

### EOBI system to be simplified

The Finance Bill, 2005, proposes a welcome simplification in EOBI.

Up to now, employers' contributions were 5% of wages, upto a maximum wage of Rs 3,000 per month. Insured persons contributed a flat Rs 20 per month. The pension was calculated as 1/50th of the average monthly wages on which contributions were paid during the last twelve calendar months, *multiplied* by the number of years of insurable employment. The minimum pension was raised to Rs 700 per month, from 1 Nov 2001.

Samee-ul-Hasan of this firm presented a paper on 19 Jan 1993, in which he said this wage-related system creates administrative complications. He advocated flat rate contributions and benefits. This would simplify the scheme, eliminate a major head of evasion and malpractice, and make it much easier to expand the scheme. There should be an annual review of the flat rates, to match rising prices and wages.

This point of view has now been accepted. The Finance Bill, 2005, proposes that from 1 July 2005, for all EOBI purposes "wages" will mean the minimum wage defined in the Minimum Wages for Unskilled Workers Ordinance, 1969. It is proposed to raise that minimum to Rs 3,000 p.m. from 1 Jan 2005, instead of Rs 2,500. Employers will contribute 6% of this, i.e. Rs 180 per month. Insured persons will contribute 1% of this i.e. Rs 30 per month. There will be no need to enquire into the actual wages received.

The minimum pension is proposed to be raised to Rs 1,000 p.m. from 1 Jan 2005.

We congratulate those who thought of the link to the Minimum Wage under the 1969

Ordinance. As this minimum wage increases, the EOBI contributions and formula benefits will automatically increase.

The EOBI delivers old-age, spouses' and invalidity pensions to about one hundred and fifty thousand persons. More than one million insured persons will in course of time get pensions. The simplification of the scheme would pave the way for the progressive expansion of EOBI into a National Minimum Pension scheme. This has been advocated by numerous commissions and committees, and should be given serious consideration.

### Akhtar & Hasan's UAN

Our UAN is (021) 111-00-00-53. It is easy to remember: 52 cards in a pack plus a joker. We enclose a pocket directory which shows extensions from this number.

### Voluntary Pension System Rules, 2005

The Voluntary Pension System Rules, 2005, were gazetted on 27 Jan 2005. The Finance Bill, 2005, contains the tax regime for the system. "Look before you leap" is a sound principle. So we will wait until the SECP has determined the investment policy for pension funds under VPS Rule 24(3), before we analyse the new system's pros and cons.

### The sinking rupee

According to the official Consumer Price Index, inflation in the fiscal year ended June 2005 was 9.5 %. This is based on the average CPI for 12 months to June 2005, *divided* by the average for 12 months to June 2004. This is a sharp increase from inflation of 4.57 % in the fiscal year ended June 2004.

(The CPI has been published upto May 2005, and was estimated for June 2005.)

### Akhtar & Hasan (Pvt) Ltd Actuaries

If the average purchasing power of the Pakistan Rupee was 100 paisas in the 12 months to June 1962, it has fallen to 3.6 paisas in the 12 months to June 2005. The compound annual average rate of inflation in these 43 years was 8.03 % pa.

### Official Inflation in 10 year periods

There were 43 periods of 10 years each from 1953 to 2005 (1953-63, 1954-64 and so on).

Compound inflation during these 10 year periods ranged from 2.79 % p.a. (1954- 64), to 13.54 % pa (1972-1982). The average was 7.83 % pa.

### National Savings yields raised

From 1 July 20, 2005, the nominal pre-tax yields on NSS schemes have been increased, according to the Table.

|                       | Term (yrs) | Nominal pre tax yield % pa |               |
|-----------------------|------------|----------------------------|---------------|
|                       |            | To 30 Jun 05               | From 1 Jul 05 |
| Savings A/cs          | N/A        | 4.00                       | 5.00          |
| Special Savings Certs | 3          | 6.95                       | 8.60          |
| Regular Income Certs  | 5          | 6.84                       | 8.88          |
| Defence Savings Certs | 10         | 8.15                       | 9.46          |
| Pensioners' / Bahbood | 10         | 10.08                      | 11.04         |

Following previous practice, it is presumed that the new yields will apply to certificates purchased on or after 1 July 2005, not to those purchased before.

The investment limit on Pensioners'/ Bahbood (P/B) has been raised from Rs 2 million to Rs 3 million.

Using lowest, highest and average observed inflation in past 10 year periods, the next Table shows the real yield net of inflation (but not net of income tax) on the new DSC nominal yield of 9.46% and the new P/B

nominal yield of 11.04 %. The P/B yield is payable monthly, so the effective compound rate is actually 11.62% pa.

| Next 10 years' inflation rate % pa | Real yield % pa net of inflation but NOT net of income tax |          |
|------------------------------------|--|----------|
|                                    | DSC  | P/B      |
| 2.79                               | 6.49   | 8.59     |
| 13.54                              | (-) 3.59   | (-) 1.69 |
| 7.83                               | 1.51   | 3.51     |

Fixed return securities are clearly a gamble on future inflation.

The nominal yield is taxed. This causes a leveraged reduction in the real yield. For example, suppose the nominal yield is taxed at 10%, and inflation in the next 10 years is at the average observed rate of 7.83%. Then the net of tax real yield on P/B would drop to 2.44% instead of 3.51%. If the nominal income is taxed at 20%, the net real yield would drop to 1.36%.

The impact of income tax on DSC's would be slightly diluted, because tax would be levied at encashment, not every year.

For a high tax payer, a positive pre-tax real could be converted into a negative post-tax real yield. It would be a tax on capital!

### The cheapest is not always the best

"It is unwise to pay too much, but it is worse to pay too little. When you pay too much, all you lose is a little money - that is all. When you pay too little, you sometimes lose everything, because the thing you bought was incapable of doing the thing it was bought to do.

The common law of business prohibits paying a little and getting a lot. It can't be done.

If you deal with the lowest bidder, it is well to add something for the risk you run, and if you do that, you will have enough to pay for something better".

(John Ruskin, 1819-1900)

**Tax points based on plain reading of law. Readers should take expert tax advice.**

**Quotations permitted, provided source cited as "Akhtar & Hasan, Actuaries"**