Everything you need to know about the cost of living adjustment

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The cost of living is the amount of money required to cater to basic expenses such as accommodation, food, and health care to maintain a certain standard of living. The cost of living has a connection with salaries and wages in normal situations. Wages should reflect the higher living costs in more expensive towns such as Harare.

Increases (or decreases) in the price of these necessities affect the cost of maintaining your lifestyle, and this, in turn, shapes how well one's income will support them and their dependents.

The computation involved in cost-of-living adjustments can vary from employer to employer. There is no official cost-of-living metric, but some employers may use the prior year's rise in the Consumer Price Index (CPI).

COLA bases its increases on the Consumer Price Index. That's the government's official measurement of inflation. It measures changes in the prices of goods and services. COLA is triggered when prices go up. It's rare to see COLA used when prices drop, a situation known as deflation.

In general, employers use COLAs to attract and keep valuable employees. A company that does not offer salary adjustments to offset inflation might find itself at a competitive disadvantage to companies that do offer this type of benefit to employees.

There is another type of cost-of-living adjustment not directly tied to the rate of inflation, but employers may offer it to make employees more willing to accept job transfers.

Private companies don't use COLA as much as the government. They hire, give raises, and fire based on merit, not a rising cost of living. They must do so to remain profitable. In most cases, if workers contribute to that profitability, they are given raises, regardless of whether the cost of living has increased or not. If they don't contribute, they won't get raises, and they might even get fired. Companies might award COLA to their best employees when they ask them to move to a more expensive location.

Sometimes an employee may transfer to a new city while maintaining the same job and receive a salary increase to offset the higher cost of living in the new location. An example is an employee who receives a salary increase because he is transferred from Harare to Bulawayo, where consumer goods and services are more expensive.

If one is considering moving to another city to accept a new job, cost-of-living indexes can be used as an indicator of how suitable a salary offer is relative to one's current income and standard of living. Housing, food, and taxes vary between cities and even regions. Cities, regions, and countries with a lower cost of living usually mean income will go further. Living in areas with a higher cost of living usually means workers have less disposable income, or money in their bank accounts, after paying for the basics and need higher incomes to live the same way they would in a less costly region.

Why COLA is important

Understanding the effects of COLA is also an important practical issue for several reasons. First, as companies continue to grow from local to national organizations, their pay systems need to be able to accommodate COLA differences across multiple locations, according to Klein et al (2006). Without clear guidance, companies may end up over-adjusting or under-adjusting pay levels and, as a result, may be paying a rate that is different from their desired compensation strategy.

Second, even if a company is located in only one location, there may not be sufficient local pay survey data upon which to base a pay structure. Again, failure to have research-based advice means that resultant decisions may deviate from organizational goals.

Third, even if local wage data are available for certain locations, the data reported in the survey may be flawed. The more specific the location in the survey, the lower the sample size,

thereby increasing the variability and potential error in reported values. Information reported in a salary survey may be based on sample sizes as low as five, making the accuracy of the point estimate of the market average subject to the sort of variability of very low power estimates.

Fourth, COLA is considered an important characteristic for pay-setting purposes, and failure to adjust for COLA is a major source of pay dissatisfaction. Companies need to adjust pay based on the level of the COLA, and it would be helpful if research could guide the extent to which such adjustments should be made.

Also, while the compensation strategy is important on its own, it is closely related to other choices the firm makes. According to Balkin & Gomez-Mejia (1987) decisions on compensation strategy can affect the firm as a whole and influence other decisions. Faced with higher wages, for example, a firm may compensate with raising prices, increasing sales, changing operational techniques, or raising productivity. Labor economists have presented evidence consistent with productivity differences across locations with different wages. Increased productivity resulting from wage increases has been recognized for decades, in the economics literature on “efficiency wages” and debates over the minimum wage, and in the management research on pay policies. Akerlof & Yellen (1990) believe that, with higher wages, workers may feel greater satisfaction with their job and may decide to put in greater work effort, and turnover may decline as the “cost of job loss” is greater.

While the benefits of higher wages can often offset the costs, there are diminishing returns to these benefits and the costs of greater wages will eventually outweigh their benefits? It is therefore important to have practical guidance for a firm’s compensation strategies concerning COLA not only because it is an important issue on its own but also because it is intertwined with other strategic decisions by the firm.

According to Numbeo, the COLA index that measures the overall cost of living in each country shows that in Africa, Mauritius has the highest cost of living followed by Zimbabwe and then Ghana.

The cost of living in Zimbabwe significantly increased from 2018 to 2020. Inflation was on an upward trend. Employee remuneration was eroded by a factor of more than 80. It was safe to say at that stage most employees were struggling to make ends meet given the devaluation of their salaries and rising inflation. The subsequent business challenges emanating from the policy changes brought in new challenges related to how people are remunerated.

The results obtained from the employee retention survey (IPC, 2019) showed that due to the economic challenges in the country and the ever-increasing cost of living, companies put in place systems to lift off part of the load off their employees' shoulders, by taking care of some of their subsistence costs. Some companies were either trying to pay their employees at the inter-bank rate or provide salary adjustments every week, however, the corrosive inflation and subsequent rise in the cost of living made it unsustainable for employers.

Households are feeling the heat as poverty levels surge at alarming levels. The country is still facing massive de-industrialization, company closures, foreign investor flight, job losses, and a decline in agricultural productivity and escalation in poverty levels. Inflation is on an upward trend. It is safe to say at this stage, most lower-level employees are struggling to make ends meet given the devaluation of their salaries and rising inflation. The subsequent business challenges emanating from the policy changes have brought in new challenges related to how people are remunerated. However, some companies are now trying to link wages to productivity.

How is COLA calculated?

COLA is one factor that helps explain regional differences in nominal earnings. Although certainly not the only factor influencing pay across locations, COL is a potentially critical factor in pay system design.

COLA indices are generally based on the idea of a "basket of goods". This means an index estimates the cost of various types of goods, products, and services in different locations, and the index reflects their relative costs. These items can represent a broad range of categories.

COLAs are based on increases in the Consumer Price Index. A COLA effective for December of the current year is equal to the percentage increase (if any) in the CPI from the average for the third quarter of the current year to the average for the third quarter of the last year in which a COLA became effective. If there is an increase, it must be rounded to the nearest tenth of one percent. If there is no increase, or if the rounded increase is zero, there is no COLA for the year.

Conclusion

The phrase "cost of living" refers to a measure of the cost of sustaining a certain standard of living. Cost-of-living indexes can be used to compare salaries across different areas. A cost-of-living adjustment calculation may be used to increase certain kinds of income, such as contracts, pensions, or government benefits, so they can keep up with increasing basic living costs, as represented by the CPI or cost-of-living indexes.

In general, cost-of-living adjustments to one's salary will be determined by their employer.

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