The data provider measures local market costs in each area, including all items in the standard basket of goods and services. Taxes are also considered. Since reviews and surveys take place on an ongoing basis, and changes that occur in the local economy are measured, the results are reflected in the data tables on an ongoing basis.

11. How Often Should COLA Be Updated?

Most companies choose to review COLA on a semi-annual or annual basis. However, the frequency of review is ultimately influenced by corporate culture and may be triggered by changes in family size, salary, fluctuations in currency, or volatility of the exchange rate in the destination location.

12. Why might a location's rate for 2020 be lower than it was in 2019?

Cost of Living Data Providers review the data on a regular basis. Most do it semi-annually, though more frequently for volatile locations. Changes occur as a result of the price fluctuation of the basket of goods at home and/or host as well as the exchange rate. Therefore, if there is a price difference for the basket of goods, and/or the home country currency purchases more or less of the host country currency, the purchasing power and the index is impacted.

13. Are The Cost Of Living And The Cost Of Labour Correlated?

Not necessarily! It is more a matter of local economy, spendable income, and cost of goods. With unemployment currently at historically low rates and a renewed war for talent, employees are more selective about accepting an assignment. This is especially the case in locations with a high cost of labour and even greater cost of living such as New York, London, and Geneva. These locations pay higher than average salaries but the high cost of living reduces the amount of money that employees can save.

In sum, as employees are more selective, organisations need to adapt to ensure they get the best talent in the right locations. Utilising data that can demonstrate the purchasing power between locations and help make assignees "whole" from a compensation standpoint will continue to play a critical role in global mobility management.

Remember:
Changes in exchange rates are different than changes in COLA. While currency adjustments can impact COLA, there is not a direct correlation (i.e. a 10% change in the exchange rate doesn't automatically equal a 10% COLA change).

LAURA LEVENSON
GPHR, GMS-T
Global Practice Leader,
Consulting Services,
Weichert Workforce Mobility
1625 State Route 10,
Morris Plains, NJ 07950
973-397-3968 (direct)
914-483-7079 (mobile)
973-630-3781 (fax)
llevenson@weichertwm.com
www.weichertworkforcemobility.com