Negative Differentials: What They Mean to Your Paycheck

Anne Teulet-Cote

Congratulations! You're going on an expatriate assignment and want to know what you should expect with regards to a key factor in your pay package: cost-of-living. Depending on your host location, you may or may not need a cost-of-living allowance (COLA, or differential) to bridge the difference in prices between your home and host locations.

In fact, you may be living and working in a place where goods and services are less expensive than in your home country – which means that your employer does not necessarily need to pay you anything more than your base salary (with the exception of allowances related to moving, education, and so on).

Let's explore this situation further with an actual example.

Cost-of-Living Basics: The Index

Assume, for example, that your company is sending you on assignment from Chicago, United States (your home location) to Bangalore, India (your host location) for two years. Also assume that the goods and services index – a number summarizing the relative total cost of the "market basket" of 180 goods and services in your host location when compared to a similar basket in your home country at the same point in time – is 80.

What Does this Number Really Mean?

The first thing to remember is that an index of 100 is your starting point (home location). Next, you should understand that an index above 100 means that a COLA is necessary to bridge the gap in prices. An index less than 100 means that nothing extra needs to be paid out; however, some employers deduct this "negative differential" from your paycheck.

If your employer does not deduct the negative differential, you receive a windfall. (See sidebar, "Why an Employer Would Deduct a Negative Differential.")

What Does an Index of 80 Mean to You in Practical Terms?

To calculate the cost-of-living difference between a home and host country, ORC Worldwide analysts undertake a process that begins with a pricing survey by ORC's network of pricing agents located around the world. ORC gathers prices for the same market basket of goods and services in both your home location (in this example, Chicago) and assignment location (Bangalore, India). This process is necessary as prices differ from one country to the next.

In the example above, assignees moving from Chicago to Bangalore will have a negative differential (calculated using an index of 80, which is lower than the home country starting index of 100) because goods and services cost less in Bangalore than they do in Chicago. Consider:

> For a family size of 2 and a base salary of USD75,000, for example, ORC research calculates a home-country "spendable income" of USD30,999; this portion of income is allocated to goods and services. The employer expects assignees to use this spendable income in the host location to purchase goods and services. After all, the company is only responsible to bridge the gap in cost-of-living between the two locations by paying out a differential, if warranted. In this case, the differential is negative (-USD5,952), so that no differential is necessary.

Still an Advantage, Even With a Negative Differential

When you go on an international assignment, it is possible that you may not receive a cost-of-living allowance, if prices in the host country are lower than in your home country. However, you are still reaping the benefits of living in a new country and experiencing a new culture, and can transfer this knowledge by sharing what you have learned with your colleagues back home or on assignment in the same location.

Anne Teulet-Cote, an international compensation consultant for ORC Worldwide, is based in San Francisco.

Why an Employer Would Deduct a Negative Differential

Although you might think it beneficial to retain the windfall should your company decide not to apply a negative differential, consider these points:

- You will enjoy a savings advantage not available to individuals in positive-index or higher-cost countries, possibly affecting the morale of your expatriate colleagues.
- When you repatriate, or perhaps accept a subsequent assignment to a higher-cost location, you are likely to feel the financial impact, as your ability to save or use windfall monies as additional spendable income disappears. You would receive a smaller increase than expected to make up for the transition back to a higher-cost location, because the company never deducted the negative differential amount from your allowance in the first place.

What happens when costs at a negative-differential host location start to rise, but remain lower than prices at home? Although you might expect an increase in your differential to keep up with the rising prices, that assumption is incorrect because the cost-of-living in your host location is *still* lower than your home country.

If you are in a situation where a negative differential is deducted from your package, remember that this practice is consistent with the balance sheet approach to keeping your purchasing power comparable to what you enjoyed at home. And don't forget, your purchasing power—not total pay—is being protected. Differentials are flexible, intended to move up or down to achieve that protection in the face of currency exchange rates and other economic factors.