

Doing Business Reforms Strategy Pakistan 2019-21

BUSINESS REGULATIONS GLOBAL UNIT
MACRO, TRADE, AND INVESTMENT



Table of Contents

1. Introduction and Recommendations	2
Economic and Policy Context.....	2
Business Environment and Pakistan’s Performance in Doing Business.....	2
Scope of the Memorandum.....	4
2. Starting a Business.....	13
3. Dealing with Construction Permits	23
4. Getting Electricity.....	38
5. Registering Property	50
6. Getting Credit.....	60
7. Protecting Minority Investors	69
8. Paying Taxes.....	77
9. Trading across Borders	90
10. Contract Enforcement	101
11. Resolving Insolvency.....	109
Acknowledgments.....	118

1. Introduction and Recommendations

Economic and Policy Context

Economic performance in Pakistan remains robust with GDP growth in FY18 at 5.8 percent - its highest level in 11 years. However, the fiscal deficit has continued to expand as revenue growth is weak and there are substantial increases in recurrent spending. This, coupled with a large current account deficit, has accentuated the country's fiscal vulnerabilities.

Pakistan's relatively poor export performance over the past decade reflects the declining competitiveness of its economy. While South Asia's exports increased by 165 percent from 2005 to 2017, Thailand's by 136 and Vietnam's by an impressive 519 percent, Pakistan's exports grew by only 50 percent, including a continuous decline and stagnation from FY11 until FY17. Integration into the global economy provides opportunities for Pakistani firms to increase productivity - the fundamental driver of growth. Two areas stand out as negatively affecting the economy's competitiveness: (i) anti-export macroeconomic and trade policies; and (ii) a poor investment climate¹.

The new Government of Pakistan recognizes the role of the private sector and the need to improve the business regulatory environment. Improving the investment climate has been on the agenda and highlighted in the Prime Minister's speeches in the past few months. Pakistan is already implementing a series of reforms to address the adverse business environment, at both the federal and provincial levels. It will be essential to maintain and increase these efforts, bearing in mind that results may materialize only with a time-lag. The prime minister's office should lead the reform efforts - a strategy that has proved useful in other countries - and is supported by improved coordination to ensure that this is a 'whole of government and federation' effort and not one of a single agency.

Business Environment and Pakistan's Performance in Doing Business

The World Bank Group's *Doing Business* project provides a measure of the "ease of doing business" in 190 countries through a set of objective indicators that focus on the impact of laws, regulations and their enforcement on the ease of *Doing Business* for domestic firms in 10 areas from starting a business, to operations to insolvency.² Rules efficiently implemented, transparent, accessible, and those that strengthen property rights are essential for growth and job creation.³ The *Doing Business* indicators cover an important, albeit not comprehensive, set of such regulations. Since the publication of the first *Doing Business* report in 2004, governments around the world have implemented over 2,900 reforms striving to align domestic business regulation with the right practices advocated by *Doing Business*. Many governments use *Doing Business* indicator sets to formulate and monitor their reform efforts. Economies have implemented regulatory reforms inspired by *Doing Business* in all regions.. Economies as diverse as Brazil, Colombia, the Russian Federation, Rwanda, and Mauritius among many others have utilized *Doing Business* as a catalyst for their business reform agenda. This drive has also had an impact in the South Asia region over the past years. In 2017/2018 alone, South Asia implemented around 20 reforms in six of the region's eight countries. India and Afghanistan were among the top 10 reformers in the *Doing Business* 2019 report.

¹ Pakistan Development Update, World Bank Group, October 2018.

² www.doingbusiness.org

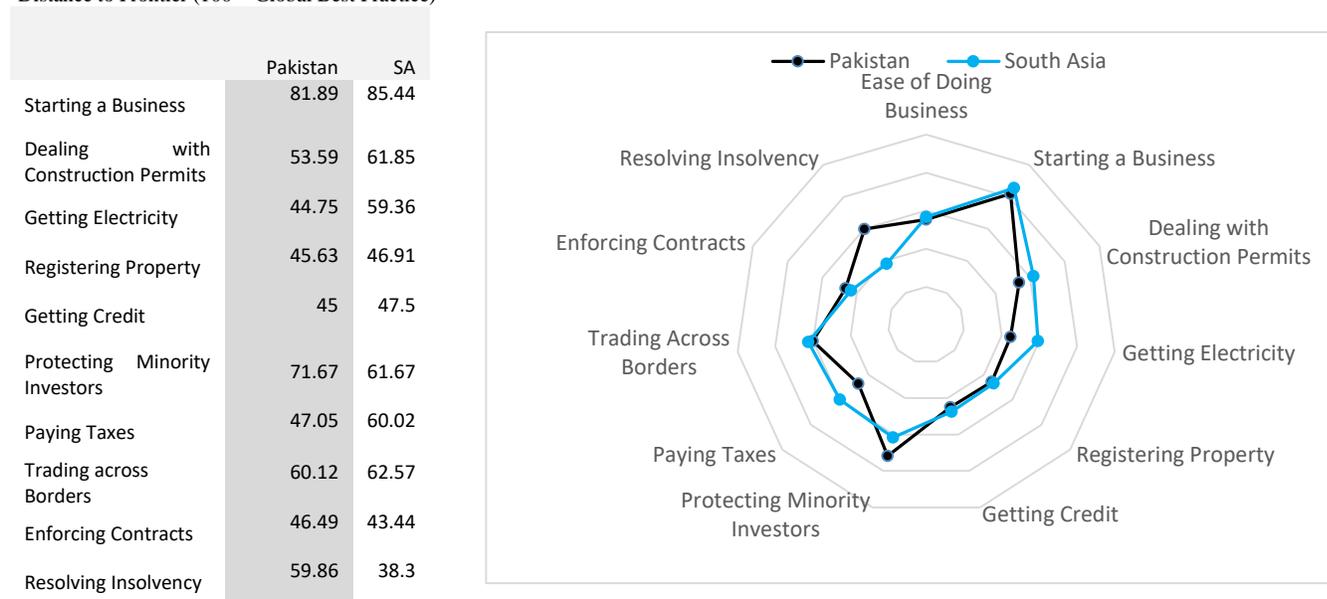
³ For an overview of relevant empirical research on the effects of business regulations, see <http://www.doingbusiness.org/reports/global-reports/doing-business-2014> pages 30-39.

Pakistan has consistently implemented efforts to improve the business environment in the areas measured by the *Doing Business* report. Since 2008, the country has implemented 16 reforms as measured by *Doing Business*. The momentum has grown especially over the last few years during which Pakistan has undertaken several legal changes such as the enactment of the Companies Act 2017, the Secured Transactions Act 2016 and the Corporate Rehabilitation Act 2018. The reform efforts resulted in easier business startup procedures by enhancing the online one-stop registration system, creating a single application form for incorporation and establishing information exchange between the registry and the tax authority. Pakistan also has made Registering Property simpler by streamlining and automating administrative procedures, and by increasing the transparency of its land administration system. Furthermore, minority shareholder protections were strengthened, and a reorganization procedure introduced to ease insolvency proceedings. Finally, the government automated customs operations through the installation of the Web-based One Customs (WeBoC) system that streamlined processes for import and export procedures.

Despite this progress, the *Doing Business* 2019 report shows that Pakistan’s overall performance on the ease of doing business has still room for improvement. In the same timeframe, since 2008, India has implemented 31 reforms and Sri Lanka 23. Pakistan’s overall rank in *Doing Business* 2019 was 136th out of 190 countries, and 5th out of eight economies in the region. Pakistan’s ranking reflects an overall ease of doing a business score of 55.31 percentage points (out of a possible 100). Pakistan lags slightly behind the South Asia regional average suggesting room for improvement especially in the areas measured by the indicators on Construction Permits, Getting Electricity, and Paying Taxes (Figure 1.1).

Figure 1.1. Pakistan’s performance across *Doing Business* topics

Distance to Frontier (100 = Global Best Practice)



Source: World Bank Group *Doing Business* 2019

Several significant opportunities for improvements emerge that span across the areas measured by the *Doing Business* report and relate to the interactions between the government and the private sector throughout the business cycle:

- **Consultation with the private sector during the policy-making process needs to be enhanced and focused.** There seems to be no consistent public-private dialogue forum either at the federal or the provincial level. Making this type of consultation more systematic would be beneficial for the reform

efforts in two ways. First, it will allow the authorities to identify the challenges of the private sector and address them through their reform efforts, and second, it will ensure that the private sector is appropriately informed on the changes put in place through the authorities' reforms.

- **There is a need for more communication of reforms as well as increased transparency of rules, regulations, and procedures.** Changes undertaken by the government should be communicated more proactively and systematically to the private sector – through a public-private dialogue platform, different media channels, communication campaigns, and *Doing Business* online portal. The authorities could also be more active in publishing rules and regulations both in government offices and on the agencies' website. The procedures for different government services towards the business community and the fee schedules for public services should be easily accessible to the private sector and citizens.
- **The application of rules and regulations should be consistent and predictable through changes in government.** The private sector expresses concern about the constant changes in policies with the change of government but also during the term of one government. It increases uncertainty for their operations.
- **More coordination is needed among government units, especially within each of the provincial levels.** Many business regulation reforms involve several government offices that should cooperate more to implement the changes. The reform coordinating bodies (the Planning and Development Departments) in both Sindh and Punjab should organize joint meetings with all actors in each area of *Doing Business*. The reforms led by the Punjab IT Board are an excellent example of coordination that can be replicated.
- **Lahore and Karachi should strive to have harmonized procedures for government-to-business services and coordinate the timing of reforms.** The reforms will be more useful for the private sector if undertaken simultaneously in both metropolises. In those cases where one of the cities is more advanced, those examples should be replicated in the other town as well. For example, the reform advancements in Starting a Business and Registering Property in Lahore could be replicated in Karachi, and the Lahore Electricity Supply Company (LESCO) could consider the ongoing reform initiatives that K-Electric is putting in place in Karachi.

The Scope of the Memorandum

Doing Business offers policymakers a benchmarking tool useful in stimulating policy debate, both by exposing potential challenges and by identifying good practices and lessons learned. Over the past decade, it has been used by policymakers in an increasing number of economies to advance their business environment and competitiveness reform agendas. More than 40 economies globally have established units dedicated to specific reform action plans leveraging *Doing Business* indicators. Economies as diverse as Malaysia, Colombia, Rwanda, Kenya, Russian Federation, and Brunei Darussalam have created regulatory reform committees using *Doing Business* as an input to inform their programs for improving the business environment. The next section provides explanations of the main features of successful reformers and examples from different countries.

Indicators and benchmarks indicate factors that contribute to the creation of an overall enabling environment for business and can help governments identify areas of business regulation that could benefit from further improvement to support private sector growth and investment. In response to the request of the Board of Investment of Pakistan, this reform memorandum provides recommendations in areas where the local and central governments can have a direct impact on business conditions, and it discusses how some of these shortcomings can be addressed through legal and regulatory reforms.

The recommendations are based on Pakistan’s results in the *Doing Business 2019* report, global regulatory trends and practices, interviews with relevant public and private sector stakeholders in Islamabad, Lahore and Karachi conducted during a visit from November 26 to December 7, 2018,⁴ as well as related analytical work. They focus on regulatory and administrative reform options in the areas of business regulation measured by the Doing Business project. Each chapter presents features of effective regulatory systems in the respective field, examples from across the world, and specific recommendations for the Government of Pakistan. The proposals do not address all aspects of the investment climate in the country, but focus on how to:

- Ease business entry and operation with a focus primarily on small and medium domestic firms by reducing complexity and cost of regulatory processes and increasing transparency (e.g., by streamlining registration and licensing procedures).
- Strengthen the regulatory and institutional framework aimed at securing property rights and increasing access to credit (e.g., through robust secured transactions and insolvency frameworks, credit information sharing systems and effective contractual enforcement mechanisms).

The recommendations take into account ongoing reform initiatives and policy discussions, some of which can positively impact the business environment as well as the areas included in the *Doing Business* report. Some of the recommendations provided can be addressed in short to medium term, while other recommendations are only implementable over a more extended period. The indicated timeframes are preliminary and based on the experience of other countries. All actions will require consultations with and coordination of different stakeholders and especially with the private sector. Interagency coordination and a strong focus on implementation will be crucial to the success of any reform efforts in Pakistan.

Predicting whether the improvements in investment climate topics highlighted in this memorandum will impact the *Doing Business* rankings for Pakistan is difficult as any ranking is relative to other countries’ performance. For reforms to be captured by the *Doing Business* report, it will also be essential that they are fully implemented and enforced by the public sector and practiced by the private sector and the practitioners. The *Doing Business* project records reforms which are not only enacted into law but that are also fully implemented (Box 1.2). Rather than aiming at specific advancements in the rankings, emphasis should be placed on implementing critical reforms to improve the investment climate. A rigorous reform effort will likely be reflected in those areas and - more importantly - provide a better business environment that is more conducive to private sector development and economic growth.

⁴ The team held meetings with public and private representatives to discuss the current systems and regulations in place, ongoing or planned reform initiatives, as well as more broadly constraints to conducting business in Pakistan with regards to 10 of the 10 regulatory areas covered by *Doing Business*: Starting a Business, Dealing with Construction Permits, Getting Electricity, Registering Property, Getting Credit, Protecting Minority Investors, Trading Across Borders, Paying Taxes, Enforcing Contracts, and Resolving Insolvency.

Box 1.2: Reform criteria according to *Doing Business*.

Reform is an action taken by government (or a private utility in the case of the Getting Electricity indicator) that impacts the *Doing Business* data. A change in the data due to other factors is not considered reform. All reforms have to be fully implemented before the cut-off date, which is May 1st of every year. Legal changes have to be entirely in effect. It entails the proper implementation as well as the public recognition (e.g., publication in the official gazette if required). For indicators that have a time and procedure component, usage by the majority of case study companies covered is a prerequisite for the reform to be counted. For example, unless the majority of domestic companies uses electronic systems, they would not be taken into account.

Source: World Bank Doing Business

Table 1.1 provides a summary of the rest of the short and medium-term reform recommendations, described in more detail in this memorandum.

Table 1.1. Pakistan's performance on the *Doing Business* indicators and suggested short and medium-term recommendations

Topics	Indicators (<i>Doing Business</i> 2019 report)	Short-term reform recommendations	Medium to long-term reform recommendations
Starting a Business	<p>Procedures: 10 Days: 16.5 Cost (% of income per capita): 6.8 % Paid-in min. capital (% of income per capita): 0 % Global rank: 130</p>	<ol style="list-style-type: none"> 1. At the federal level, fully integrate EOBI registration with the e-services portal of SECP. 2. Merge the registration of Social Security Institutes (PESSI/SESSI) and the Provincial Labor Departments in Punjab and Sindh. 3. Clarify the business start-up processes to the public and explore ways to increase the uptake of online registration for those institutions that provide the option. 	<ol style="list-style-type: none"> 4. Explore ways to simplify the registration for sales tax by eliminating the physical inspection at the business location and the biometric appointment. 5. Merge STRN and NTN and introduce a unique business identification number. 6. Integrate all agencies, both federal and state, into one single portal for online registration without the need for physical presence. 7. Eliminate the requirement of obtaining an official company seal by changing the Company Act, followed by extensive awareness campaigns to support implementation.
Dealing with Construction Permits	<p>Procedures: 18 (Karachi); 20 (Lahore) Days: 261 (Karachi); 266 (Lahore) Cost (percent of warehouse value): 11.8 % (Karachi); 3.6% (Lahore) Building quality control index: 12.5/15 (Karachi); 12/15 (Lahore) Global rank: 166</p>	<ol style="list-style-type: none"> 1. Improve pre-screening of construction permit applications and abide by the published time objectives. 2. Increase the transparency of the construction permit approval process by releasing and proactively informing the public on the documents needed for the issuance of a building permit. 3. Re-engineer business processes for all construction types to centralize the obtaining of all NOCs from the required agencies. 4. Remove the property valuation form (PT-1) as a requirement from WASA in Lahore. 5. Roll-out the e-permit system in Lahore to all types of buildings and allow for e-payments. 	<ol style="list-style-type: none"> 6. Link the systems of LDA and SBCA with those of the land management authorities to expedite the obtainment of the proof of ownership. 7. Introduce a risk-based system for construction approvals and inspections based on the buildings' essential features and intended use. 8. Set up a single window for construction permit application processing at SBCA and eventually make it available online. 9. Consider allowing private firms to sign-off on the completion certificate, while ensuring the quality of professional qualifications. 10. Introduce legislation in Lahore on possible defect liability and introduce liability insurance requirement in both cities.
Getting Electricity	<p>Procedures: 5 (Karachi); 6 (Lahore) Days: 185 (Karachi); 117 (Lahore) Cost (percent of property value): 1587 % (Karachi); 1582 % (Lahore)</p>	<ol style="list-style-type: none"> 1. Undertake a detailed study of the application process to understand the bottlenecks. 	<ol style="list-style-type: none"> 6. Increase the availability of material at the utility companies. 7. Enforce internal wiring inspection and streamline its procedure.

Topics	Indicators (<i>Doing Business 2019</i> report)	Short-term reform recommendations	Medium to long-term reform recommendations
	Reliability of supply and transparency of tariffs index: 0 Global rank: 167	<ol style="list-style-type: none"> 2. Introduce a cost calculator and make procedures, guidelines, and fees more transparent. 3. Provide option to pay connection fees and security deposits in installments - and consider cross subsidizing connections. 4. Include load shedding in the calculation of SAIDI and SAIFI. 5. Set up binding time limits on procedures to connect to the electricity grid. 	<ol style="list-style-type: none"> 8. Roll out the full online application system, with an e-payment option. 9. Introduce a Geographic Information System (GIS) for the electricity distribution network. 10. Obtain excavation permit on behalf of clients in Karachi. 11. Invest in smart meters.
Registering Property	Procedures: 8 (Karachi); 6 (Lahore) Days: 208 (Karachi); 25.5 (Lahore) Cost (percent of property value): 4.2 % Quality of land administration index: 7/30 (Karachi); 14/30 (Lahore) Global rank: 161	<ol style="list-style-type: none"> 1. Strengthen service standards and time limits and make them publicly available online in Karachi. 2. Increase transparency by publishing statistics on land disputes in Karachi. 3. Increase awareness-raising efforts on recent reforms and clarify the legal requirements to avoid over-compliance and close implementation gaps. 4. Establish a dedicated and independent mechanism to track and deal with complaints related to property registration and cadaster in Karachi. 5. Fully automate the process of paying stamp duties in Karachi and Lahore. 6. In Lahore, integrate databases further by linking PLRA and Excise and Taxation Department's systems to check property tax liabilities automatically. 7. In Karachi, ensure full automation of the procedure to obtain the sales certificate (NOC). 8. In Karachi, review land-related procedures at the Board of Revenue to identify bottlenecks 	<ol style="list-style-type: none"> 9. Achieve full digitalization of ownership records and cadastral plans and continue improving the GIS system in Karachi and Lahore. 10. In Karachi, establish a single-client-facing agency for land administration and integrate the databases and systems for land registration and cadaster. 11. Provide training for land registry and cadaster staff after the introduction of the new land administration system in Karachi. 12. Reduce the time to obtain decisions on land disputes from the district courts (See also recommendations under Enforcing Contracts).

Topics	Indicators (<i>Doing Business 2019</i> report)	Short-term reform recommendations	Medium to long-term reform recommendations
		and explore ways to streamline the deed execution, registration, and scanning processes.	
Getting Credit	The strength of legal rights index: 2/12 The depth of credit information index: 7/8 Credit registry coverage (% of adults): 10.7% Credit bureau coverage (% of adults): 7.2% Global rank: 112	<ol style="list-style-type: none"> 1. Operationalize the secured transactions framework by adopting regulations for the ST Act. 2. Extend the information covered by credit reporting service providers to include data from retailers or utilities. 3. Implement a unified geographically notice-based, searchable electronic secured transactions registry under the ST Act. 	<ol style="list-style-type: none"> 4. Consider amending the secured transactions legal framework to implement a unified or integrated system. 5. Amend the Corporate Rehabilitation Act 2018 to introduce automatic stay, as well as time limits for its duration in reorganization proceedings. 6. Amend the Companies Act to assure secured creditors are paid with priority in liquidation. 7. Implement an awareness-raising campaign and capacity building activities on the new tools introduced by the ST Act.
Protecting Minority Investors	The extent of disclosure index: 6/10 The extent of director liability index: 7/10 Ease of shareholder suits index: 6/10 The extent of shareholder rights index: 8/10 The extent of ownership and control index: 9/10 The extent of the corporate transparency index: 7/10 Global rank: 26		<ol style="list-style-type: none"> 1. Require independent review of related-party transactions before they take place in the Companies Act or the Listed Companies Regulations. 2. Require the immediate public disclosure of related party transactions. 3. During a related party transaction, allow shareholders to hold directors (both interested and disinterested) liable also for unfair or prejudicial and not only negligent related party transactions. 4. Give courts authority to cancel unfair related party transactions. 5. Allow the plaintiff to question the defendant and witnesses at trial directly. 6. Allow plaintiffs to recover legal expenses from the company.

Topics	Indicators (<i>Doing Business 2019</i> report)	Short-term reform recommendations	Medium to long-term reform recommendations
			<ol style="list-style-type: none"> 7. Require shareholder approval when issuing new shares or new members. 8. In case of limited liability companies, require the buyer to make a tender offer to all shareholders when acquiring 50% of the company. 9. Increase the protection of investors by requiring disclosure of management compensation. 10. Allow shareholders owning 5% of shares or members representing 5% of the capital put items on the meeting agenda for both listed and limited liability companies.
Paying Taxes	<p>Number of payments: 47 Time (hours): 293.5 Total tax rate (percent of profit): 34.2% Post-filing index: 10.49/100 Global rank: 173</p>	<ol style="list-style-type: none"> 1. Ensure that e-payment is available in practice for corporate accounts to provide all types of companies with the option to pay Corporate Income Tax and GST through the FBR electronic platform. 2. Conduct a review of the tax forms and documentary requirements and streamline the process to file and pay GST while continuing to improve STRIVE. 3. Plan an outreach campaign to familiarize taxpayers with new systems and tax reforms. 	<ol style="list-style-type: none"> 4. Extend e-filing and e-payment services for all taxes and contributions, including social security and pension contributions as well as provincial taxes. 5. Conduct a feasibility study of merging the filing and payment of taxes with the same tax base. 6. Review and streamline internal processes at FBR for GST refunds to reduce processing time and introduce good financial management practices. 7. Strengthen risk-based categorization, improve efficiency, and monitor performance indicators to make sure that targets are met for GST and CIT audits (selection targets, and audit length).
Trading Across Borders	<p>Time to export: Border compliance (hours): 75 The cost to export: Border compliance (USD): 356 Time to export: Documentary compliance (hours): 55</p>	<ol style="list-style-type: none"> 1. Analyze port processes to eliminate duplicate regulatory activities and shorten the time to export and import. 2. Review and improve the Customs risk management system to achieve greater efficiency. 	<ol style="list-style-type: none"> 6. Improve the system of the electronic issuance of I-Form and Form-E. 7. Introduce a smart examination system for red channel consignments. 8. Take administrative measures to discourage use of port as a free storage area.

Topics	Indicators (<i>Doing Business 2019</i> report)	Short-term reform recommendations	Medium to long-term reform recommendations
	<p>The cost to export: Documentary compliance (USD): 118 Time to import: Border compliance (hours): 120 The cost to import: Border compliance (USD): 476 Time to import: Documentary compliance (hours): 143 The cost to import: Documentary compliance (USD): 250 Global rank: 142</p>	<ol style="list-style-type: none"> 3. Review the necessity of issuing price certificates for cotton and other export consignments and consider their automation through the Customs' WeBOC system. 4. Reduce the processing time for the issuance of the bill of lading. 5. Remove obstacles in the electronic issuance of Certificate of Origin to reduce processing time from eight hours to two. 	<ol style="list-style-type: none"> 9. Deploy active business intelligence and data analytics tools. 10. Implement the Port Community System (PCS). 11. Implement the Pakistan National Single Window System (PNSW).
Enforcing Contracts	<p>Time (days): 1096 (Karachi); 1025 (Lahore) Cost (% of claim): 18.1 (Karachi); 25 (Lahore) Quality of judicial processes: 6/18 (Karachi); 5/18 (Lahore) Global rank: 156</p>	<ol style="list-style-type: none"> 1. Conduct an in-depth assessment of court processes as well as the legal framework for handling commercial cases to identify and address the underlying causes of delays. 	<ol style="list-style-type: none"> 2. Consider the creation of specialized commercial courts, divisions or benches. 3. Introduce case management practices to address delays during the trial process – such as limiting excessive adjournments and enforcing time standards. 4. Introduce pretrial conferences as a critical element of case management. 5. Support the introduction of electronic filing of initial complaints and other court automation elements in commercial cases. 6. Provide continuous training to judges with jurisdiction over business matters. 7. Strengthen efforts to promote mediation and conciliation. 8. Evaluate increasing the minimum amount, a claim must have to trigger the original jurisdiction of the Sindh High Court.
Resolving Insolvency	<p>Time (years): 2.8 (Karachi); 2.3 (Lahore) Cost (percent of the estate): 4% Recovery rate (cents on the dollar): 43.4 (Karachi); 46.4 (Lahore) The strength of insolvency framework: 11.5/16</p>	<ol style="list-style-type: none"> 1. Enact secondary legislation to facilitate the operationalization of the Corporate Rehabilitation Act, including a regulatory framework for professional insolvency practitioners. 	<ol style="list-style-type: none"> 3. Introduce special simplified procedures for Small and Medium Enterprises (SMEs) insolvency.

Topics	Indicators (<i>Doing Business 2019</i> report)	Short-term reform recommendations	Medium to long-term reform recommendations
	Global rank: 53	2. Create an insolvency registry where information about insolvency cases can be accessed.	4. Extend the possibility of granting post-commencement financing to non-administration proceedings. 5. Revise the Corporate Rehabilitation Act to enhance creditors' rights in insolvency proceedings. 6. Extend the power to assume or reject executory contracts to debtor-in-possession rehabilitation and liquidation procedures. 7. Incorporate a pre-packaged restructuring option to the Corporate Rehabilitation Act to enable the fast and swift court processing of out of court restructurings. 8. Improve the judicial capacity to handle insolvency cases.

2. Starting a Business

Efficient and effective business regulations support firm creation and productivity. Economies that have efficient business registration processes also tend to have a higher entry rate by new firms and greater business density.⁵ Faster business registration is associated with more businesses registering in industries with the strongest potential for growth, such as those experiencing expansionary global demand or technology shifts.⁶ Empirical evidence also suggests that more efficient business entry regulations improve firm productivity and macroeconomic performance.⁷ Another recent study found that higher entry costs are associated with a larger informal sector and a smaller number of legally registered firms.⁸ Furthermore, higher compliance costs cut into firm profits and discourage entrepreneurs, which in turn reduces job creation in the economy.⁹

The *Doing Business* “Starting a Business” indicator measures the procedures, cost, time and minimum paid-in capital necessary for domestic entrepreneurs to register and formally operate a new limited liability company. *Doing Business* 2019 reports that to start a business in both Karachi and Lahore, entrepreneurs must go through 10 procedures, which take 16.5 days on average and cost 6.8 percent of Pakistan’s income per capita. No minimum paid-in capital is required. Globally, Pakistan ranks 130th out of 190 economies in *Doing Business* 2019 on the ease of Starting a Business and 6th out of eight economies in South Asia. It scores 81.89 points (out of 100) on the ease of Starting a Business score.¹⁰

Starting a Business in Pakistan requires many interactions with federal and provincial authorities – as well as private entities. Budding entrepreneurs in both Lahore and Karachi need to reserve the company name, register their business with the Securities and Exchange Commission of Pakistan (SECP) and obtain a national tax number and sales tax number from the Federal Board of Revenue (FBR). For companies with more than five employees, registration with the federal Employees Old-Age Benefits Institution (EOBI) is also required. At the provincial level – and depending on a company’s activity and headcount - registration with the provincial Employees Social Security Institution (SESSI in Sindh and PESSI in Punjab) and Labor Department is needed. In addition to federal and provincial authorities, companies also need to interact with private entities to open a bank account for tax registration and make a company seal from a seal maker, as required by *Article 23 of the Companies Act, 2017*.

The high number of procedures - and associated time – suggest that there is room for improvement. In economies like New Zealand, for example, an entrepreneur can start a business in half a day with only one procedure). In South Asia, as well as at the global level, most countries have been able to streamline more processes than Pakistan.

⁵ Klapper, Leora, Anat Lewin and Juan Manuel Quesada Delgado. 2009. “The Impact of the Business Environment on the Business Creation Process.” Policy Research Working Paper 4937, World Bank, Washington, DC

⁶ Ciccone, Antonio and Elias Papaioannou. 2007. “Red Tape and Delayed Entry.” *Journal of the European Economic Association* 5(2-3): 444-58.

⁷ Loayza, Norman, Ana Maria Oviedo and Luis Servén. 2005. “Regulation and Macroeconomic Performance.” Policy Research Working Paper 3469, World Bank, Washington, DC, and Barseghyan, Levon. 2008. “Entry Costs and Cross-Country Differences in Productivity and Output.” *Journal of Economic Growth* 13 (2): 145-67.

⁸ Barseghyan, Levon, and Riccardo DiCecio. 2009. “Entry Costs, Industry Structure and Cross-Country Income and TFP Differences.” Working Paper 2009-005C, Federal Reserve Bank of St. Louis.

⁹ Fonseca, Raquel, Paloma Lopez-Garcia and Christopher Pissarides. 2001. “Entrepreneurship, Start-Up Costs and Employment.” *European Economic Review* 45 (4–6): 692–705.

¹⁰ The ease of Starting a Business score captures the gap between an economy’s performance and a measure of best practice in Starting a Business. It is the simple average of the scores for each of the component indicators. The closer the score is to 100, the closer the regulatory practice is to global best. For further details on how the score and rankings are calculated, see www.doingbusiness.org.

Table 2.1 Starting a Business ranking and best performers

<i>Doing Business</i> Indicator	Pakistan	Regional Average	Regional best performer	Global best performer
Procedures (number)	10	7.7	4.5 (Afghanistan)	1 (New Zealand; Georgia)
Time (days)	16.5	13.8	8.5 (Afghanistan)	0.5 (New Zealand)
Cost (percent of income per capita)	6.8	11.0	3.5 (Bhutan)	0 (Slovenia)
Paid-in Min. capital (percent of income per capita)	0.0	0.2	0 (7 economies)	0 (117 economies)

Source: World Bank, *Doing Business 2019 data*

Starting a Business over time

Several regulations legislate the registration of private limited liability companies in Pakistan. The *Company Act 2017*, sets the legal framework that relates to company law and matters connected in addition to that. Among other areas, it establishes the power and functions of the Securities and Exchange Commission of Pakistan (SECP), the rules governing incorporation (e.g., provisions concerning company names, obligation to publish a company name and create a company seal) as well as regulations for the management of different company types. The *Companies (Incorporation) Regulations 2017 S.R.O 704 (I)/2017*, lists all the requirements, documentation and procedural steps to incorporate at the SECP and obtain a national tax number (NTN). The amended *EOBI Act 1976 effective as of July 2008* dictates that every industry or a commercial establishment with five or more employees must register with the federal Employees Old-Age Benefits Institution. The *Pakistan Shops and Establishment Ordinance 1969* requires every establishment other than a one-person shop to be registered with the Deputy Chief Inspector of the Labor Department in each district. The *Sales Tax Act 1990* and *Sales Tax Rules 2006* require companies to register for sales tax at the nearest Regional Tax Office (RTO). Finally, provincial law oversees the registration with social security. For example, the *Punjab Employees Social Security Ordinance 1965*, updated through the *PESSI Amendment Act 2013* requires registration with the Punjab Employees Social Security Institution (PESSI).

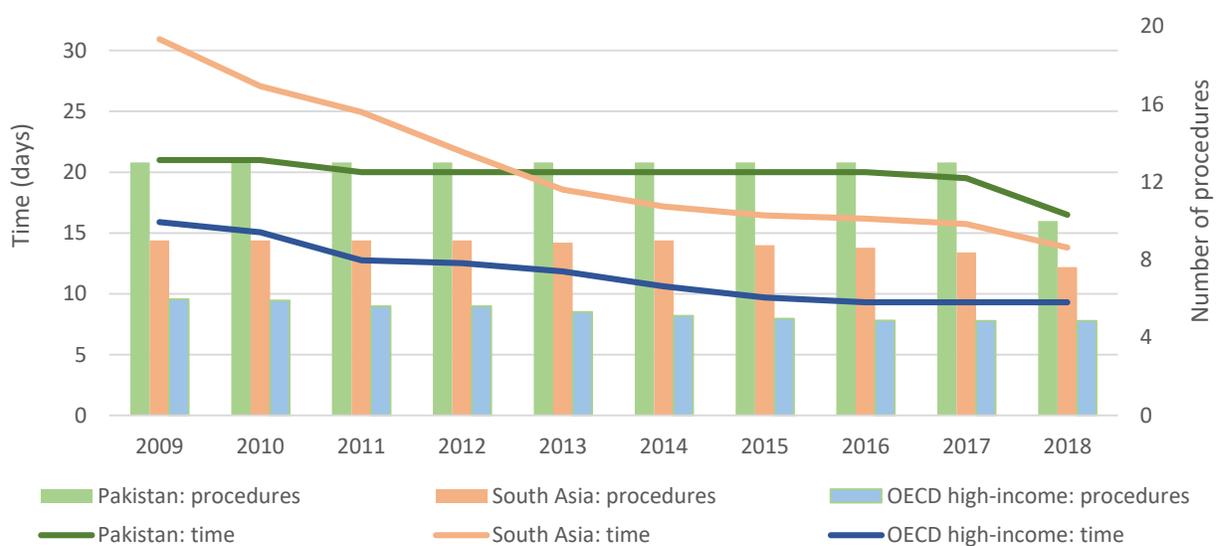
Pakistan has made notable progress to improve business registration in recent years. In 2016/17 Starting a Business was made easier by replacing the need to obtain a digital signature for company incorporation with a less expensive personal identification number. The following year, Pakistan streamlined procedures and decreased time through several initiatives:

- 1) In early 2018, the Securities and Exchange Commission of Pakistan (SECP) launched a single online process for user registration, name reservation, company incorporation, and notification of appointment of CEO. The *Companies (Incorporation) Regulations* set the legal framework for the changes, 2017 S.R.O 704 (I)/2017 dated July 26, 2017 and enforced on August 14, 2017. The new process allows applicants to conduct several procedures at once, including name reservation and payment.
- 2) The regulation mentioned above abolished the fee for providing the CEO's details on the incorporation application. Moreover, the four incorporation forms previously required (i.e., Form 1, 21, 29, Memorandum) were merged into one. A single filing fee is also charged - as specified in paragraph I (8) of Seventh Schedule of the *Companies Act 2017*. The new template form also allows SECP to collect all the required information on the CEO, eliminating the need for follow-ups.

- The SECP collaborated with the Federal Board of Revenue (FBR) to enhance the scope of existing data exchange between the two federal agencies. The increased cooperation was piloted in early 2018 and released in March 2018. This new system enables FBR to automatically issue a national tax number (NTN) to companies once they are registered with the SECP. Once the incorporation application is submitted at the SECP, the information on the new company is shared with the FBR, and the company receives the national tax number as part of the incorporation documents package.

Despite Pakistan’s onwards efforts in business registration, there is ample room to improve the process further to register a company. While it is relatively cost-efficient to start a business in Lahore and Karachi, there is still a noticeable gap on time and procedures compared to both the global and regional average (figure 2.1). Several measures are, therefore, presented below so Pakistan can align its practices to some of the best performers worldwide.

Figure 2.1: Starting a Business is getting easier across the globe, but Pakistan now lags behind other countries.



Short-term reform recommendations

1. At the federal level, fully integrate EOBI registration with the e-services portal of SECP.

The Amendment in the *EOBI Act 1976 effective as of July 2008* requires that every industry or commercial establishment with five or more employees register with the federal Employees Old-Age Benefits Institution (EOBI). Under the Employees Old-Age Benefits Scheme, insured persons are entitled to a pension upon retirement or invalidity. The employer must pay a contribution of 5% of minimum wage, and the employee 1% of the minimum wage.

According to *Doing Business 2019*, the registration with EOBI in both Lahore and Karachi is done on a standalone basis once incorporation with SECP has been completed through the e-services portal. Companies are not required to register for EOBI if the number of employees is below a threshold of five. When the threshold is met months or years later after incorporation, companies must then undertake the EOBI registration process, which can be done in person or online through the EOBI Facilitation System. Many firms, however, end up never doing this - either due to a lack of awareness or a reluctance to make contributions. In any case, this creates a shortfall in revenue for EOBI. Also, the institution has limited capacity to track delinquent nonregistration cases as, historically, it is not integrated with the Federal Board

of Revenue (FBR) where companies' tax declarations are lodged - which include information on the number of employees.

Ultimately, EOBI registration should be done through the e-services portal of SECP. As SECP and the FBR are already interlinked, integrating EOBI into the e-services portal will allow the latter institution to gain access to FBR data and identify all companies with five employees or more that have failed to register. While most private limited liability companies typically have less than five employees upon incorporation, those that do should be prompted to register for EOBI immediately. This may already reduce the cases of delinquent nonregistration.

A Memorandum of Understanding signed in 2013 between SECP, FBR and EOBI had the intent of centralizing registration with the respective agencies. Today EOBI is the only institution that remains not fully integrated. The Virtual One Stop Shop (VOSS) does link users to EOBI's Facilitation System, but the registration is separate. Moreover, while SECP was planning to share data with EOBI on company registration before the end of 2018, EOBI contends that no such data are currently being pushed to the institution. Furthermore, the ultimate objective is not for SECP to merely transfer information to EOBI, but to make sure there is only one registration process.

2. Merge the registration of Social Security Institutes (PESSI/SESSI) and the Provincial Labor Departments in Punjab and Sindh.

Notable efforts are underway in Punjab to streamline company registration with state authorities, namely the Punjab Employees Social Security Institution (PESSI) and the Provincial Labor Department (PLD). On January 31, 2018, the Punjab Business Registration Portal was launched by the Punjab IT Board, making it possible to register for both PESSI and PLD at once. In June 2018, the PLD revised its regulations to eliminate the registration fee and the inspection required for registration. Today, companies using the system have already experienced time gains from two procedures being merged: official statistics report that online registration for PESSI and PLD takes 48 hours, compared to about a week when registration is done in person at the two institutions (as reported by *Doing Business* 2019). Unfortunately, however, there is currently a low uptake in the system - i.e., in June 2018, about 5% of registrations were done offsite using the online system. All other registrations were done at facilitation offices. These data stress the need for a communication campaign to encourage the use of the portal, especially as the Punjab IT board plans to integrate the portal mentioned above with the SECP system in early 2019.

Given the benefits that the Punjab Business Registration Portal has already showcased, a similar initiative is recommended for Sindh so that the registration with Sindh Employee Social Security Institution (SESSI) and the Sindh Labor Department is merged. With support from international donors, the provincial authorities in Sindh plan to create such a unified web portal driven by a central database that will source its information to provincial departments such as the Excise and Taxation Department, SESSI and the local Labor Department. A memorandum of understanding still needs to be signed between the respective institutions, which should be finalized in early 2019. It is vital that the MOU be signed as planned so that the new portal - which is reportedly already being tested - is launched in 2019 (provided all the necessary piloting has been done). As shown in Punjab, it will take time - perhaps many years - for the portal to be widely used for registrations. Moreover, delaying things further will not just prevent early adopters from experiencing time gains by using the system, it will also hinder Pakistan's effort to usher into the digital age.

3. Clarify the business start-up processes to the public and explore ways to increase the uptake of online registration for those institutions that provide the option.

There is confusion between the business community and public agencies as to what are the necessary steps to operate a business formally. For example, after incorporation, some businesses report that an authorized business representative still needs to go the FBR in person to submit documents. It is needed for partnerships but not officially required for LLCs since the launch of SECP's e-system platform a national tax number can be issued without further customer engagement.

The case above clearly illustrates that there is a communication gap between the private sector and the agencies involved in the business start-up process. The reform coordinating bodies in both Sindh and Punjab (the Planning and Development Departments) should organize joint meetings with big trade groups and business organizations (e.g., chamber of commerce) as well as the consultants who facilitate the start-up process. Furthermore, a nationwide and statewide campaign through several media outlets would help entrepreneurs know what the formal steps are to start a business. Box 2.1 provides some guidance on the channels through which to communicate the changes.

BOX 2.1. Considerations for the Design of a Communications Strategy

Selecting spokespersons from the business community. Using government officials as the primary spokespeople for successful regulatory reforms is ineffective, as they generally relate less to businesses and their priorities than other businesspeople do. To effectively convey messages about what can be gained from the reforms, select entrepreneurs and use them in the information campaigns. The message is more potent if conveyed by a beneficiary.

Using mass communication channels. Using specialized "passive" information channels (such as the legal gazette) is unlikely to reach the targeted audience. Sharing information about the benefits of the reforms, as well as the results of business surveys on remaining obstacles is best done through the mass media or social media. News stories could feature entrepreneurs, present new statistics, and describe what current reforms are taking place. Communications staff could be hired with the reform committee to do this effectively.

Organizing public events and gathering feedback. Invite entrepreneurs to talk about existing problems and gather their input - as well as what improvements they see. Invite the media and always leave ample time for questions. Do not organize only with the business associations; invite entrepreneurs directly. Communication works both ways in such events; they also allow businesses to explain their priorities to the government.

Using comparisons with other countries. Businesses and citizens are generally patriotic, regardless of how they regard their government's effort to reform. Parallels with the regulatory burdens in other countries especially in areas where the country is reforming, would catch the attention of entrepreneurs and media. They are especially useful for newspaper stories where figures can be shown.

Talk about future reforms. Start communicating early about the expected results and sustain the message as the change progresses. The longer the message stays in the news, the more likely it is that businesses will notice. The communication needs to be clear and direct on when the announced measures will be implemented. It is not just good marketing. Reforms are only useful if businesses learn how to take advantage of them. Also, businesses will only determine if the news has reached them.

Source: World Bank Group (2007).

The communication campaigns should also encourage companies to use the online systems provided – and ultimately go through the entire business process without the need of a consultant. As stated above, less than 5% of companies in Punjab make use of the Business Registration Portal for registrations with the Social Security and the Labor Department. It is because some companies have experienced difficulties with the e-system. Other firms out of habit voice a preference to use the facilitation centers while others are unaware that a portal even exists. Walk-in customers who visit the facilitation centers should, therefore, be made aware that a portal exists through brochures and advertisements. Facilitators can also guide these

customers. For example, Kazakhstan set up computers at its Public Registration Center one-stop shop over the last few years, and consultants now offer to help users with the online registration, guiding them through the entire process.

Medium and long-term reform recommendations

4. Explore ways to simplify the registration for sales tax by eliminating the physical inspection at the business location and the biometric appointment.

One of the bottlenecks in the business startup process in both Karachi and Lahore is the registration for the sales tax number (STRN). This process is reportedly taking a week – and sometimes even longer. It is because once the STR-1 form is submitted at a tax counter at the nearest Regional Tax Office (RTO) of FBR, an inspection is scheduled, followed by a biometric appointment with the founder(s) of the companies.

The physical inspection carried out by a tax officer typically occurs within three days of submission of the STR-1 form for the manufacturer but, depending on the location of a business' operations, it can take longer and further delay the start-up process. The inspection is necessary to check the place of the business and whether it matches what the RTO has on its records. Upon verification, the inspector submits a report with the commissioner who will issue a biometric appointment. To do away with the inspection, the RTOs in Lahore and Karachi are working on a geotagging system, whereby the location of the business can be checked against land records for ownership.

While a GIS may indeed eliminate the need for the RTO to inspect premises and involve businesses for what essentially amounts to a due-diligence check, the technology typically takes much time to implement and deploy. More realistically, the authority could switch from an ex-ante to an ex-post inspection regime given that a high percentage of companies indicate a correct address on their registration form. This would necessarily mean that the RTO would check companies' premises during the operation – and not registration – stage. The most common type of ex-post inspection is tax audits. In some countries, a tax audit inspection is conducted for all companies on a time-specific basis (e.g., each company is audited at least once in three years). Other economies follow the best practice, which is to conduct risk-based audits. In any case, the STRN inspection can be performed ex-post in a similar fashion to tax audit – or conjunctly with tax audits.

Another bottleneck for the STRN registration has to do with the biometric appointment, which was introduced in June 2016 by FBR for precautionary reasons. In short, businesses that were not paying their sales tax liability were claiming they had not registered for the STRN in the first place. Now that company founders are required to come for a biometric appointment such denial is harder to make. This requirement, unfortunately, delays the time for companies to start-up. It also results in more interaction with government officials, increasing the likelihood for a bribe. It is particularly problematic in Pakistan, as Enterprise Surveys data show that 46% of firms expect to give gifts to public officials "to get things done," which is more than double the global average.

It is recommended to explore ways to do away with the biometric appointment. One possibility is to use the data that commercial banks have already collected. Indeed, since November 30, 2018, the State Bank of Pakistan has directed all commercial banks, including microfinance and Development Finance Institutions (DFIs), to verify bank accounts of customers including individuals, corporations, and associations with biometric data. So now, when customers open a bank account (i.e., procedure 4 in the startup process according to Doing Business), fingerprints are taken and cross-checked with those that the National Database and Registration Authority (NADRA) has on file. It serves as an identity check. So, given that the bank now performs a biometric verification, the RTO should be dispensed from also doing a check. Alternatively, the PIN that is issued by SECP at the incorporation stage (i.e., procedure 1) can be used by entrepreneurs as a proof of identification when applying for their STRN number.

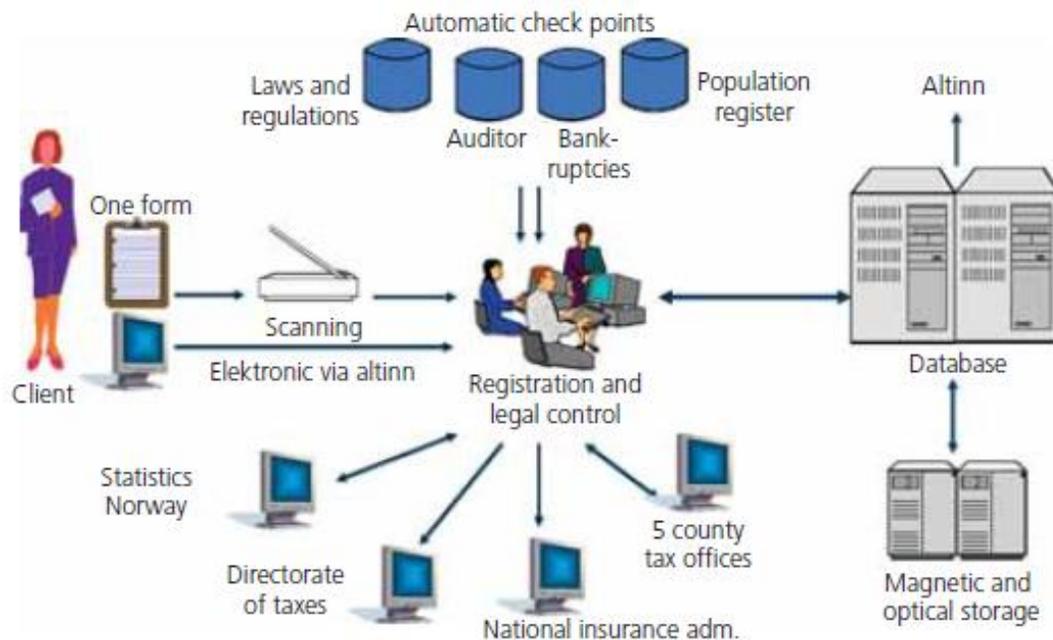
5. Merge STRN and NTN and introduce a unique business identification number.

Today, newly created companies in Pakistan need to obtain a national tax identification number and a separate sales tax number – in addition to a company registration number following the incorporation with SECP. To achieve greater integration of registration services, Pakistan should introduce a unique business identification number. It would reduce the risk of errors in identifying the same companies and facilitate enforcement.

To successfully implement the single ID a common database and interoperable information and communication technology (ICT) system of relevant government agencies should be developed to transmit and share business information among all agencies. Such an organization would make it easy for businesses to deal with different regulations, and for various government agencies to effectively monitor and regulate business activities.

Two approaches to implement this reform are most common. In one case, business registration is the initial step and includes the allocation of a unique ID, which is then reused by other authorities, such as the tax authorities or social security agencies. In Australia, for example, business registration is the first step in the process and includes the allocation of the company ID. Norway takes another approach, as entrepreneurs are allocated a unique ID before they proceed to register their business. The ID and the identifying information are then made available and reused by all agencies involved in the registration process. Before introducing such a change in Pakistan, it is vital to make sure that the databases of the agencies are integrated and that a unified ID would satisfy their needs.

Figure 2.2. - Back-office workflow at the Brønnøysund Register Center, Norway.¹¹



Source: World Bank Group

¹¹ “Business Registration Reform Case Study. Norway,” Investment Climate, World Bank Group, September 2011, p. 35., available here: <http://docplayer.net/16304244-September-2011-business-registration-reform-case-study-norway-investment-climate-world-bank-group-in-partnership-with.html>

Introducing a common ID for businesses requires mapping and conversion of existing identifiers. It is a comparatively complex and cost-intensive reform. Nonetheless, a growing number of countries have introduced such IDs to increase efficiency within the public sector and reduce the administrative burden on businesses. In 2009, Singapore launched a single identification number (SINGPASS) for all business-to-government transactions. In Estonia and Norway, systems are interoperable and interlinked with six other agency systems, namely the e-procurement system for government agencies, and the land, labor, tax, pledges and citizen’s registries (for Norway, Figure 2.2.). Slovenia’s system is also interoperable with six systems: land, labor, tax, pledges and citizen’s registries and the trade database.

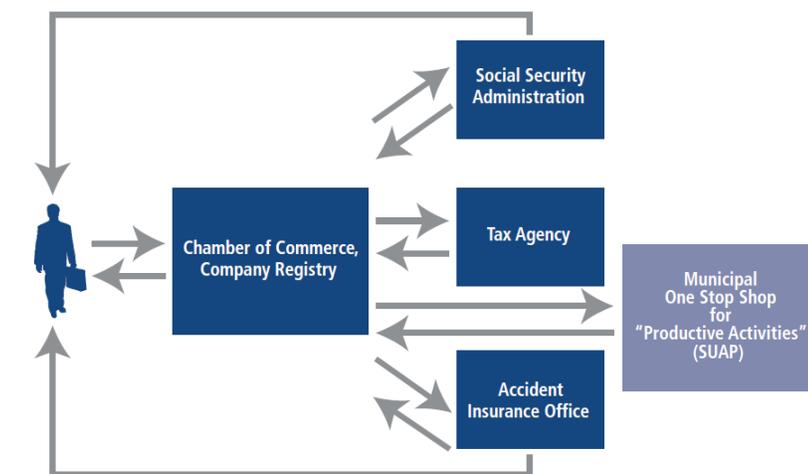
6. Integrate all agencies, both federal and state, into one single portal for online registration without the need for physical presence.

After having streamlined and modernized the registration systems with different agencies as recommended above, SECP should create a single interface for all registration formalities. At the back end, multiple agencies would be involved in the incorporation and post-registration process so that entrepreneurs benefit from complete company creation in just one interaction. To this end, a single electronic registration form could be introduced to capture all the information required by the relevant federal and state agencies. Of course, the form would need to account for different business cases based on activity and location. An interactive form that updates the required field based on user selection would provide such a feature.

Before establishing a single comprehensive portal, it is critical to streamlining all business registration processes currently in place, as recommended in the short-term recommendations. Requirements should be removed or merged, so that, in time, all approvals be consolidated. The key to a single unified portal is giving officials involved in the business start-up process, decision-making power for their respective agencies and foster cooperation.

Today around 115 economies have some kind of one-stop shop for business registration – but only a few carry out many integrated functions, including post-registration formalities with all tax authorities and social security. Also, a handful of these provides a single electronic interface for entrepreneurs, as in Denmark, New Zealand, and Norway.

Figure 2.3 – *Comunicazione Unica*: the Italian Single Notice System



Source: Doing Business database.

An example of a highly streamlined company registration process comes from Italy where starting a business requires just 5.5 days and allows applicants to electronically file a single notice (*Comunicazione Unica*) with the Register of Enterprises. This notice automatically registers the company for tax identification number, and VAT number with the Tax Agency, processes the company with the Social Security Administration and Accident Insurance Office and notifies the local municipality about the company address and commencement of operations (Figure 2.3).

Making registration electronic is the ultimate way to speed up and streamline business start-up and make it predictable. Seven of the economies with the fastest business start-up offer online electronic registration - Australia, Canada, Denmark, Estonia, New Zealand, Portugal, and Singapore. More than 20 economies have introduced electronic registration over the past six years.

Mauritius provides an example of a successful reform in this area. Since October 2006, all new businesses, including companies and individuals in Mauritius are registered through a “Companies & Business Registration Integrated System.” The applications for incorporation and registration are made online. The Commercial Registry grants access to information on new company registrations to tax, social security and local authorities through a Central Business Registration Database. At the time of registration, the Company Registry electronically informs the tax and local authorities of newly registered companies. Tax registration then takes place automatically. Once notified by the registry, local authorities will contact the companies and inform them of fees to be paid or any additional requirements based on the activity of the company. After the introduction of the computerized system in Mauritius, the total time of business registration was reduced by 80%.

Since SECP already carries company incorporation and partial tax registration, it is recommended that they further expand their e-portal system to to integrate all registration and post-registration procedures with state authorities fully. The payment at the provincial level for the District Labor Department would need to be digitalized and combined into a single one-time payment – meaning that the said labor department would need to agree on the modalities of the payment.

Box 2.2 contains some key considerations to keep in mind before implementing a comprehensive online business registration system.

Box 2.2: Key Considerations in Implementing Company Registry Software Applications

1. Complete the legal and business process reforms before automation - to fully realize the potential benefits of technology.
2. Critically assess the agency’s ICT capacity, both staff, and infrastructure - if internal capacity is inadequate, identify hosting alternatives within the government or the private sector.
3. Thoroughly document the business and functionality requirements before procuring a technology solution - this will also inform decisions concerning packaged versus custom-developed software.
4. Identify and build data linkages with other government agencies - both to simplify the overall business entry process and ensure company data is fully leveraged to improve regulatory oversight.
5. Leverage the technology platform to produce new revenue streams - including information products for financial institutions, credit bureaus, and other firms seeking company data.
6. Address change management and communications in the implementation plan - to ensure all stakeholders are fully invested in the new solution.

Source: Leveraging Technology to Support Business Registration Reform, World Bank 2011

7. Eliminate the requirement of obtaining an official company seal by changing the Company Act, followed by extensive awareness campaigns to support implementation.

Currently, an entrepreneur who launches a business in Pakistan is required by Article 23 of the Company Act 2017 to obtain an official company seal. Beyond a legal requirement, the seal is also needed to open a bank account and to conduct ordinary business transactions. One of the first procedures recorded by *Doing Business* is to obtain a company seal from a seal maker (i.e., procedure 3). It typically costs between PKR 400 and 600.

In the past, states required businesses to use official seals to authenticate their transactions. Company seals were predominantly used in common law jurisdictions, and their presence on a document indicated that it represents the will of the company as a separate entity and not of its representative agents. However, this requirement has been removed in many countries as they are of limited use because they can be easily forged. The United Kingdom, for example, made the requirement for a company seal optional in 1990. Its Companies Act now provides that a document is validly executed by a company if signed on behalf of the company by (i) two ‘authorized signatories,’ or (ii) one director, in the presence of a witness who attests the director’s signature. Further, the authentication of the person signing on behalf of the company can be easily verified through the commercial registry. It is one of the most important things for successful seals abolishment – having a secure and reliable alternative to verify identity of the company/representative.

As Pakistan and other countries become increasingly integrated into the modern global economy, company seals are becoming increasingly antiquated because the rationale of formality is being progressively abandoned, and businesses turn to the use of electronic signatures. In contrast with company seals, electronic signatures have little or no costs, allow faster approval of official documents and, most importantly, are more difficult to forge.

In 2013, only 79 of the 189 economies measured by the World Bank’s *Doing Business* report required a business to obtain a company seal to operate lawfully. Besides, none of the top-ranking countries on *Doing Business*’ ease of Starting a Business indicator requires new companies to get seals. The main reasons for eliminating the seal are the following:

1. **Company seals have become obsolete due to new technology.** The practice of sending documents electronically has made physical company seals obsolete, because they are incompatible with electronic communication. In comparison with company seals, electronic signatures or seals typically have no or low costs, allow faster approval and are more difficult to forge.
2. **Company seals do not serve their original purpose.** The materials and procedures to make company seals are easily reproduced, so that company seals can be imitated with little difficulty. It undercuts the very rationale for the seal requirement, i.e., to ensure that the company authenticates a document.

Eliminating company seals is a popular reform. In East Asia and the Pacific region, Hong Kong (China) removed the requirement for the seal in 2015. In South Asia, Sri Lanka made the company seal optional in 2007. In Sub-Saharan Africa, Ghana, Rwanda, and Tanzania also took the necessary steps to abolish it. In Eastern Europe and Central Asia, the Kyrgyz Republic made obtaining a company seal optional, while Azerbaijan, Bulgaria, Slovenia and Georgia, and Lithuania eliminated it.

In Pakistan, eliminating the company seal – both *de jure* and *de facto* – would involve amending the Companies Act 2017, where the seal is mentioned several times, as well as any other relevant legislative and sub-legislative act. As a transitional step, the Government of Pakistan could consider removing the requirement of approval of the seal by government departments involved in the registration process.

3. Dealing with Construction Permits

Reforms that make regulation of constructions more efficient and transparent can help reduce corruption and informality while encouraging construction companies to go through formal channels and ensuring compliance with important standards, such as those impacting safety or mitigating climate change. Proper regulations, combined with sound enforcement mechanisms, provide safety standards that protect the public while making the permitting process efficient, transparent and affordable for both building authorities and the private professionals who use it. A recent study shows that long delays to obtain permits could lead to higher transaction costs and fewer transactions.¹² However, the payoff of construction permitting reforms can be significant. In 2005, a PricewaterhouseCoopers study found that accelerating permit processes in the United States could permanently increase government revenues.¹³ Examining the impact of building permit reforms on new income generation - for every ten jobs directly related to a construction project -another eight jobs are created locally.¹⁴ These impacts yield not only additional income for the community but also other investments and tax revenues. Beyond economic returns and the pay-off in attracting more investment, the most important benefit of building permit reforms is to protect public safety.

Efficient building permitting systems share vital features. Clear building codes and regulations written with a consultative process are at the core of well-designed construction permitting systems. Countries like Canada and New Zealand are increasingly steering towards performance-based codes.¹⁵ Germany, Singapore, and Mauritius have incorporated risk-management tools to streamline the issuing of permits and optimize the effectiveness of inspections. Up to date land use and zoning plans improve transparency and predictability for developers.¹⁶ Establishing sound licensing mechanisms for practitioners, in addition to well-functioning liability regimes and compulsory insurance systems, have become pivotal to introduce more efficient regulatory systems. Many countries are outsourcing building control procedures to the private sector. For example, France and the UK introduced inspections by accredited bodies, which in turn required improvements in their private liability and insurance regimes.¹⁷

***Doing Business 2019* records the procedures, time and cost required to build a warehouse and connect it to water and sewage services in Karachi and Lahore following all the official requirements.** Pakistan ranks 166th globally on the ease of Dealing with Construction Permits and 7th out of eight economies in the South Asia region, with an overall *Doing Business* score of 53.59 percentage points out of 100. According to the report, in Karachi, Dealing with Construction Permits requires 18 procedures, takes 261 days and costs 11.8 percent of the warehouse value. In Lahore, it takes 20 processes, 266 days and 3.6% of the cost of the warehouse. Pakistan lags below the South Asia regional averages on time and procedures but does

¹² Sonia Hamman, "Housing matters, Volume 1," World Bank Policy Research Working Paper 6876, 2014. In particular, the paper mentions that "Mayer and Somerville's (2000) study of U.S. regulations estimates that a metropolitan area with a 4.5-month delay in approval and two different types of growth-control restrictions would have about 45% less construction than a metropolitan area with a 1.5-month delay and no growth management policy."

¹³ For a single building project, accelerating permit processes provides a temporary acceleration of property tax collections. For a representative series of projects, the study shows that these revenue increases could reach 16% over a period of five years. "Economic Impact of Accelerating Permit Processes on Local Development and Government Revenues" PricewaterhouseCoopers, December 2005.

¹⁴ PricewaterhouseCoopers. 2005. "Economic Impact of Accelerating Permit Processes on Local Development and Government Revenues." Report prepared for the American Institute of Architects, Washington, DC.

¹⁵ Performance-based codes provide more flexibility and support innovation by focusing on outcomes to be achieved rather than prescribing how the building must be constructed. The use of performance-based codes, however, requires a higher level of technical competence to enforce than other approaches.

¹⁶ World Bank. 2013. "Urbanization beyond Municipal Boundaries: Nurturing Metropolitan Economies and Connecting Peri-Urban Areas in India." Directions in Development. Washington, DC: World Bank, p. 44.

¹⁷ For example, in France, the Spinetta Act of 1978, required broad-based insurance and warranty coverage.

slightly better on costs (Table 3.1). Since 2016, the *Doing Business* report also benchmarks building quality control.¹⁸ This index looks at the quality of building regulations, the strength of quality control and safety mechanisms, liability and insurance regimes, and professional certification requirements. Out of 15 possible points, Pakistan scores on average slightly over 12 in the building quality control index and ranks higher than the average 9.2 for South Asian countries.

Table 3.1 Dealing with Construction Permits ranking and best performers

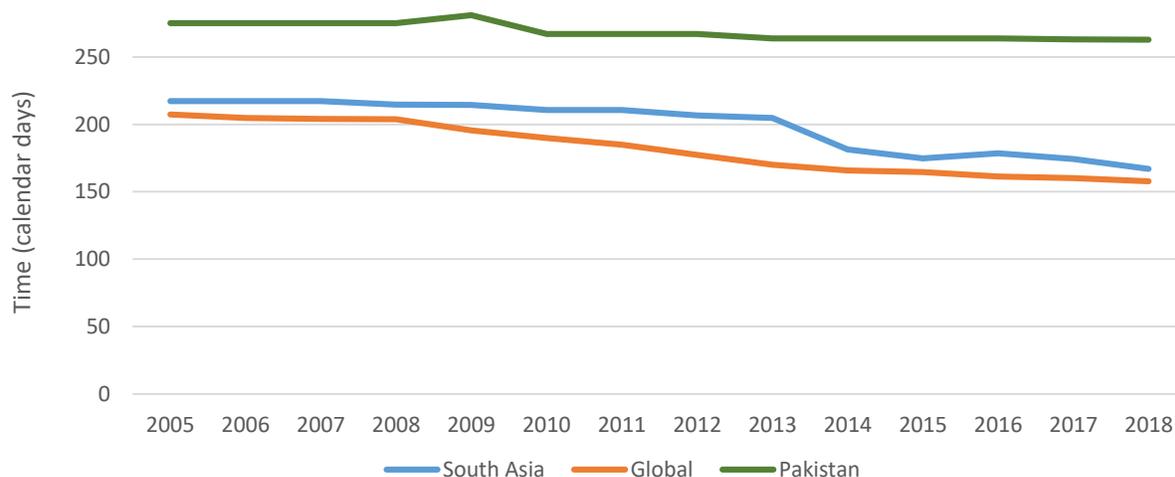
<i>Doing Business</i> Indicator	Pakistan - Karachi	Pakistan - Lahore	Regional average	Regional best performer	Global Best Performer
Procedures (number)	18	20	15.2	10 (Maldives)	7 (Denmark, Marshall Islands)
Duration (days)	261	266	165.5	87 (Sri Lanka)	27.5 (Korea)
Cost (percent of warehouse value)	11.8	3.6	13.2	0.3 (Sri Lanka)	0.1 (3 economies)
Building quality control index (0-15)	12.5	12.0	9.2	14 (India)	15 (New Zealand, Luxembourg, UAE)

Source: *Doing Business* 2019.

Dealing with construction permits over time

Dealing with Construction Permits in Pakistan is relatively cumbersome, and no notable improvement has been recorded by *Doing Business*. Since 2005, *Doing Business* has recorded 273 reforms across 190 economies facilitating the building permitting process. None of these reforms were in Pakistan. The procedures related to obtaining building permits in Pakistan are still manual, whereby the application for a building permit is lodged in person and on paper. As other countries' respective building authorities have ushered into the digital age, Pakistan has fallen behind, particularly in terms of the time to get construction permits (figure 3.1).

Figure 3.1. The time to deal with construction permits has steadily declined globally, while it has stalled in Pakistan

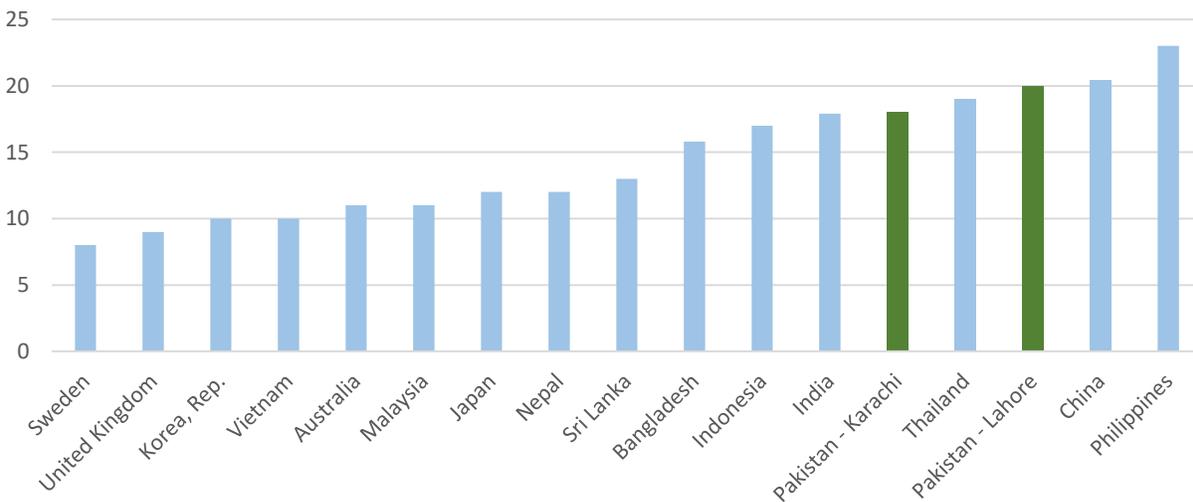


¹⁸ It accounts for a quarter of the overall ranking for Dealing with Construction Permits indicator.

The construction permitting process in Pakistan is mainly under the purview of provincial authorities, following the 18th Amendment to the Constitution in 2010. In Lahore, depending on location, the agencies in charge are the Lahore Development Authority (LDA) (considered by the *Doing Business* case study) or the Metropolitan Corporation Lahore (MCL). In Karachi, it is the Sindh Building Control Authority (SBCA). While the agencies are different, the challenges builders face in both Lahore and Karachi are similar - notably, many interactions are necessary with various authorities. It increases opportunities for discretion and bribes. According to the most recent Pakistan Enterprise Surveys dataset (2013), 29 percent of firms in Pakistan expect to give gifts to obtain construction permits. It is higher than the global average (24 percent).

The absence of a risk-based system means building projects are categorized according to their building use in Lahore and Karachi and then sub-categorized on criteria such as size. It has created confusion for construction firms and architects alike. As the designation of building categories in both Lahore and Karachi is unclear to the public, construction experts report having to go through multiple inspections and documents from various authorities - such as no-objection certificates - that are, in fact, not necessary for low-risk warehouses per existing regulation. As *Doing Business* records processes required in practice, many procedures are counted for Pakistan relative to its South Asian peers (Figure 3.2). This stresses the need for better communication between the building authorities and the public in both Lahore and Karachi.

Figure 3.2. Dealing with Construction Permits in Pakistan and comparator economies, the number of procedures



Source: *Doing Business 2019*.

By and large, Pakistan has adopted many good practices on building quality control. The relevant building codes and zoning regulations are available online free of charge on the websites of SBCA and LDA. In Lahore and Karachi, building plans are checked by qualified professionals within the building authority. For example, the *LDA Building and Zoning Regulations 2017* states that a structural engineer working for the Authority is tasked to review the architectural drawings. Moreover, all building plans for multi-story buildings are to be scrutinized by a committee consisting of a director architect. Similarly, the building codes for Lahore and Karachi mandate that a final inspection is carried out by the building authority. Regarding professional certifications, Pakistan also follows the best practices. The parties reviewing the building plans and supervising the construction need to meet multiple criteria, specifically on (i) professional experience and (ii) tertiary education. The *Karachi Building and Town*

Planning Regulations 2002, for example, provides a whole chapter on licensing and registration of professionals. It further states that a building supervisor must possess a recognized university diploma (three years) in either civil engineering or architecture, plus two to ten years' experience in building construction (depending on the categorization of the building). Constructors must also be registered with the Pakistan Engineering Council, while the architect that reviews and stamps the building plan needs to be recognized by the Pakistan Council of Architects and Town Planners (Ordinance IX of 1983). The main requirements to register with the council are three years of professional experience and a recognized degree from a listed university.

One area where there is room for improvement, however, is on Latent Defect Liability Insurance as no private parties in Pakistan involved in the construction are legally required to obtain an insurance policy to cover possible structural flaws in the building once it is used.

While no significant improvement has historically been recorded, SBCA and LDA are currently taking steps to streamline the building permitting process. In February 2018, SBCA issued a notification re-categorizing construction projects based on their complexity so that low-risk warehouses (i.e., height up to 35ft and plot area of less than 1100 square yards) be included in Category I buildings, eliminating the need to obtain an environmental checklist with the Environmental Protection Agency and all-floor slab casting inspections. LDA has also undertaken various initiatives. The authority has aimed to eliminate the need to obtain a no-objection certificate for non-hazardous warehouses per *Notification No.: Dir (EIA)/01/2017 Dated: 29.05.2017*. LDA has also committed to more transparency, publishing the required documents for a building permit application – as well as the list of procedures applicants need to go through. LDA also created in 2017 the “Building Planning Unit,” a team of eight officers that specializes in processing commercial building permit applications. Finally, LDA is working on its “One Window Facilitation Center” which will allow for building permit applications to be lodged online along with all the required uploaded documents. It is essential that the efforts recently displayed continue and are implemented in practice. Several reform recommendations are, therefore, presented below so that Pakistan adopts global best practices and eases the building permitting process while also making sure that building control and safety are held to a high standard.

Short-term reform recommendations

1. Improve pre-screening of construction permit applications and abide by the published time objectives.

In both Lahore and Karachi, architects and construction experts report that building permit applications are often rejected days – sometimes weeks – after they are lodged due to an incomplete documentation packet or minor omissions on some forms. When this is the case, applications must then be amended and filed once again for processing. It essentially resets the time objective LDA and SCBA have committed to in their bylaws (e.g., 30 days for ‘Category 1’ buildings in Sindh).

It is recommended that LDA and SBCA pre-screen all submitted applications consistently. LDA has already attempted to do this through its Building Planning Unit, but screening is reported to be inconsistent. SBCA does not have a dedicated taskforce altogether. In short, designated staff should be appointed to check that all forms listed in the document checklist are presented. Moreover, fields that are often erroneously inputted should be verified. In sum, once an application is pre-screened, the assessment of the application should be based on the building plans and zoning regulations – not paperwork. Customers in Karachi should also be able to follow the status of their application on the website of the building authority, as LDA currently provides.

To further incentivize LDA and SBCA to comply with the time objectives, official statistics including building permit processing times should be made available to the public. To this end, a formal complaint mechanism should be rolled out wherein clients can complain should the time commitments not be met.

2. Increase the transparency of the construction permit approval process by publishing and proactively informing the public on the documents needed for the issuance of a building permit.

As per the *Provisions of Pakistan Environment Protection Act 1997*, a no-objection certificate (NOC) from the Environment Protection Agency (EPA) is only required for a select class of buildings that includes hospitals and industrial buildings. A nonhazardous warehouse, as considered by *Doing Business*, requires no such approval. Many architects and construction experts nonetheless report that a NOC is needed for all types of warehouse. A similar observation is made for the obtainment of an undertaking on stamp paper. LDA requires the document for industrial constructions, as it stipulates that the owner (and builder) are liable for damages caused to any person or adjoining property. The precautionary legal document is not needed for commercial constructions, yet most building experts report still obtaining it.

In Karachi, there is also a noticeable difference between regulations and practice. Processes that are not needed for ‘Category 1’ buildings - which comprise residential buildings and “non-obnoxious warehouses” - are nonetheless reported as required in practice. This is the case, for example, with the environmental checklist from the EPA, which was waived according to the *Sindh Environmental Protection Agency Regulations 2014*. Per regulation, this document is only required for ‘Category 4’ buildings, which comprise “obnoxious warehouses.” As almost all warehouse constructions in Karachi are “obnoxious warehouses,” private sector experts report needing the form regardless of the warehouse type.

The cases above illustrate that there is a communication gap between the respective building authorities and the private sector. Part of the confusion is attributable to the classification of buildings; specific constructions, like warehouses, can fall in several categories depending on their intended use. This only increases the need for both LDA and SBCA to make more proactive efforts to publish the documents needed for each construction type.

Building professionals should be provided with brochures presenting flow charts on the requirements and documents needed according to the specificities of different constructions. The time for permit issuance that LDA and SBCA commit to should also clearly be laid out for each construction category. The material should further stress that some buildings, like warehouses, do not fall automatically in one category as it depends on the building’s intended use. More examples should also be provided in terms of what is a non-hazardous/obnoxious warehouse. To further convey the differentiation in building categories, workshops with sector experts can be organized.

Information should also be provided online. For example, in Sindh, the process of applying for a construction permit involves physical movement to the office of SBCA. To ensure transparency and remove options for discretionary actions, the application form for construction permits should be made easily accessible online. The example of Nigeria here is relevant. In early 2017, the Kano Urban Planning and Development Authority (KNUPDA) began publishing all applicable regulations, fee schedules and pre-application requirements related to construction permitting on the KNUPDA website www.knupda.org.ng.

3. Re-engineer business processes for all construction types to centralize the obtaining of all NOCs from the required agencies.

In both Lahore and Karachi, simple warehouses that are labelled as non-obnoxious or non-hazardous don’t require approvals outside the land authority from agencies such as the EPA. Other select classes of buildings (e.g., hospitals and industrial buildings), however, do require no-objection certificates from several

agencies. For example, for industrial buildings in Lahore, applicants typically need to obtain three no-objection certificates; one from the Environment Department (EPA), another from the Traffic Control Department and, finally, one from the Water and Sewage Authority (WASA). All three NOCs must be obtained separately at the relevant agencies where the application is manually lodged. After getting the NOC, it is to be presented to LDA as part of the building permit application. This process is time-consuming; the NOC from the EPA just in itself takes over three months. Moreover, in Karachi, the process can be similar depending on the location of construction.

All requests for NOCs should be centralized and then dispatched to the relevant authorities through a back-office to ease the burden on customers. Ideally, this can be done by a single window or facilitation center – which LDA is already working on - so that interface with the agencies does not rest with the building permit applicants. Distribution utility companies should, likewise, be incorporated to the single window. Alternatively, the centralization can happen gradually - as the United Arab Emirates did over the past decade (see box 3.1) - and the NOCs can first be processed together through a separate authority.

Box 3.1: How Dubai merged all NOCs applications:

Over the past decade, the Dubai Municipality introduced several changes for obtaining no objection certificates, cutting four procedures and two weeks in the process.

Before 2009, builders in Dubai were required to obtain No Objection Certificates from various agencies on their designs. The case of a commercial warehouse required approximately five NOCs from the following departments:

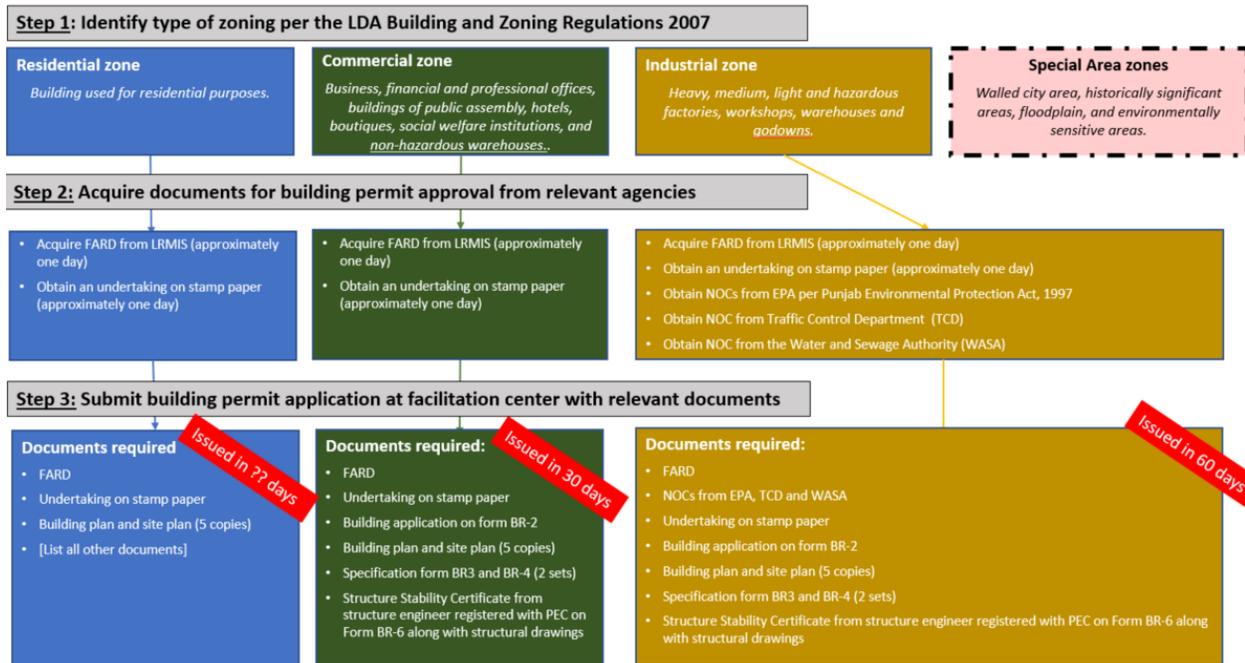
- Dubai Electricity and Water Authority (DEWA) on electrical wiring installation drawings
- Dubai Electricity and Water Authority (DEWA) on the water connection
- Drainage and Irrigation Department of Dubai Municipality on drainage and sewage
- Etisalat on phone connection
- Civil Defense Department on fire safety compliance

In 2009, the Road and Transport Authority centralized NOCs request through its website wherein contractors filed for the NOCs and received notification that their designs were approved electronically so that they could proceed with the building permit submission. Then, as of May 2014, the Dubai Municipality granted direct access for the Dubai Civil Defense Authority to the Building Permit Control System to review and give approval for applicants. Therefore, it became possible to request and obtain the civil defense approval jointly with the request for the NOCs and building permit.

India is another notable example of a recent reform wherein all NOCs were streamlined through an online building permitting portal. Both Delhi and Mumbai developed an online portal that links all the agencies involved in the permitting process, and the NOCs are sent to the respective agencies electronically after an application is submitted. A policy of ‘silent is consent’ is then followed, as agencies have 15 days to adjudicate.

Centralizing the issuances of NOCs through the building authorities presents an opportunity for SBCA and LDA to re-engineer the building permit process to streamline procedures and documentation further. This exercise may also force LDA and SBCA to assess which NOCs are truly needed based on building profiles and locations. In any case, the centralization should go hand in hand with the publication of the exhaustive procedural requirements building permit applicants need to go through. This information should be presented online and through brochures in a user-friendly fashion. Online information should also be presented in a more user-friendly way. Currently LDA – and to a lesser extent SBCA – have dedicated sections on their websites that list the documents needed to apply for a permit, as well as time objective for the issuance of the permit. There is, however, no clear explanation on which buildings fall into what category, as well as what the step by step process is like – especially with regards to the different building

types. Information should be centralized into a section of the website and flow charts should be provided that illustrates the process from the perspective of the user. Figure 3.3 serves as a limited example for Lahore, which should be expanded to include the procedures and documents required to obtain the completion certificate – as well as all the necessary inspections during the construction phase. Hyperlinks to the forms (and when relevant links to the authorities delivering forms) should be inserted along with LDA time commitments for delivery.



Source: Illustrative example based on team research from LDA sources. The process is not exhaustive.

4. Remove the property valuation form (PT-1) as a requirement from WASA in Lahore.

In Lahore, connecting to the sewage and water network is time-consuming - in part because of the documents required for the said application. A month is needed to obtain the PT-1 from the Excise & Taxation Department. The form provides the assessed value of the property and the property tax to be charged. From the perspective of WASA, the form is a requirement since partition as the document shows proof of ownership. WASA and private construction experts report that today the form is only needed when a building's location is in a densely populated area with lots of informal settlements. Nonetheless, the PT-1 form is listed as a required document for all water and sewage connections.

It is recommended that WASA officially do away with the PT-1 requirement as it is not the mandate of the utility to check property ownership. It will expedite the construction permitting process by a full month for customers. A review of the documentation required for a connection application should also be undertaken to see if forms can be further streamlined.

5. Roll-out the e-permit system in Lahore to all types of buildings and allow for e-payments.

LDA is planning to launch its e-permit system before the end of 2018 which will allow customers to upload documents and file applications online. The current system however, has several limitations. Notably, it will apply only to “non-hazardous” warehouse constructions, which serves little purpose as these constructions are not commonly built in the city. For example, out of the 30 to 50 building permits LDA issues daily, 80% are categorized as “residential.”

By limiting the e-permit system to a small subset of buildings, builders and architects won't have many opportunities to use the system, thereby increasing the likelihood that they submit all documentation and applications in person – even when the concerned building is, in fact, a “non-hazardous” warehouse. It would further make it likely that LDA will not see any resource gains from having digitized the application process. Ultimately, the e-permit system should be available for permit processes that are common and widespread to test and scale up the system.

Another limitation of the e-permit system is online payments, which the e-system platform will not incorporate when it launches. It means that customers will need to continue providing a challan from the bank as proof that all building permit fees have been paid. It again, limits the impact that the e-permit system will have as LDA and clients will continue to interface several times.

Currently, e-payments can only be made through individual accounts as this facility is not available on corporate accounts. It needs to be taken up with the state bank so that a mechanism can be devised in which corporate accounts are also allowed to make e-payments.

Given the limitations described above, it is recommended that the e-permit system is rolled out for most building permit types once the system has been tested. Further, an e-payment option should be provided – first to individual accounts and corporate accounts when the facility becomes available. While there are IT challenges to overcome, notably related to identification and theft, many public agencies (such as electricity distribution utilities) in Pakistan allow for online bill payments.

Medium and long-term reform recommendations

6. Link the systems of LDA and SBCA with those of the land management authorities to expedite the obtainment of the proof of ownership.

To apply for a building permit proof of ownership is required. In Karachi, this typically means that applicants need to go in person to the Sindh Board of Revenue to request a letter confirming land title (otherwise known as Fard) – provided that the plot of land is not under the purveyance of a military cantonment. It takes two weeks. In Lahore, a visit to the Punjab Lands Records Authority is required. The process is quite straightforward as most records are now digitized, allowing the authorities to produce the document in a single day. Ideally, however, individuals should not have to visit the land authority.

The onus to obtain land ownership proof should not be on the customer. To this end, LDA and SBCA should process land ownership requests with the land management authorities directly themselves once an application is submitted. Ultimately, their systems should be linked so LDA and SBCA – and eventually distribution utilities - can conduct a simple search themselves. The technology is already there in Lahore as LRMIS can do a title search seamlessly through its record system. Granting LDA access to this system would then eliminate the need to involve LRMIS in the construction permit application.

Sri Lanka undertook such a reform recently. The Colombo Municipal Council launched in March 2018 a Single Window Counter. Capitalizing on the launch of the fully digital database *Bim Saviya* (Title Registration System) the single window can now issue simultaneously three types of certificates required for obtaining a building permit: the non-vesting certificate, the certificate of ownership and the building and street line certificate. All of these were previously separate procedures.

7. Introduce a risk-based system for construction approvals and inspections based on the buildings essential features and intended use.

As detailed above, the building classification laid out in the *Lahore Development Authority Building and Zoning Regulations 2007* as well as in the *Karachi Building and Town Planning Regulations 2002* introduced much confusion with regards to the categories into which specific buildings fall. Moreover, as stated above, the current categorization is primarily based on building use and surface, not the risk.

It is recommended to conduct a risk assessment of the stock of buildings in both Karachi and Lahore which would serve as the basis for a risk-based system for building permits applications and pre/post construction inspections, and a review of existing construction regulations to differentiate areas that warrant more attention and direct controls from the building authorities. This exercise would allow LDA and SBCA to streamline and prioritize the issuance of building permits in a responsible manner. It would provide the basis for actions that could reduce the procedures and the time to obtain building permits in the future. For example, all NOCs could be reviewed to determine which ones are currently needed based on building profile and location.

Correctly phased inspections conducted at the main stages of construction are critical, but they should also be based on the risk profile of the buildings in question to ensure implementation of the legal requirements and at the same time placing little burden on entrepreneurs. International good practice shows that not all building projects are associated with the same economic or environmental risks and, as a result, not all construction plans require the same degree of scrutiny. Efficient governments have implemented rigorous yet differentiated construction permitting processes to treat buildings according to their risk level and location.

The Republic of Korea introduced risk-based approvals in 2005/06. In May 2006, small construction projects were allowed to choose a fast-track option. It allowed regulators to focus their time and resources on more complex projects with potential environmental or public safety risks. The reform was timely because it coincided with a higher demand for construction. Between 2004 and 2009, the number of applications for commercial building permits in Seoul increased from 1,521 to 3,895.¹⁹ As a general rule, fast-track options should only be implemented where regulations spell out the requirements, and enforcement is strong. This can avoid risks associated with structural flaws, as well as corruption.

Risk-based inspections, as opposed to random, untargeted checks, allow governments to allocate resources where they are needed the most without compromising worker and public safety. Inspections during the construction of buildings are crucial - but assessing potential risks might be even more critical. For example, several factors must be considered when building a power plant, such as the pollution it is likely to cause, which will affect how thoroughly it needs to be inspected. Accordingly, there has been growing consensus in the construction industry on the need for supervisory bodies to consider the potential risks imposed by a building, rather than applying the same inspection standards to all buildings.

Many economies are adopting innovative approaches to construction controls, with the focus shifting from random, systematic and untargeted inspections to more targeted, selective and risk-based inspections. Both developed and developing economies have implemented risk-based inspections which take into account the varying risks for different types of buildings. Australia privatized its inspection system while France strengthened and clarified its liability regime. Technical controllers must be licensed, and specialized control agencies are held accountable for building safety. Moreover, while Australia categorizes buildings based on their uses, France categorizes its buildings based on their occupancy. Though the two countries took different approaches, both emerged with far more efficient construction inspection systems.²⁰

¹⁹ *Doing Business* Report 2012

²⁰ World Bank Group. *Doing Business Case Study: What role should inspections play during construction?* 2014

Since 2005, 18 economies have incorporated elements of risk-based inspection systems. For example, Germany adopted a system similar to Australia's that makes private inspectors responsible for ensuring buildings' safety and thus responsible for conducting the required inspections based on the type of construction.

Modern best practices have established risk categorizations typically associated with the footprint of the building, its size and height, and its intended purpose. This classification determines the level of checks required for each building type and creates a predictable framework for building authorities and building professionals. See Box 3.2 below for the risk-based classification of buildings in Ontario, Canada.

Today many countries have a risk-differentiated approach to building regulation.²¹ Under the "Smart Regulator" program, Hong Kong reduced the time to deal with construction permits by 36 days and eliminated or merged eight procedures related to inspections and pre-approvals. In the European Union, the European Standard EN 1990 sets three "Consequence Classes" determined by the risks to users as well as social and economic consequences (Figure 3.4). Each category requires a different and proportionate degree of scrutiny from building authorities.²²

Box 3.2: Experience of Ontario (Canada) in developing a risk classification (fundamental principles, not exhaustive):

- Buildings under 100 square feet. do not require a building permit.
- Most "small buildings" up to and including three stories and 6,000 square feet in total (gross) floor area do not require professional design (by an architect or engineer). Residential buildings within this size category, for example, do not require automatic sprinklers or fire separations.
- Some higher risk "small buildings" such as "assembly buildings" (theatres) and higher occupancy industrial buildings within the size category of small buildings, require professional design.
- "Large buildings" over the small building threshold, require professional design.
- "High buildings" which are above 18 meters (about 60 feet or six stories) from the grade level (ground level) require firefighters' elevators, pressurized stairwells, and other measures for fire safety (these buildings are harder to get out of because of height, therefore, they need extra provisions).
- Specific additional requirements apply to assembly buildings, high hazard industrial uses and care facilities such as nursing homes that have fewer mobile occupants.
- Post-disaster buildings such as police stations and hospitals, and water treatment plants (that must provide public services in the event of a severe event (seismic, wind) must be constructed to withstand higher loads. Large buildings are designed to the 50-year wind load whereas post-disaster buildings are designed to this load with a further safety factor referred to as an "importance factor". It means that in effect it can withstand a more severe event than a 50-year storm.

Other jurisdictions have combined the use of risk-based approvals with the provision of fast-track options. For example, for small, low-risk projects, developers of commercial buildings in Ontario, Canada, can opt for the "Commercial Xpress" permit review process which takes just ten days.²³ A similar procedure is in place for further construction works in existing residential buildings. Under Article 10 of the new building code, anyone who intends to construct a building may choose to apply for a fast-track procedure. Similar

²¹ *Doing Business* database.

²² See for example the Guidelines of the Government of Queensland Australia on inspections depending on the risk category of buildings. <http://www.hpw.qld.gov.au/SiteCollectionDocuments/guidelines-inspection-of-class-2-to-9-buildings.pdf>

²³ The following projects qualify for the Commercial Xpress service: interior alterations to assembly, business, industrial, office, and retail uses, up to 300m² in area, no change of use, no change in patron area for restaurants, tents, and minor fire damage repair. For more information on the project based building permitting procedures in Ontario, please visit:

<http://www1.toronto.ca/wps/portal/contentonly?vgnextoid=e7c14b1c296c0410VgnVCM10000071d60f89RCRD>

fast-track procedures exist in the United States. For example, the New York City Department of Buildings (DOB) offers a fast-track service for simple projects called the Professional Certification Program, as it relies on self-certification mechanisms by certified private practitioners. In these cases, the process of DOB examination and approval of plans is eliminated, although the application must go through the same pre-filing payment and data entry process as regular applications. Besides, 20% of all applications will have an audit within ten days of the building permit issuance.²⁴

Figure 3.4: EN standard 1990. European approach to risk categorization, using “Consequence Classes”²⁵

Definition of Consequences Classes		
Consequence Class	Description	Example of Buildings and Civil Engineering Works
CC3	High consequence for loss of human life; high consequences for economic, social, or environmental consequences	Grandstands, public buildings where consequences of failure are high (e.g., a concert hall)
CC2	Medium consequence for loss of human life, considerable economic, social, or environmental consequences	Residential and office buildings, public buildings where consequences of failure are medium (e.g., an office building)
CC1	Low consequence for loss of human life; small or negligible economic, social, or environmental consequences	Agricultural buildings people do not normally enter (e.g., storage buildings), greenhouses
Control at the Design Stage (Design Supervision Levels, or DSL)		
Design Supervision Levels	Characteristics	Minimum recommended requirements for checking of calculations, drawings and specifications.
DSL3	Extended supervision	Third party checking: Checking performed by an organization different from that which prepared the design
DSL2	Normal supervision	Checking by different persons than those originally responsible and in accordance with the procedure of the organization
DSL1	Normal supervision	Self-checking: Checking performed by the person who has prepared the design
Controls by Inspectors (Inspection Levels or IL)		
Inspection Levels	Characteristics	Requirements
IL3 Relating to RC3	Extended inspection	Third-party inspection
IL2 Relating to RC2	Normal inspection	Inspection in accordance with the procedures of the organization
IL1 Relating to RC1	Normal inspection	Self-inspection

8. Set up a single window for construction permit application processing at SBCA and eventually make it available online.

The Lahore Development Authority is currently implementing a one window facilitation center along with an e-permit system. In Karachi, there is no definite timeline for such a project, meaning all building permit applications will continue to be lodged in person in the foreseeable future. It is, therefore, important that SBCA works toward creating a single portal for building applicants that links all agencies and related towns.

New technologies such as e-applications (e.g., web-based software applications) or web and SMS-based tracking and notification systems can bring automation which can substantially improve efficiency in construction-permitting administration as well as increase formality and compliance with safety

²⁴ <http://www1.nyc.gov/site/buildings/industry/professional-certification.page>

²⁵ Source: European Union, as summarized in “Good Practices for Construction Regulation and Enforcement Reform. *Guidelines for Reformers.*” Investment Climate, World Bank Group, January 2013, p. 17.

requirements. Automation will require transparency concerning regulatory agency approval processes and documentary requirements. Such a system would include:

- Online submission of applications for construction license or notification, renewals, appeal processes, inspections, occupancy certificates
- Online tracking of applications
- Comprehensive database pertinent to construction permitting processes that shall include: legacy data of construction permit approval, renewal, rejection, related inspections, related appeals, and occupancy certification; this should also include a database of registered vendors/ architects' information
- Automated workflow capabilities for construction permit approval, renewal, carrying out inspection activities such as planning, scheduling, risk assessment, documenting visit checklists, reports and actions, communication with business via e-mail or SMS, and occupancy certification
- Analytical reporting
- Document management and archiving capabilities to handle attachment uploaded to the system.

Several countries already have such computerized systems in place. Developers in Austria, Denmark, Iceland, Norway, Portugal, and the United States can complete their building permit applications online. In Singapore, the data management system, established in 2001, enables easy access to information needed for obtaining a building permit. It allows online submission of plans, and it facilitates efficient permit processing. Today, builders regularly receive updates on the status of their application either by e-mail or text messaging. As a result, the time for dealing with construction permits has been reduced by two-thirds. This reform saves time for builders and government officials alike. Besides, developers can pay the fees by using an online system called CORENET.

In 2009, Egypt introduced a single window for processing construction-related approvals. In September 2011, Kenya implemented a web-based software application to automate plan review procedures and delivery of construction and occupancy certificates, also complemented by a web and SMS-based tracking and notification system. Before this reform it used to take six months for a building permit approval in Nairobi. It now requires 30 days. The services of 'expeditors' or middlemen by architects have been eliminated (see Box 3.3).

Box 3.3: Key features of a new online platform introduced by Kenya in 2011

- Online registration of building professionals/property developers
- Online submission of building plans
- Workflow management – concurrent review/evaluation
- Online issuance of a permit upon approval
- Document management and archival (no storage constraints)
- Support for field inspections using mobile devices
- Client interactions - SMS/email notifications & online tracking
- Management reporting & oversight

In its ultimate form, automation would allow for the electronic submission and review of building plans. However, automation, unlike the other reforms, would require substantial technical hardware investments. Lastly, to reap the full benefits of automation and new technologies, prior initiatives must be undertaken. Before implementing automated solutions, it is advisable to re-engineer the issuance of building permits, modernize the workflow systems and physically reorganize the office floor to mirror the steps of a simplified process.

After the full operationalization of the online application process, the SBCA could extend the existing single window to the application and approval of connections with utility companies where applicants would be able to apply simultaneously and pay the respective fees for all clearances and utility connections online. Agencies can include K-Electric, Karachi Water and Sewerage Board and others. There should be inbuilt safeguards to allow for the confidentiality and security of information provided by building professionals. Strict digital signature protocols, as well as data encryption functionalities, should be incorporated into the system.

9. Consider allowing private firms to sign-off on the completion certificate, while ensuring the quality of professional qualifications.

In both Lahore and Karachi, a significant amount of time is recorded to obtain the completion certificate. Once the building is completed, it takes 60 and 45 days in the two cities respectively to get the form from the time the certificate application is submitted. This time is partly driven by the need for LDA and SBCA to carry out a final inspection.

One possibility to ease the process and time constraint without compromising safety is to transfer the responsibility to the private sector provided that professional qualifications and standards are ensured, and liability regimes established. As stated above, the professional accreditation system in Pakistan follows some of the best practices in making sure architects and engineers have the necessary qualifications. The Pakistan Council of Architects and Town Planners (Ordinance IX of 1983) essentially give recognition and protection to the profession of architects. Application for registration as an architect is only possible if several conditions concerning experience and education through an accredited degree are met. Similarly, professional engineers need to be recognized by the Pakistan Engineering Council, per PEC Act 1976. To obtain the title of professional engineer the council requires an accredited engineering qualification and a professional experience of five years and clearing the prescribed engineering practice examination.

The degree to which the private sector is engaged in building supervision varies significantly across economies. By and large, the primary function of private entities involved in construction regulation tends to focus on building inspections during project execution, as is the case in 92% of economies with private participation mechanisms. Of these economies, 54% engage private entities in conducting final inspections upon the completion of construction.²⁶

In the United Kingdom, Approved Inspectors (AI) are companies or individuals authorized under the *Building Act 1984* to carry out building control work in England and Wales. On a building's completion, an AI makes the last inspection and prepares the final certificate of completion. This report states that the building was built according to the approved plans and that there is no significant work to be completed or that there are no remaining pending issues on any part of the building. The AI will then send a copy of the completion certificate to the building control department of the local authority. There are no inspections by the local authority.

LDA and SBCA could consider testing a similar approach if first tested on low-risk buildings. As the qualification requirements in the country are well established for the architects' profession, they could, for example, fulfill that role.

10. Introduce legislation in Punjab on possible defect liability and introduce liability insurance requirement in both cities.

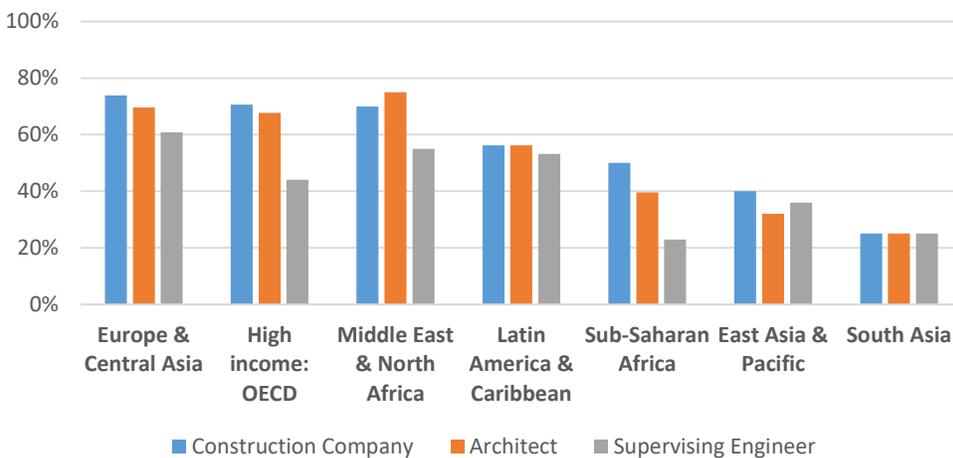
²⁶ Doing Business 2018

Since 2015, *Doing Business* incorporates an index on building quality control, evaluating the quality of building regulations, safety mechanisms, and professional certification requirements. Pakistan performs well above the regional and global average on the index. However, Lahore has room for improvement on the matter of liability and insurance regimes.

To date, more than 109 economies have introduced provisions on latent defects; typically holding the construction company and architect liable (Figure 3.5). The goal of such regulations is to protect building owners in case a building has design and/or construction flaws that were unbeknownst to the construction authorities that issued a completion certificate. The duration of the liability period varies from country to country. For example, in France, multiple parties are held liable for any construction failure for a period of 10 years. In Karachi, the *Karachi Building and Town Planning Regulations 2002* states in Section 5-2-22 that the developer assumes defect liability of the unit for a period of 12 months in respect of structure from the date of offering possession of the unit after obtaining the completion certificate.

While the liability timeframe in Karachi is relatively short, the building code still offers more protection than in Lahore from the perspective of new building owners. Indeed, the *Lahore Development Authority Building and Zoning Regulation 2007* does not explicitly state anywhere whether a party involved in the construction process is held liable for any structural flaw following the obtainment of the completion certificate. The building code should, therefore, be amended to extend protection to prospective owners for a defined duration. Ideally, the legislation should be implemented at the provincial level to provide more consistency across the territory for buildings and architects.

Figure 3.5. In many economies around the world, the architect or construction company are held liable for structural defects



Another area where regulation is silent, in both Karachi and Lahore, is on latent defect liability insurance. In about 30 economies, the parties involved in the construction process are legally required to obtain such insurance. The rationale here is that a liability regime (see above) may not serve its full intended purpose in the advent of a significant structural flaw if the parties held liable do not have the resources to cover the costs of any latent defects. Having insurance helps all parties involved, from clients to contractors. It ensures that damages will be covered if abnormalities are detected once the building is occupied - and when parties know they are protected, this can encourage more construction. Insurance also makes it possible to avoid lengthy and expensive legal battles through the court system, which in turn reduces construction costs. It further creates an incentive to carefully supervise construction projects to make sure they are built according to standards and codes.

To sum up, having insurance to protect against the excessive costs from potential damages can be particularly crucial for small and medium-sized construction companies.²⁷ Moreover, while some builders in Karachi and Lahore report still obtaining insurance in practice to mitigate risks, this should become a state level legal requirement and be clearly stated in the city's respective building codes.

²⁷ Doing Business 2016

4. Getting Electricity

Infrastructure services such as roads, water, electricity, and telecommunications matter for businesses. A reliable electricity supply notably boosts firms' output while also affecting societal welfare in areas like education²⁸ and healthcare.²⁹ Without a stable energy supply, businesses cannot make full use of their capital and risk under production. Where the quality and accessibility of infrastructure services is poor, companies' productivity gets negatively impacted.³⁰ This holds especially true for small and medium enterprises (SMEs), as many cannot turn to captive power options (e.g., generator) due to limited resources.³¹ Empirical research has shown that investment (domestic and foreign) tends to be attracted to countries that can offer a reliable supply of electricity.³² Moreover, the 2018 World Bank Enterprise Surveys data reports that business owners in developing economies perceive power (or lack thereof) as the fourth biggest obstacle to their activities behind only access to finance, the informal sector and political instability.

Impediments to electricity access are not restricted to just power reliability and supply adequacy. A recent World Bank study has shown that more straightforward electricity connections - in terms of time, cost and procedures - positively impact firm performance. This is particularly the case in industries with high electricity needs, such as manufacturing.³³ The same study also finds that the hurdles related to obtaining an electricity connection are associated with several sector outcomes like electrification rates and the incidence of bribe payments to the utility personnel. Finally, research shows that businesses that lack access to electricity connections are prevented from moving into higher-value-added activities.³⁴

Efficient electricity connection processes share vital features. Approvals that customers must obtain for the connection should be consolidated with other permissions. Moreover, in countries with efficient electricity connection processes, the responsibility for the safety compliance of the building's internal wiring is transferred to private electrical contractors, and customers do not have to go through inspection procedures instead. In Denmark, Germany, Japan, and Mauritius the customer's electrical contractor is required to submit an electrical installation certificate with the service application. Economies where responsibility for safety compliance is transferred to private electrical contractors, usually have a well-regulated industry of electrical contractors and electrical engineers with a national accreditation system and professional licensing.

The *Doing Business* Getting Electricity indicator measures access to electricity and the reliability of its supply, along with the transparency of commercial tariffs. The indicator set helps to understand the challenges and potential bottlenecks firms face vis-à-vis the electricity sector. For example, it provides data on the process of obtaining a new electricity connection for local SMEs, detailing the required associated procedures along with their time and cost. This benchmark enables utilities and regulators to gauge the connection service and learn from best practices as efficient connection processes share vital features. For instance, approvals are consolidated, and the responsibility for the safety compliance of the building's internal wiring is transferred to private electrical contractors.

²⁸ Khandker, Shahidur R., Hussain A. Samad, Rubaba Ali, and Douglas F. Barnes. "Who Benefits Most from Rural Electrification? Evidence in India." *Research in Agriculture and Applied Economics*. May 2012. Web. 1 Apr. 2016.

²⁹ Adair-Rohani, Heather et al. "Limited Electricity Access in Health Facilities of Sub-Saharan Africa: A Systematic Review of Data on Electricity Access, Sources, and Reliability." *Global Health, Science and Practice* 1.2 (2013): 249–261. *PMC*.

³⁰ Calderon and Serven (2003), Dollar et al. (2005), Eiffert (2007).

³¹ Moyo (2013)

³² Audinet and Rodriguez Pardina 2010.

³³ Ramalho and Geginat 2015.

³⁴ Shaw (2014).

The Getting Electricity indicator presents an index score from 0 to 8 points to measure the reliability of supply and transparency of tariffs. It encompasses quantitative output data on the duration and frequency of power outages, measured through SAIDI and SAIFI³⁵ for calendar year 2017, as well as qualitative input information, i.e. the role of the energy regulator, the systems used to monitor power outages, whether financial deterrents exist to limit disruptions, and whether tariffs and tariff changes are communicated effectively to customers. Firms need an uninterrupted supply of electricity to be competitive.

As reported in the *Doing Business 2019* report, the process to connect in Karachi is slightly different than in Lahore. In both cities, however, the process is cumbersome and takes well over 100 days. Furthermore, it costs more than 15 times the income per capita. Pakistan also scores 0 out of 8 on the reliability of supply and transparency of tariffs, given the high frequency and duration of power outages. Globally, Pakistan ranks 167 out of 190 economies on the ease of Getting Electricity with a score of 44.75. Pakistan underperforms compared to the averages in South Asia on all sub-indicators. Overall, Getting Electricity is one of the areas where Pakistan has the most room for improvement. Table 4.1 provides an overview of the country’s performance in Getting Electricity.

<i>Doing Business</i> indicator	Karachi	Lahore	South Asia average	Regional best performer	Global best performer
Procedures (number)	5	6	5.4	3 India (Delhi)	2 (United Arab Emirates)
Time (days)	185	117	98.3	31 India (Delhi)	10 (United Arab Emirates)
Cost (% of GNI)	1,587.1	1,582	1,054.7	46.4 India (Delhi)	0.0 (Japan and UAE)
Reliability of supply and transparency of tariff index (0–8)	0	0	2.1	7.0 India (Mumbai)	8.0 (27 economies)

Source: *Doing Business 2019*.

Getting Electricity over time in Pakistan

Nearly all the Pakistani population has access to electricity if captive and off-grid power solutions are included.³⁶ However, only three-quarters of Pakistanis are connected to the electricity grid.³⁷ This is likely due to several factors. For example, it is costly to obtain a new connection, in large part because transformers are often necessary and in short supply on the market. Moreover, once connected, power outages are frequent. For example, the latest NEPRA State of the Industry Report indicates that from July 2016 to June 2017, daily scheduled outages (i.e., load shedding) in Karachi amounted to 2.5 hours.³⁸

Without a stable electricity supply, the performance of firms is undermined. The 2013 Enterprise Surveys data indicates that losses in annual sales due to electrical outages in Lahore amounted to about 35%. As a

³⁵ *Doing Business* uses the system average interruption duration index (SAIDI) and the system average interruption frequency index (SAIFI) to measure the duration and frequency of power outages in the largest business city of each economy. SAIDI is the average total duration of outages over the course of a year for each customer served, while SAIFI is the average number of service interruptions experienced by a customer in a year.

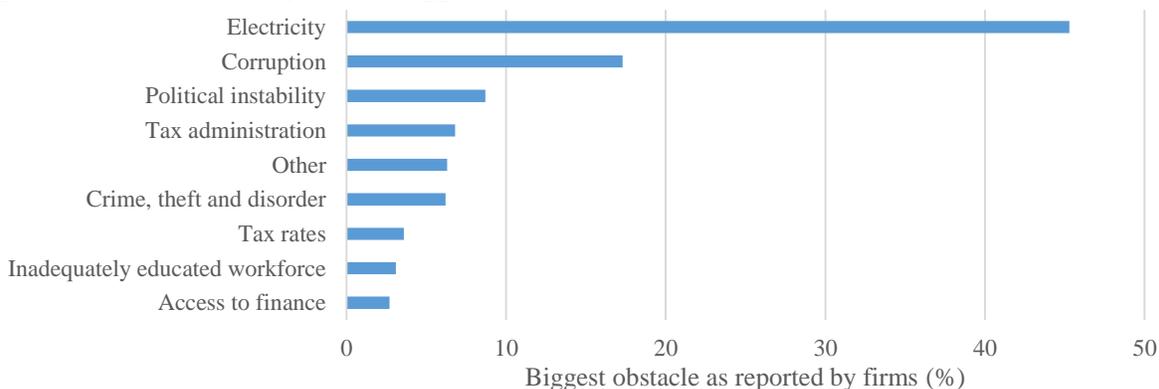
³⁶ World Bank, Sustainable Energy for All (SE4ALL) database for the calendar year 2016.

³⁷ According to the International Energy Agency, the proportion of the population with access to electricity in Pakistan in 2017 stood at 73.6 %. <https://www.iea.org/sdg/electricity/>

³⁸ NEPRA State of the Industry Report

workaround, over 70% of firms in both Lahore and Karachi own diesel generators, which can typically retail for up to \$20,000. Given such challenges, it is not surprising to see that firms in Pakistan identify ‘electricity’ as by far the biggest obstacle in the business environment according to Enterprise Surveys data (Figure 4.1).³⁹

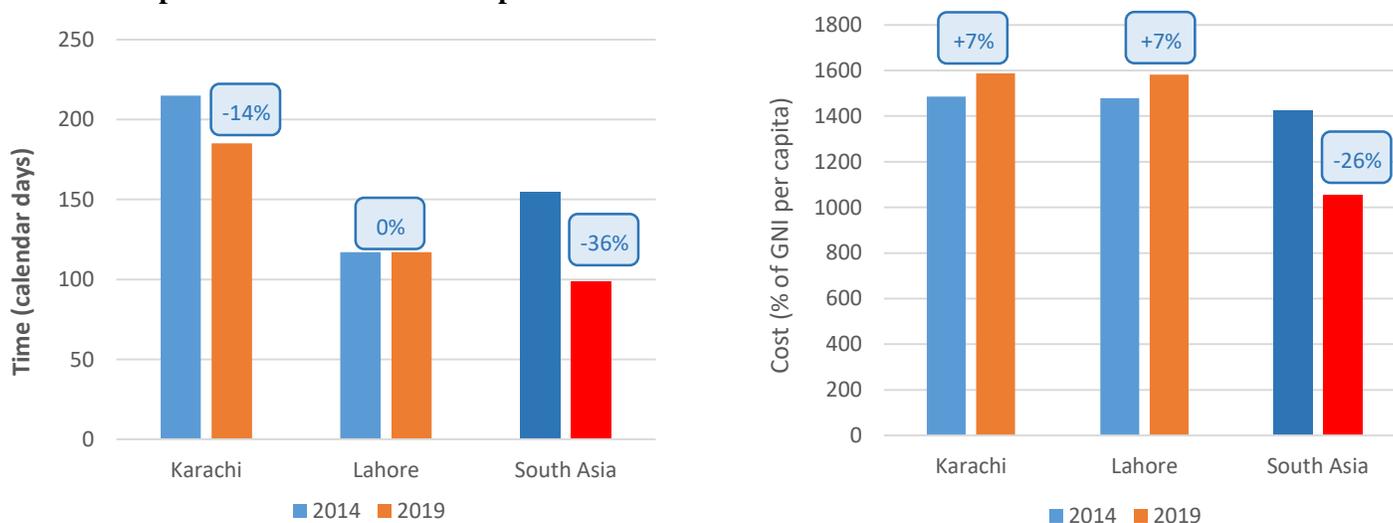
Figure 4.1 Electricity is by far the biggest obstacle for firms in Pakistan



Source: World Bank Enterprise Surveys 2013.

Getting an electricity connection in Pakistan is comparatively time-consuming and costly, without significant changes in recent years. For example, in 2014 the average time and cost to get a connection to the grid in Pakistan were similar to the South Asia average. Since then, a total of eight reforms were undertaken in South Asia on Getting Electricity, only one of which concerned Pakistan wherein K-Electric made the process for getting an electricity connection faster in 2015 by improving the stock of material for the connection works. In short, as other countries reformed at a faster pace, Pakistan’s ranking on Getting Electricity area dropped, from 157th in *Doing Business* 2016 to 176th in *Doing Business* 2019. Also, it now takes less time and financial resources to get a new connection in most South Asian countries compared to Karachi and Lahore (Figure 4.2).

Figure 4.2 In the last five years, the time and cost to get a new connection has decreased at a much faster pace across South Asia compared to Pakistan



Source: *Doing Business* 2019.

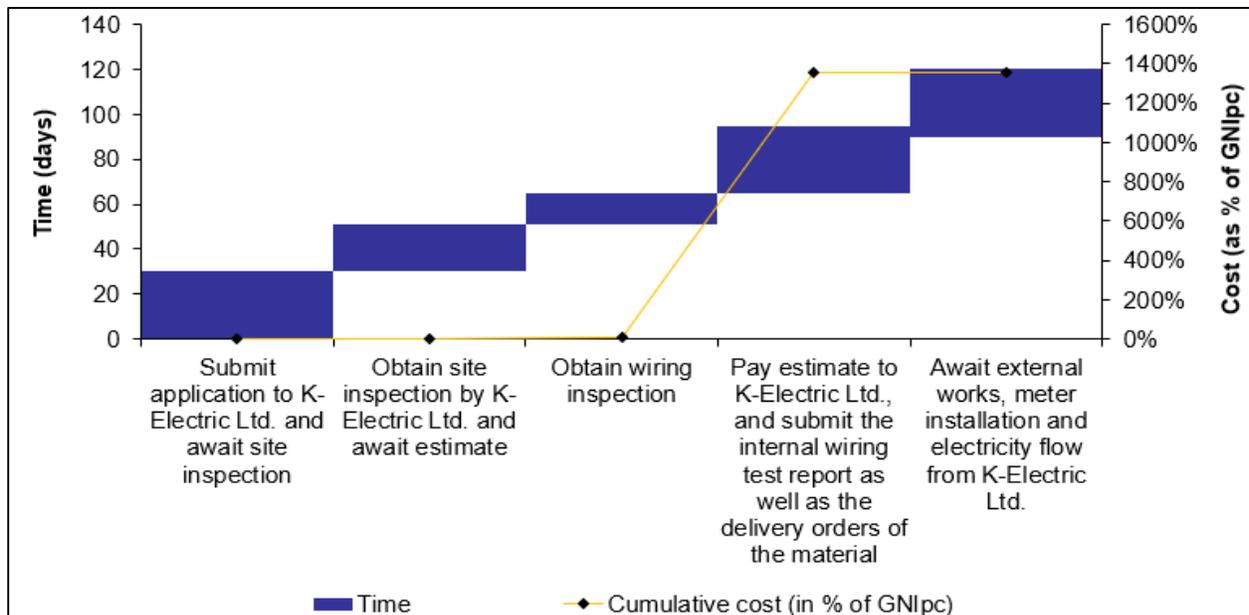
³⁹ After being presented with a list of 15 business environment obstacles, business owners and top managers in over 1,000 firms were asked in 2013 to choose the biggest obstacle to their business.

According to *Doing Business* data, a Pakistani firm seeking an industrial-type connection, new medium voltage connection to the grid will need to go through several procedures some of which vary depending on the city considered (Figure 4.3). In Karachi, where the privately-owned K-Electric issues connections, it takes five procedures, 185 days and 1,587.1 percent of income per capita to get connected to the medium voltage grid. In Lahore, where the publicly-owned distribution utility is LESCO, entrepreneurs must go through six procedures over 117 calendar days and pay the equivalent of 1,582 percent of GNI to comply with all official requirements. While the process is slightly different across cities, the bottlenecks for businesses are quite similar. In both cities, it takes about two months from the time a new connection request is lodged to the time where the estimate is issued following a site survey from a utility inspector (i.e., procedures 1 and 2). Customers complain that the lead time to get the said estimate is often considerable due to a shortage in the material – so the utility delays requests as it re-stocks on the articles. Also, once estimates are finally provided, many entrepreneurs struggle with financing due to a higher than expected invoice (challan).

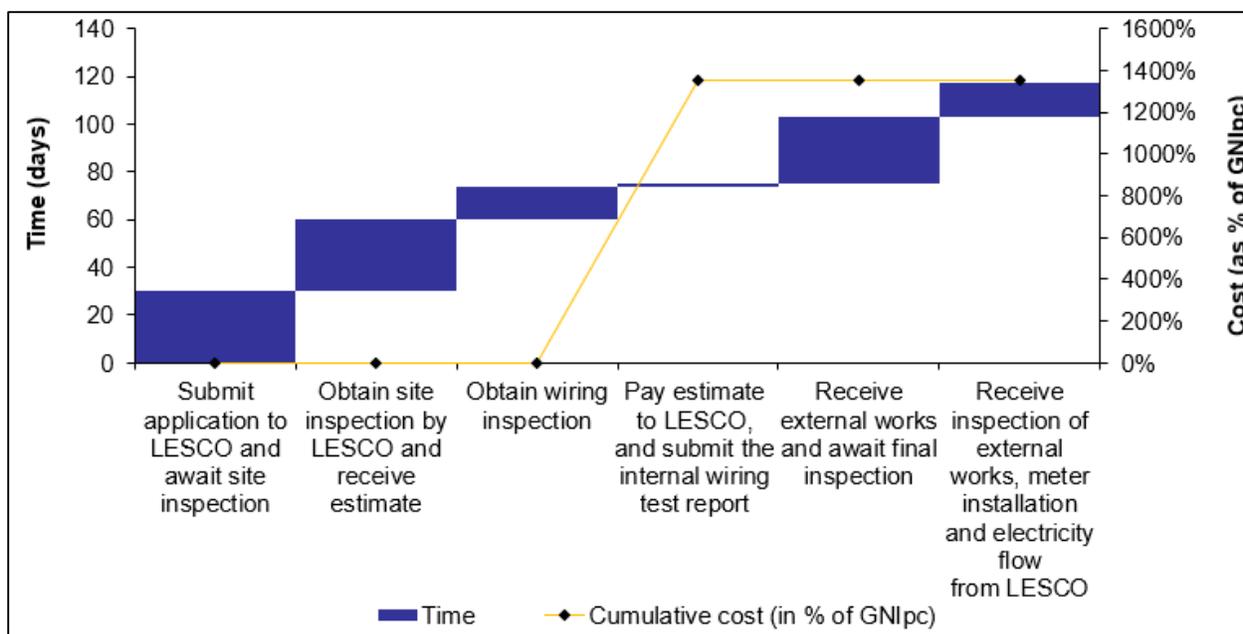
As there are many interactions with LESCO and K-Electric, this, in turn, increases opportunities for bribes. According to the 2016-2017 World Economic Forum (WEF) Competitiveness Rankings, Pakistan ranks 127th out of 140 economies on the index related to irregular payments and bribes to public utilities. In other words, the WEF suggests that it is not uncommon for Pakistani companies to make undocumented payments in connection with public services. Enterprise Surveys data corroborate this; it reports that nearly 60 percent of firms in Pakistan are expected to give gifts to administrators to obtain an electricity connection.

Figure 4.3: Procedures to get a new electricity connection in Pakistan

Karachi



Lahore



Source: *Doing Business 2019*

The reliability of supply and transparency of the tariff index shows that the electricity sector in Pakistan is well regulated, but the lack of reliability still massively undermines firms. Pakistan is taking steps to address the issue, boosting installed generation capacity nationwide from 21,593 MW in June 2010 to 28,399 MW in June 2017.⁴⁰ From a generation standpoint, supply is now able to meet demand. However, transmission capacity is still lacking, and large urban areas still experience transmission congestions. As a result, in the warm summer months, many neighborhoods of Karachi and Lahore are targeted for load shedding. These neighborhoods are typically located in non-industrial zones where electricity theft is common. SMEs in these locations must, then, resort to captive power solutions provided they have the means. Yet, their experience is not fully reflected in the SAIDI and SAIFI index that NEPRA reports for DISCOs since load shedding outages are excluded. For this reason, Pakistan scores 0 out of 8 points on the above-mentioned index.⁴¹

Beyond power outages, the data on Pakistan show that LESCO and K-Electric have a SCADA system⁴², which allows the utilities to monitor interruptions automatically and restore service. Moreover, Pakistan has a robust regulatory agency (i.e., NEPRA) which advocates for the interests of customers and oversees the performance of distribution utilities on matters such as reliability. NEPRA has the power to fine utilities if they fail to meet their performance objectives.

The recommendations below do not address all issues affecting the energy sector in Pakistan and focus only on the electrical connection process and power reliability from the perspective of end-users.

Short-term reform recommendations

⁴⁰ NEPRA State of the Industry Report

⁴¹ An economy is eligible to obtain a score on the reliability of supply and transparency of tariffs index if the utility collects data on all electricity outages including load shedding with a minimum interruption time of five minutes and if the SAIDI/SAIFI values are below a threshold of 100 hours.

⁴² A Supervisory Control and Data Acquisition (SCADA) system is used to inspect and analyze real-time to identify faults in the network, send signals to the staff through monitors and restore electricity service remotely.

1. Undertake a detailed study of the application process to understand the bottlenecks.

According to the *Doing Business* data, once an industrial type connection application is lodged, the particular distribution utilities in Lahore (LESCO) and Karachi (K-Electric) take one month to send an inspector on-site to conduct a feasibility study. From there it takes nearly another month to issue the demand notice and estimate, which the customer is tasked to pay ahead of the external connection works. This process to receive the estimates takes up nearly half of the total connection time in both Karachi and Lahore. In contrast, in Ho Chi Minh City, Vietnam, the utility sends an inspector and provides an estimate within a week of the application submission.

When questioned on the reasons behind the delays mentioned above, there are conflicting reports between local engineers and the concerned distribution utilities. For example, the former group reports that network capacity is lacking and there is a backlog in applications, while the latter group states that applications are often incomplete. Both K-Electric and LESCO need to undertake a study whereby they follow the application, from desk to desk, and see where bottlenecks arise and understand the reasons behind them. For tracking purposes, connection requests can be broken down by length, location, and load. LESCO has agreed to conduct the study and K-Electric should follow suit by appointing a designated team to track all applications, from start to end, and identify the sources of delays. Ultimately, this will help them to design a feasible plan to streamline the process and reduce aggregate time.

2. Introduce a cost calculator and make processes, guidelines, and fees more transparent.

From the perspective of customers, one of the biggest challenges when getting a new connection in Karachi or Lahore is cost. Typically, for an industrial type medium voltage connection, costs amount up to ten times income per capita or much more in some cases. Also, prices largely vary depending on the specificities of the connection (e.g., power load requested) as well as the location of the building. Unfortunately, there are no resources for connection applicants to determine ahead of time what will be the connection cost, even if one wants to obtain a rough range. The only way to know is to lodge an application and wait two months for an estimate. This has created a backlog in applications as many customers request an estimate, but then cancel their request when presented with the challan/bill. To this end, customers would benefit from having more predictability with regards to connection costs.

The respective websites of LESCO and K-Electric provide basic information on the application process, such as the documents needed to apply. The information provided, however, is limited. For instance, the websites do not give a breakdown on the cost of material, even if it is now primarily supplied directly by the distribution companies. This could quickly be addressed by publishing online the value of the transformers and meters the utilities carry in stock as well as the cost of labor charged for connection types. In Malaysia, for example, the distribution utility TNB has a detailed document on its website that describes different connection schemes and the formulas used to calculate the connection costs.

A complementary solution to increase cost transparency is to publish an online calculator for customers. MOESK, a Russian utility, provides such a tool - and K-Electric or LESCO could replicate this. Customers would need to input some basic connection specificities, and a preliminary estimate would then be computed from there. At first, a broad range could be provided as K-Electric and LESCO refine the calculator and acquire data. A disclaimer would further be needed as it is likely that the final estimate issued following the site survey is different from the one provided by the calculator. Nonetheless, it would help guide customers and discourage applicants with insufficient funds.

Customers would also benefit from increased transparency of the connection process. Some documents required in the application packet are unclear and the relevant agencies in which they are obtained, not listed. Better advertising of the process and documentation could cut the time for both the applicants and

the electricity authorities. K-Electric and LESCO could publicize in plain language the guidelines for the overall process and guarantee public access of information. This information should be easily accessible through the utility's websites as well as brochures.

3. Provide option to pay connection fees and security deposits in installments and consider cross-subsiding connections.

Given the considerable amount customers need to disburse to get a new connection, many applicants cannot immediately finance the connection when they get the estimate. Both LESCO and K-Electric have reported that connection delays are often attributable to clients not paying their estimate despite the 30-day time limit instituted by the utilities. As a result, in addition to the transparency measures described above, LESCO and K-Electric should carry out an analysis of their financial capacity and determine if they can extend a subsidy scheme or deferred payment options to customers. The review would determine whether such options are financially feasible for the utilities.

One option worth considering is the payment in installments – wherein interests could be charged if needed. A fraction of the bill would need to be paid immediately, but the balance could then be reported back to the first few electricity bills after the connection gets finalized. K-Electric has recently introduced a semblance of this, but all the installments need to be paid before the connection work even begins. In contrast, in countries like the FYR of Macedonia or the Republic of Korea, premises are energized ahead of the last installment payment, which is reported to the first electricity bill.

In the Republic of Korea, the distribution utility, KEPCO, charges a standard construction cost of about USD 10,000 for a 150-meter service line and 140 kW load for underground power intake. Thirty percent of the cost is paid up front, while the remaining 70 percent is paid in installments over a period of up to two years. In some Sub-Saharan African economies where the security deposit is typically thousands of dollars, an installment option is also available for customers as in the Democratic Republic of Congo or Togo. As the Security Deposits levied by K-Electric and LESCO are considerable (i.e., over USD 3,000), they could return the deposit after a couple of years provided the customer is in good financial standing as opposed to at the end of the connection contract. Alternatively, deposits could be returned with interest. For example, in India and Malaysia, the utilities return the deposit with a 6% and 2.5% interest rate, respectively.

Another option to ease the financial burden of new connections is cross-subsidization. Currently, costs are largely determined by the location of applicants and the capacity of the network nearby. If an applicant is fortunate, the network next to his/her premises will have sufficient capacity to accommodate a new connection, resulting in lower costs. If an applicant is unlucky, however, he/she may need to pay for entire network expansion, essentially subsidizing all future connection applications in the vicinity. To prevent connection cost to vary drastically according to factors that are out of the control of applicants, LESCO and K-Electric may want to revise their fee structure and have customers cross-subsidize new connections so that no applicant pays above a certain amount.

If the options above are difficult to implement, distribution utilities should at least provide more information on their plans to increase network capacity as this influences the decision of companies on where to build and expand.

4. Include load shedding in the calculation of SAIDI and SAIFI.

An economy's electricity supply is one of the main determinants of firm productivity. It is, therefore, important for utilities to assess the reliability of the network by quantifying power outages from the perspective of customers. Utility companies do this by calculating two widely used key performance indicators - the system average interruption duration index (SAIDI) and the system average interruption

frequency index (SAIFI). The indices provide data from the perspective of an average customer over a calendar year and focus, respectively, on total outage duration (in hours) and frequency.

Measuring SAIDI and SAIFI data is identified as good practice by the Institute of Electrical and Electronics Engineers (IEEE) and allows distribution utilities to compare their network reliability internationally (over two-thirds of economies worldwide use the metrics). As a result, common standards to measure SAIDI and SAIFI are necessary. Most utilities that calculate SAIDI and SAIFI today capture all power outages (including load shedding) of five minutes or more. LESCO and K-Electric should follow suit. Moreover, NEPRA should consider amending its *Overall Standards of Performance in the National Electric Power Regulatory Authority Performance Standards (Distribution) Rules, 2005* so that SAIDI and SAIFI are calculated inclusive of load shedding data. At the same time, NEPRA can also continue to publish a separate KPI wherein SAIDI, and SAIFI exclude load shedding to show only distribution losses.

5. Set up binding time limits on procedures to connect to the electricity grid.

The time limits set forth by NEPRA in the *National Electric Power Regulatory Authority Performance Standards (Distribution) Rules, 2005* seem arbitrary in that they do not differentiate for the different potential specificities of connections. Time objective should be set not just on a load of a connection, but also depending on the area and length. For example, a new connection request in a densely populated area will take more time as the external work will be more disruptive.

Time objectives need to be strictly monitored and enforced to have an impact so that there are incentives (or deterrents) for successful compliance (or failure to comply). Currently, there is no defined penalty or bonus structure per se between the utilities and NEPRA. It could be amended, provided that the time limits are (i) realistic and (ii) key performance indicators (KPIs) from the utility are reviewed and audited.

Equally important is the existence of a complaint mechanism for customers should the utility fail to deliver a connection in the time stated by regulation. Currently, no such complaint mechanism exists either at LESCO or K-Electric.

Long and medium-term reform recommendations

6. Increase the availability of material at the utility companies.

The time to get a new connection is driven largely by a shortage of material – notably transformers and meters. Starting in 2018, the material is almost exclusively provided by LESCO and K-Electric, which tender with a limited number of approved retailers. It is understood that this is likely to lower costs for customers as distribution utilities have more bargaining power given the large orders they place. Utilities becoming the exclusive supplier for customers may also ensure better quality control of the material.

Notwithstanding the above, precautions are necessary to make sure the stock of transformers and meters does not run out. In Lahore, for example, the tendering process can take up to five months, meaning LESCO should begin the procurement process as soon as the stock of material is forecast to run out seven months into the future. It will provide at least a two-month window for the utility. The number of authorized retailers should also be expanded (there are only five currently), so there is more competition in the market. Moreover, if the utility is unable to ensure a steady stock of material, customers should also have the option to obtain the material themselves. If the material is imported – as opposed to being ordered through a local retailer – then its quality can be checked through the delivery order, and the model purchased.

In recent years, many distribution utilities recorded reforms by increasing the stock of material and lowering the time to issue connections in the process (e.g., Botswana, Indonesia, and Niger). One such reform was

recorded in Pakistan, Karachi. In 2014, the budget to purchase material for distribution and transmission at K-Electric increased from \$50 million to \$150 million, prompting the company to revamp its supply chain proactively. As a result, the stock of material increased (cables, transformers and other materials), leading to a decrease of 30 days in 2015 in the time for K-Electric to carry out the external work. These gains, however, have been partially offset by an uptick in connection requests over the years. The United Nations Population Division estimates that Karachi's population has increased by almost 2 million since 2014. This has contributed to more construction in the city, and more buildings thereby in need of electricity. Further investments are therefore needed to increase the stock of material and reduce procurement delays in Karachi. Lahore should follow suit.

7. Enforce internal wiring inspection and streamline its procedure.

Faulty wiring can cause direct harm or indirect injury due to fires or explosions. Moreover, deadly fires involving electrical failure are unfortunately all too common, particularly in developing economies. For example, seven of every ten fires in urban areas in Peru are the result of defective electricity installations, such as faulty wiring or equipment that does not comply with building norms.⁴³

Given the importance of electricity, managing the risks associated with its use is imperative. Therefore, an inspection of a new building's electrical wiring is compulsory in many countries – including Pakistan. Ahead of the electricity turn-on, the internal wiring of a building needs to be checked and certified by (i) the Electric Inspectorate in Karachi and (ii) the Punjab Energy Department in Lahore. That said, the inspections currently do not serve their purpose as they are rarely carried out. Moreover, in practice, it is often the case that the local building authority does the only safety check (e.g., SBCA in Karachi and LBA in Lahore) on the wiring plans when a building permit application is submitted.

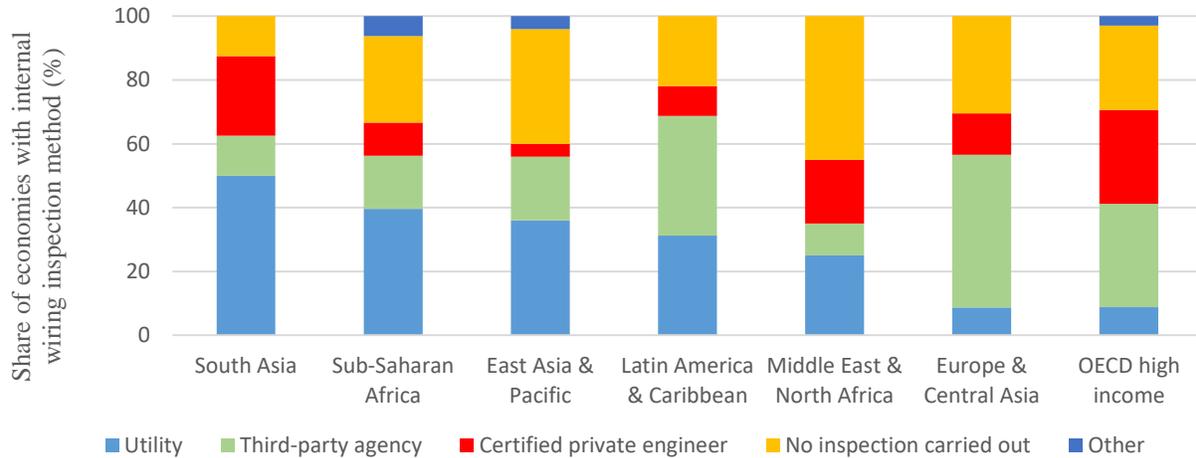
Unless regulation is strictly enforced so that the Electric Inspectorate in Karachi and the Punjab Energy Department in Lahore perform inspections when they are intended to, it is recommended that a different entity is considered for the wiring check. The most common option is for the distribution utility to carry out the check, as is the case in 40% of all economies (Figure 4.4). For example, in the United Arab Emirates, the Dubai Electricity and Water Authority (DEWA) checks the internal wiring of the building to ensure compliance with the approved plans. Inspections approval is communicated internally within the utility, allowing DEWA to carry out the external electrical work immediately without involving the customer.

Alternatively, accredited private engineers could be tasked with issuing the certificate. In Croatia, an internal wiring certificate must be submitted before the utility, Hrvatska Elektroprivreda (HEP), installs the meter. The document which proves that the electrical installation has been tested, is prepared by a third-party firm. The utility then issues a final connection approval once this documentation is deemed satisfactory.

Regardless of who conducts the internal wiring check in both cities, the certificate should be transmitted directly by the agency in charge of the wiring check to the utility so that the client does not have to bear this responsibility. At the very least, customers should be able to upload the document through an e-portal (see recommendation #8). It will minimize customer/utility interactions.

Figure 4.4 Who inspects the internal wiring installation before the electrification of a commercial building?

⁴³ International Copper Association Latin America. 2012. "El 70% de los incendios urbanos se debe a las malas instalaciones electricas." September 4. [http:// programacasasegura.org/pe/2012/09/04 /el-70-de-los-incendios-urbanos-se-debe-a -las-malas-instalaciones-electricas/](http://programacasasegura.org/pe/2012/09/04/el-70-de-los-incendios-urbanos-se-debe-a-las-malas-instalaciones-electricas/).



8. Roll out the full online application system, with an e-payment option.

Currently, it is not possible to apply online for new electricity connections in Lahore and Karachi. As such, LESCO and K-Electric should consider automating the application process for new commercial electricity connections, after they streamline their internal procedures.

An e-portal should be provided wherein all the application documents can be uploaded and online payments accepted. Connection charges are currently paid via bank deposit after which a challan needs to be produced and showed to the utility. It is cumbersome for customers as it requires going back and forth. The technology at both LESCO and K-Electric is also there for an e-payment system since utility bills can be paid online. Moreover, companies currently use e-payments for other services provided by public institutions. For example, incorporation fees (name reservation, registration, and filing fees) can all be paid online on the e-portal of SECP.

Box 4.1: The benefits of online portals

In the past decades, several distribution utilities have recorded significant time gains for customers by rolling out online application portals. One such example is the United Arab Emirates. The Dubai Electricity and Water Authority (DEWA) introduced a 'One Window/One Step Application for Getting Electricity' that went live in April 2012. The new system first allowed customers to submit their application and track it online. It also enabled customers to schedule site surveys. Over the years, new features were added - such as e-payments and the possibility to schedule the internal wiring inspection – resulting in large part to the UAE setting the *Doing Business* best practice at ten days for the lowest time to issue new electricity connections.

Another excellent example of the benefit of an online portal comes from Russia. In 2012, it took 281 days to get connected to the medium voltage grid in Moscow. In contrast, it now merely takes 70 days. MOESK, the distribution utility in Moscow, achieved the reduction through several initiatives, including the creation of a comprehensive online portal. Today, all new connection applications are submitted electronically through the website of MOESK, and no visit to the client services office is required. Along with the application form, clients need to upload several documents, including the internal wiring and equipment location plan and a copy of the license of the firm that prepared the plan. Within seven days of the application, MOESK provides the customer with the technical conditions for the connection along with the signed connection and supply contracts. Upon signing these documents electronically, the customer makes an online payment, and the external connection work can then commence. At every stage of the application processing, the applicant receives text-message updates. The customer can also track the status of the application through his/her online personal account.

Based on the experience of other countries (see box 4.1), creating an online application system should benefit applicants in Pakistan by lowering the time for LESCO and K-Electric to issue new grid connections. An online portal typically prompts by default customers to submit a complete application – otherwise, submission is not possible. These systems also free up human resources for utilities, which they can then allocate towards other functions. Finally, an online portal also increases transparency; customers can usually track the status of their application while the utility can determine in real time what the pending applications are.

9. Introduce a Geographic Information System (GIS) for the electricity distribution network.

The electricity distribution company should consider the use of a GIS system to map its distribution network and connection points throughout Karachi and Lahore. Thanks to such a system, the electricity utility would be able to have better control over new connections. More importantly, external site inspection may no longer be necessary. In other economies, the use of a GIS has streamlined the process of electrical connections. In Bangkok, the distribution utility, the Metropolitan Electricity Authority (MEA) enhanced its GIS system in 2016. As a result, the utility can define the connection point upon receiving the application, eliminating the need for the site inspection by the service to determine the connection specifications.

10. Obtain excavation permit on behalf of clients in Karachi.

Depending on a building's location and whether a new electricity connection must go underground connection applicants need to obtain an excavation permit ahead of the external connection work. In Karachi, where underground connections are more likely than in Lahore, 19 civic agencies issue the right of way, depending on the location. Sometimes two agencies are involved in issuing the permit if a building is situated between two zones. This then requires much time for the client to deal with the agencies, get the permit and present it back to the utility. The best practice consists of not having a customer apply for the excavation permit in the first place; instead, the service should be responsible for obtaining all the required documents.

11. Invest in smart meters.

Power outages throughout Karachi and Lahore have decreased in recent years thanks to an increase in production capacity (see above). However, load shedding is still prevalent due to lack of transmission capacity, particularly around large cities. According to the 2017 NEPRA State of the Industry Report, there was two hours or more, on average, of load shedding in both Lahore and Karachi.

With investments in the transmission and distribution network dearly needed, load shedding will continue to be a reality for many Pakistanis in the years to come. Currently, load shedding is targeted at the feeder level to specific neighborhoods where power thefts are common, as are delinquencies on bill payments. While this course of action is pragmatic, it also poses a moral dilemma as some dues paying customers in the targeted areas do not get the same level of service as customers in industrial zones. Installing smart meters would address this issue.

Unlike a traditional electricity meter, a smart meter digitally reads and stores data on electricity usage in real time. Smart meters also remotely send information to energy distributors. This two-way communication allows utilities to connect/disconnect service remotely. It has several benefits. First, it results in significant labor savings for the utility. It also provides for better fault detection to help networks restore power quickly after an outage. In the case of Pakistan, smart meters would also allow LESCO and K-Electric to target the

customers (not neighborhoods) who do not pay their bills as the power supply can be cut at the circuit-breaker level.

The benefits smart meters can have on grid reliability are well documented,⁴⁴ and *Doing Business* has showcased the example of Mexico recently. Through 2016, the utility company in Mexico City (CFE Distribución) installed over 100,000 smart meters and distributed automation switches throughout the city's network. These investments coincided with a reduction in outages as measured by SAIDI and SAIFI as CFE Distribución can now detect outages and restore service faster. It also provides the utility with big data to use power resources more efficiently.

⁴⁴ S. S. R. Depuru, L. Wang, V. Devabhaktuni and N. Gudi, "Smart meters for power grid — Challenges, issues, advantages and status," *2011 IEEE/PES Power Systems Conference and Exposition*, Phoenix, AZ, 2011, pp. 1-7.

5. Registering Property

Registered property rights are essential to support investment, productivity, and growth.⁴⁵ Research suggests that property owners with secure ownership are more likely to invest in private enterprises and transfer land to users that are more efficient. The ability to access authoritative information on land ownership also reduces the transaction cost in financial markets, making it easier to use a property as collateral.⁴⁶ Land Registries and Cadasters are part of the land information system of an economy. With land and buildings accounting for between half and three-quarters of the wealth in most economies, having an up-to-date land information system matters.⁴⁷ For governments, having reliable, up-to-date information in cadasters and land registries is essential to assess and collect tax revenues correctly. With up-to-date land information, governments can map out the varying requirements of their cities and strategically plan the provision of services and infrastructure in the areas of each city where they are most needed.⁴⁸

International experience also shows that a unified computerized registry with clear titles is one of the main features of an effective property registration system. A unified electronic registry would make information and procedures available online, offer expedited procedures, lower transaction costs, set reasonable transfer fees, and respect practical time limits to complete the property transfer process. In countries with the most efficient property registry systems, such as Norway, New Zealand, and Denmark, a single agency oversees all property transfers and registration. In Norway, for example, the Norwegian Mapping and Cadaster Authority maintains a single registration office for the entire country. Property registration can be done in one procedure and three days. The application is easily accessible online. In Denmark, Norway, Portugal, Singapore, and New Zealand, the transfer can be done electronically. In Italy and Poland, there are strict time limits to complete property transfers, but these have been implemented along with streamlining procedures through reorganization and computerization.

The *Doing Business* Registering Property indicator records the full sequence of procedures, time and cost necessary for a business to transfer a property title of land and a building to another business in Karachi and Lahore. Also, it presents an index on the quality of the land administration system in each city, based on five dimensions - reliability of infrastructure, transparency of information, geographic coverage, land dispute resolution and equal access to property rights. Pakistan ranks 161st out of 190 economies in the ease of Registering Property and 4th out of eight economies in the South Asia region, with an overall score of 45.63 percentage points in the Registering Property Score (Table 5.1). Nevertheless, the total data for the whole country hides significant differences between the two main cities. While completing property transfer procedures requires six procedural steps, takes 25.5 days and costs 4.2 % of the property value in Lahore, which is in line with OECD countries' performance, dealing with the land administration is much more cumbersome in Karachi. Registering a property there requires eight procedural steps, costs 4.2% of the property value and, more importantly, takes as many as 208 days. Lahore also performs better on the quality of land administration index with 14 out of 30 possible points, while Karachi only receives seven points in *Doing Business* 2019. In Bhutan, which is ranked 54th in the world and 1st in South Asia, the quality of the land administration index is 23.5 out of 30, and property transfers can be completed in three steps. In Nepal, which is ranked 88th in the world, and 2nd in South Asia, a property can be registered in four procedures and six days. Registering Property is an area where Pakistan could improve its

⁴⁵ Claessens, Stijn and Luc Laeven, Financial Development, Property Rights, and Growth, *Journal of Finance*, 58 (6): 2401–36, 2003.

⁴⁶ Simon Johnson, John McMillan, and Christopher Woodruff, Property Rights and Finance, *The American Economic Review*, Volume 92, Issue 5, Pages 1335-1356, December 2002.

⁴⁷ World Bank. 1989. *World Development Report 1989*. New York: Oxford University Press.

⁴⁸ Property information held in cadasters and land registries is part of the land information available to governments. Land information also includes other geographic, environmental and socioeconomic data related to land that are useful for urban planning and development.

performance, especially by focusing on reform efforts in the Sindh province, which could replicate the successful initiatives recently implemented in Lahore.

Table 5.1 Registering Property rankings and best performers

Doing Business Indicator	Pakistan	Karachi	Lahore	Regional Average	Regional best performer	Global best performer
Procedures (number)	7.3	8	6	6.8	Bhutan (3)	1 (Georgia, Norway, Sweden, Portugal)
Time (days)	144.1	208	25.5	114.1	Nepal (6)	1 (New Zealand, Georgia)
Cost (percent of property value)	4.2	4.2	4.2	6.9	Pakistan (4.2)	0 (Belarus, Georgia, Kiribati, Saudi Arabia, Slovak Republic)
Quality of land administration index (0-30)	9.5	7.0	14.0	8.8	Bhutan (23.5)	28.5 (Lithuania, Rwanda, Singapore, Taiwan, Netherlands)

Registering Property over time

In Pakistan, property administration has mainly become a provincial domain. Following the 18th Amendment to the Constitution in 2010, the provinces of Sindh (Karachi) and Punjab (Lahore), home to the two largest business cities of the country, are now in charge of the land administration system through their respective Boards of Revenue.

While Lahore has significantly improved its land administration and streamlined procedures in recent years, completing property transfers in Karachi remains a lengthy and complicated endeavor. It involves interactions with multiple agencies, including the land revenue department, the sub-registrar office, and numerous land-owning agencies. The land administration is mainly fragmented in Karachi, as there are more than 20 land-owning agencies in the city. These include Karachi Development Authority (KDA) and Cantonment Board Clifton (CBC) for instance. In Karachi, the processes for the registration of the sales deed, at the sub-registrar, and for the mutation of the land records, at the Land Revenue Department, are still not linked and require users to have separate dealings with both entities.

On the other hand, in Lahore, there is an umbrella authority, the Punjab Land Records Authority (PLRA), which is in charge of land administration across the province, oversees the sub-registrar offices as well as *arazi* record centers, and promotes cooperation and integration of the systems. By linking databases, PLRA has been able to automate several processes and significantly reduce delivery time as well as the number of interactions between users and the administration. In Punjab, the mutation process is now automatically done after registering the sales deed. Parties submit their documents at the sub-registrar which executes and registers the deed, and then sends the information to the *arazi* records center, which completes the mutation and updates ownership records, without requiring any additional physical interaction between the users and the administration. Punjab has also introduced a single identification number for properties, the *khasra* number, which is used for both ownership and cadastral purposes. Both provinces have made efforts to increase transparency by publishing more information online (fees, guidelines, list of documents), have introduced standardized sales deeds to remove the need to hire lawyers, and have implemented e-stamp initiatives. In terms of computerization of maps and records, there is still room for improvement in both provinces, as full digitalization has not been achieved yet. Records for urban areas, including Lahore, are

not fully digitalized in Punjab. In Sindh, the Board of Revenue (BOR) has launched an initiative to scan maps and records through a scanning unit, but the province has yet to move to a fully digitalized data-centric system which would link multiple databases. In parallel, both cities are also developing a Geographic Information System (GIS).

Given the federal structure of the country, the following reform actions would need implementation at the provincial level by the Sindh and Punjab provinces.

Short-term reform recommendations

1. Strengthen service standards and time limits and make them publicly available online in Karachi.

Transparency is a critical element in the quality of land administration systems. It helps eliminate asymmetries in information between users and public officials and increases the efficiency of the land market⁴⁹. A transparent land administration system – one in which all land-related information is publicly available all procedures and property transactions are clear, and information on delivery performance is easy to access – minimizes the possibilities for informal payments and abuses of the system itself. One crucial consequence of transparency is accountability: information gives citizens the power of knowing what to expect and whom to hold accountable in case things go awry.

For the public to be informed about the expected delivery timeframes for property registration procedures and obtaining updated cadastral maps, it would be useful to make these service standards publicly available, both online and at the service centers. While land management agencies in Lahore have made service standards publicly available online, the same does not apply to Karachi. The Sindh Board of Revenue (BOR) could publish service standards online and follow the example of PLRA which commits to deliver documents within specific timeframes - in Lahore, 18 days is the maximum time limit to deliver a registered deed along with a mutation copy and seven days is the limit to provide updated cadastral plans⁵⁰.

Time limits give citizens a reference for how much time a procedure will take. If the process is not completed within that time limit, they know they need to follow up. Twenty-two economies introduced time limits over the past decade. However, time limits work only when the agency can comply with them. In most economies, therefore, time limits have served to support broader changes. Ten economies –the Russian Federation, Bosnia and Herzegovina, Burundi, Cyprus, the Czech Republic, Israel, Italy, Mauritius, Ukraine, and Poland – introduced time limits while at the same time streamlining procedures through computerization and reorganization. In Russia the creation of a unified electronic land and property database eliminated the need for applicants to visit the Bureau of Technical Inventory and obtain a cadastral passport, reducing the time to transfer property by up to 22 days.

Examples of good service standards are:

- clearly defined steps for the land registration procedure
- transparent and fixed fees for registration, notaries, surveying
- use of standard forms
- public notice of the procedure (in offices, websites, leaflets)
- complaint mechanisms such as regular surveys, hotlines, complaints boxes (See Recommendation 4)

⁴⁹ One definition of a transparent business environment is one in which individuals possess essential information about the environment in which they operate, meaning that information asymmetries do not place an unjustifiable burden on them (OECD 2002).

⁵⁰ For more information, please see <<http://rodportal.punjab-zameen.gov.pk/process>>

2. Increase transparency by publishing statistics on land disputes in Karachi.

When land disputes occur, it is vital to ensure that they clear the courts quickly so that citizens' resources are not perpetually tied up in the legal system. The availability of statistics on the number of first-instance land disputes is a measure of the quality of the land administration system. Such statistics help citizens learn about the true performance of the courts and offer the courts information on current bottlenecks and challenges that can stimulate future initiatives to streamline the courts' operations.

Currently, while official statistics on property transfer transactions (e.g., the number of transactions per year) are made available to the public in both Karachi⁵¹ and Lahore⁵², only PLRA made statistics on land disputes in district courts⁵³ available online. With the objective of improving transparency, it is recommended that Karachi's land management agencies and courts implement the publication of such data. Across the globe, 24 economies provide such statistics, including Colombia, Croatia, Jordan, Singapore, the United Kingdom, and the Netherlands.

3. Increase awareness-raising efforts on recent reforms and clarify the legal requirements to avoid over-compliance and close implementation gaps.

While reforms are being implemented in Karachi and Lahore, it is recommended to increase outreach efforts to explain the changes and present the newly-introduced procedures and systems to users. It could be done through official websites but also videos and social media. Organizing seminars or workshops with associations and main stakeholders will also help in disseminating the information.

Educating the public on the recent reforms will be beneficial in multiple ways. It will improve the new electronic systems' uptake and promote compliance as well as efficiency. Additional efforts need to be undertaken to make applicants aware of the new requirements. While some users are reluctant to use electronic systems when they are available and prefer to go to the service centers in person, they should be reminded that this is not required by law and encouraged to use e-services through enhanced performance. In many countries⁵⁴, the reason why users are reluctant to use electronic platforms is that they don't trust the systems. Therefore, it is critical for the government to show that the system is reliable and that processing times are shorter. Educating the public on the formal requirements will also help in avoiding over-compliance (i.e., the submission of additional documents⁵⁵, on top of those that are required by law), which increases the administrative burden on businesses.

More specifically, authorities should clarify with users:

- They are not required to submit a PT1 form⁵⁶ for property registration and mutation in Lahore (see also Recommendation 6). While this is not a legal requirement, the practice is that users request it to reduce the risk of future litigations as the PT1 form allows parties to verify whether the property has outstanding debts related to property taxes. Addressing this underlying concern about the risk of litigations will also be vital in eliminating this practice from the private sector.
- They don't need to advertise the transaction in the newspapers⁵⁷

⁵¹ For more information, please see <<https://sindhzameen.gos.pk/asrkh/>>

⁵² For more information, please see <<https://rodportal.punjab-zameen.gov.pk/>>

⁵³ For more information, please see <<https://rodportal.punjab-zameen.gov.pk/stay-order-report/>>

⁵⁴ In India, it took four years for the online platform to be widely used by architects.

⁵⁵ The PT1 form in Lahore for instance.

⁵⁶ The PT1 form is obtained at the Provincial Excise and Taxation Department. According to *Doing Business 2019*, this procedural step takes five days and costs PKR 20 in Lahore.

⁵⁷ While this is not legally required, advertising the property transfer in a local newspaper to invite interested third parties to submit objections is a widespread due diligence practice carried out by the majority of entrepreneurs in

- Nor conduct a title search at the sub-registrar⁵⁸ in Karachi;
- They are not required by law to hire a lawyer⁵⁹ to draft the sale agreement and assist with the transaction in Karachi and Lahore⁵⁹.

Pakistan has already taken steps to reduce the involvement of lawyers in property transfer procedures by making standardized deeds available online⁶⁰. Authorities should increase public awareness about the availability and benefits of such standardized contracts and consider introducing incentives for their use (e.g., lower registration fees). PLRA has developed a standardized software application for recording the deeds and mutation which is in line with international best practices. Globally, initiatives to promote the use of standardized contracts reduce the potential for irregularities in the contracts, thus helping reduce the time it takes to record the transfer later on in the process. Colombia made property transfers easier by introducing standard preliminary sale agreements free of charge in 2010. Thailand and Turkey also provide standardized contracts at the registry, where parties fill out the contracts and submit them on the spot.

4. Establish a dedicated and independent mechanism to track and deal with complaints related to property registration and cadaster in Karachi.

According to *Doing Business 2019*, Karachi lacks a specific and independent mechanism for filing complaints related to property registration for problems that occurred at the sub-registrar office or for filing complaints related to cadastral issues that happened at the Land Revenue Department. The Sindh Board of Revenue has introduced an online complaint mechanism,⁶¹ but it lacks sufficient independence and needs strengthening.

International best practice in the transparency of information mandates that citizens should be provided with an independent mechanism for filing complaints about problems that occur at the property registry and the cadaster. Facilitating the correction of administrative mistakes in property registration avoids issues with property rights down the road and provides land registries with information on potential systematic errors in processing. A good practice solution for addressing administrative mistakes is the introduction of a third-party mechanism or agency which operates independently from the land registry/cadaster and reviews complaints about problems that occurred at the agency in charge of immovable property registration.

The Sindh Board of Revenue could follow Lahore's example which deployed an independent third party-based Complaint Management Cell, operated by private companies⁶². In Punjab, complaints can be submitted through an online form⁶³, by phone, through email⁶⁴ or by fax⁶⁵, and they are reviewed and

Karachi. Specifically, the advertisement is widely used to reduce the risk of future disputes over the property and the transaction. This procedural step takes eight days and costs PKR 10,000 according to *Doing Business 2019*.

⁵⁸ Although this is not a requirement in Karachi, the common practice is to conduct a title search with the sub-registrar office. According to *Doing Business 2019*, this procedural step takes seven days and is free of charge.

⁵⁹ According to *Doing Business 2019*, this step takes five days and costs PKR 7,500 in Karachi and takes three days and costs PKR 12,500 in Lahore. Users who need a lawyer to assist them (i.e., if they are illiterate) would still be able to do so.

⁶⁰ Standardized deeds in Lahore: <<https://rodportal.punjab-zameen.gov.pk/specimen/>> ; Standardized deeds in Karachi: <https://sindhzameen.gos.pk/demo_registries/templates.aspx>

⁶¹ For more information, please see <<http://borsindh.gov.pk/index.php/complaint>>

⁶² A third party operates the phone-based complaint system: M/S Abacus Pvt. Ltd. The e-system for complaints is handled by a third-party: M/S systems Ltd. For more information, please see <<https://rodportal.punjab-zameen.gov.pk/complaint-management-cell>>

⁶³ For more information, please see <<https://rodportal.punjab-zameen.gov.pk/complaint-page>>

⁶⁴ contactus.rod@punjab-zameen.gov.pk and complaint.rod@punjab-zameen.gov.pk

⁶⁵ +92-42-99330127

answered within three working days. Additionally, if applicants are dissatisfied with the response, they can escalate the complaint to the district administration, and ultimately the Punjab Ombudsperson.

Globally, there is a specific and independent mechanism for filing complaints at the land registry in 24 out of the 190 economies covered by the *Doing Business* project, and 22 economies have this type of mechanism related to the cadaster. Recently, Hong Kong SAR China implemented a complaint mechanism to solve disputes that arise from its land registry. On December 2016, the government of Hong Kong launched a new independent and specific complaint mechanism via the land registry's website for problems that occurred at the agency. Also, the public may contact the land registry: (i) through calling the service hotline; (ii) by submitting the online form; (iii) by writing to the land registry offices (iv) by fax or (v) by email.

5. Fully automate the process of paying stamp duties in Karachi and Lahore.

Both Karachi and Lahore have recently introduced e-stamp initiatives. Users can now pay the stamp duty, the capital value tax, the town tax, and the registration fee online⁶⁶, and generate a challan/invoice from the website. However, after paying these taxes and fees, users need to bring the receipt with the payment reference number to a designated commercial bank to obtain the stamp papers to be attached to the sales deed before submitting the transfer instrument for registration. Authorities in Karachi and Lahore could go further by fully automating the process of paying the taxes and duties to reduce the number of procedural steps and physical interactions. The Government of Pakistan could review the Stamp Act, other relevant laws and regulations and amend them if necessary to achieve full implementation of the e-payment initiative for taxes and duties.

6. In Lahore, further, integrate databases by linking PLRA and Excise and Taxation Department's systems to check property tax liabilities automatically.

Although the PT1 form (property valuation form) is not legally required by PLRA to register the sales deed or complete the mutation, obtaining it is a widespread due diligence practice carried out by a majority of entrepreneurs in Lahore (See Recommendation 3). Specifically, this form is widely used to reduce the risk of future litigations as the PT1 form allows parties to verify whether the property has outstanding debts related to property taxes. This document lists the physical characteristics of a given immovable property to assess the applicable property tax, and it shows the property tax levied on the property and the outstanding tax liabilities. The PT1 form must be obtained in person at the provincial Excise and Taxation Department. According to *Doing Business* 2019, this procedural step takes five days and costs PKR 20 in Lahore.

Authorities in Punjab could carry out their plans to integrate PLRA's system with the Excise and Taxation Department's portal and database to check property tax liabilities automatically, through a back-office function. A shorter-term option would be to allow the printing of NOC through the website by the landowner and to permit it to be verified through SMS or web tracking. This option would not eliminate the procedure but would make it easier in the short-term.

7. In Karachi, ensure full automation of the procedure to obtain the sales certificate (NOC).

In Karachi, at the onset of the procedure for property transfers, users need to obtain a no-objection certificate (NOC). If the Board of Revenue has jurisdiction over the land, the NOC is obtained from the *mukhtiarkar*, who is a senior officer of the Land Revenue Department placed in the field. The NOC permits the sale of

⁶⁶ See

<<https://es.punjab.gov.pk/eStampCitizenPortal/ChallanFormView/AddChallan?name=GenerateChallan&vCount=4384683&agree=true>>

the property and shows whether the property taxes were paid. According to *Doing Business 2019*, obtaining this document takes 14 days and costs PKR 300. However, there are more than 20 land-owning agencies in Karachi and if a different land-owning agency⁶⁷ than BOR has jurisdiction over the property, the procedure might be different and even more cumbersome.

Although the Sindh Board of Revenue has recently introduced initiatives to automate this procedure, those reforms still need to be fully implemented in practice. In the short-term, under BOR's current plan, each landowning agency will arrange a digital NOC Unit that will scan NOCs and provide them to the LARMIS⁶⁸ Data Center so that it can upload them on its website,⁶⁹ where the applicants and the sub-registrar offices will be able to access them. This short-term initiative is sound and should be implemented to eliminate the need for applicants to obtain the NOC in person from the relevant land-owning agency.

In the longer term, authorities in Sindh could consider further automating this process by having the land-owning agencies computerize their land management systems to enable the establishment of online linkages among all agencies to verify land titles and obtain NOCs electronically (see Recommendation 10).

8. In Karachi, review land-related procedures at the Board of Revenue to identify bottlenecks and explore ways to streamline the deed execution, registration, and scanning processes.

According to *Doing Business 2019* which measures the administrative burden and time it takes to complete a property transfer through the ordinary procedure (i.e., without additional informal payments or using a fast-track channel), processing a sales deed at the sub-registrars in Karachi takes six months on average. This procedural step alone accounts for more than 85% of the overall duration of the property transfer procedure which takes 208 days to complete under the *Doing Business's* Registering Property indicator's case study. This procedure that must be completed at one of the 29 sub-registrars in Karachi includes the following steps: (i) first, the parties submit their documents⁷⁰ and arrange an appointment to sign and execute the sales deed in front of the sub-registrar; (ii) after executing the deed, the sub-registrar sends the transfer instrument to the scanning unit⁷¹ which scans the deed and inputs the information in the electronic database for indexation of the sales deed and publishes this information online in the Board of Revenue's website; (iii) the sales deed is then sent back to the sub-registrar office and must be picked up by the buyer.

Achieving meaningful improvements in terms of performance will require addressing these delays that occur along the delivery chain. Based on interviews with public and private stakeholders, it seems that one of the causes of these delays might be the lack of capacity at the scanning unit which generates bottlenecks. The additional review that this unit conducts for each file is another cause for delays. According to official statistics⁷², around 500 deeds are scanned per day in Karachi, which amounts to 10,000 per month.

BOR could produce a comprehensive process map and review its internal processes along the whole delivery chain to identify delays, bottlenecks, and duplicate procedures. Based on these findings, systems and operations could be streamlined or merged to reduce delays. Introducing and monitoring performance indicators and collecting regular data will also help in identifying issues and opportunities for streamlining.

⁶⁷ As many as 20 landowning agencies are involved in this process in Karachi (Karachi Development Authority, Clifton Board Cantonment, etc.)

⁶⁸ Land Administration and Revenue Management Information System.

⁶⁹ See <www.sindhzameen.gos.pk>

⁷⁰ (i) Conveyance/Sale Deed (stamped after payment in Procedure 5); (ii) ID of parties; (iii) Original title deed of seller; (iv) Sales Certificate (obtained in Procedure 1); and (v) If the parties have authorized someone else through a power of attorney, the power of attorney in original with copies.

⁷¹

⁷² See <https://sindhzameen.gos.pk/asrkhi/khi_dashboard.aspx>

Officials, departments and units could then be held accountable and encouraged to improve performance. Additionally, BOR could consider establishing a robust case management system. That system should be able to track transactions and documents along the delivery chain and provide realtime data on service performance. It could also give users the opportunity to check the status of their request online and send email or SMS notifications to inform them when they need to take action.

Medium to long-term reform recommendations

9. Achieve full digitalization of ownership records and cadastral plans and continue improving the GIS system in Karachi and Lahore.

In Punjab, PLRA has embarked on a large-scale reform initiative aiming at fully digitalizing cadaster and land ownership records, while, in Sindh, BOR has launched an initiative to scan them⁷³. In parallel, both cities are also developing a Geographic Information System⁷⁴ for their plots. Punjab has recently made progress in digitalizing property information, especially in rural areas⁷⁵. However, as full digitalization has still not been achieved for urban areas, including Lahore, PLRA should continue its digitalization efforts to make full coverage. In Karachi, records are currently scanned by a dedicated scanning unit (see Recommendation 8), but most of them are still kept in paper format. Private stakeholders report that errors and missing information in records are frequent in Karachi, which opens the door for disputes and lengthy litigation procedures.

Although scanned records will increase the reliability of the land registry by storing the records digitally, it does not allow users to extract information, as they are stored as images. In addition to scanning, the data from land records need to be digitalized into an electronic database in a data-centric and exploitable way. This approach is costlier and more time-consuming, but it has a much more significant effect on efficiency as it makes the data usable. A digital database allows users to conduct quick title searches while providing protection against double registration. Besides, digital records will also provide the foundation for centralized liens and encumbrances' database and online registration. Digital files have apparent advantages over paper records (less storage space, easily shareable), and although electronic systems are not immune to errors, they allow for easy identification of overlapping titles.

Transferring property takes about half as much time in economies with computerized registries compared to those without them. All 32 OECD high-income economies have electronic registries. Eleven, including Denmark, the Netherlands and New Zealand, offer electronic registration. In South Asia and Sub-Saharan Africa, by contrast, 68 percent of economies still have paper-based systems. OECD high-income economies have the fastest property registration, taking 22 days on average. Recently, Kenya and Mauritius finalized digitalizing their scores. In 2015, the land registry in Mauritius completed the digitization of all its paper-based records from 1804 to 2015. Denmark is another excellent example of a country that transitioned from a paper-based to an electronic system. In 2009, the Danish land registry initiated its computerization and records were progressively digitized. Once digitization was complete, the land registry introduced electronic lodgment of property transfers. By 2011, property transfer applications were only accepted online, and the information technology system efficiently started screening applications.

10. In Karachi, establish a single-client-facing agency for land administration and integrate the databases and systems for land registration and cadaster.

⁷³ See Sindh's BOR scanned maps available online at < http://map.sindhzameen.gos.pk/Sindh_Map.aspx>

⁷⁴ See PLRA's GIS system: < http://gisportal.punjab-zameen.gov.pk:81/lrmis_geo/>

⁷⁵ With WBG support, PLRA fully digitalized records in rural areas. The same does not apply to urban areas, including Lahore, where records are not fully digitalized.

Currently, the land administration is fragmented in Karachi with many actors and institutions involved in the property registration procedures (sub-registrar offices, land revenue department, and over 20 land-owning agencies) and cooperation as well as data-sharing are lacking, resulting in multiple interactions between the users and relevant departments.

To facilitate cooperation between the relevant agencies and integrate the databases and systems for land registration and cadaster the Sindh province would need to establish an umbrella agency that would be specifically in charge of property administration. Sindh could follow Punjab's example and turn its ad hoc LARMIS project management unit⁷⁶ into a permanent body with sufficient resources and dedicated staff. In Punjab, the LRMIS delivery unit has become a fully-fledged agency with dedicated team and resources within the Punjab Board of Revenue - the Punjab Land Records Authority (PLRA), which is now in charge of land administration across the province and oversees the sub-registrars as well as *arazi* record centers.

The Sindh province could follow suit and integrate databases and systems for registration and mutation which will create opportunities to streamline and automate procedures. Introducing a single identification number for properties will also help in integrating systems, as authorities in Karachi are now using two different ID numbers - the RD number for registration, and the CNIC⁷⁷ for land ownership information. Punjab, on the other hand, has managed to introduce a single ID number, the *khasra* number, which is identical within registration and cadastral agencies. These initiatives should be implemented in parallel with the digitalization of records and cadastral maps or plans (see Recommendation 9) to achieve additional efficiency gains.

Globally, best practice principles indicate that the expected benefits from integration can be achieved through one or more of the following:

- the sharing of data, with individual agencies given primary or "custodial" responsibility for selected data, e.g., the land records might be responsible for the parcel identifier, owner's name, and current legal status, while the property valuation and taxation agency would be responsible for information about improvements to the property and its value;
- the sharing of common materials and procedures for similar functions (such as the use of standard forms, terminology, data tables, and indexing); and
- the sharing of a common database environment, for example, by using standardized inquiry and communications software to provide access to a family of databases

One of the more successful examples of functional integration is in the Canadian provinces of New Brunswick, Nova Scotia, British Columbia and Alberta where the land registry, property mapping, and topographic mapping, personal property registry, and property valuation functions have been made the responsibility of one government agency. Previously, each one of these functions had people and facilities assigned exclusively to it. The agency now shares these resources throughout the province, has developed common standards for data, and has moved towards an integrated database environment. Many other economies have been able to coordinate the functions or records of at least two institutions involved in the property transfer process. One way to do this is to have a representative of one of the institutions present at the other - as in Ethiopia. Another is to link agencies electronically - as in Latvia, Lithuania, and Peru. In Latvia, the land registry gained electronic access to municipal tax information on real estate. That freed entrepreneurs from having to provide this information in a paper format.

Streamlining procedures and linking agencies' information systems is a popular reform in many countries. Fifty economies did so to simplify property registration in the past ten years. These measures reduced interactions between entrepreneurs and agencies while maintaining or increasing security and controls.

⁷⁶ See < <http://www.sindhlarmls.gos.pk/>>

⁷⁷ Computerized National Identity Card (CNIC).

Digitizing and linking land records is a precondition to offering the end-user the option of a fully-fledged electronic registration. Ultimately, by creating an electronic system of land-related information and matching records across agencies, Karachi could maintain accurate and transparent land information which would limit disputes over land and improve predictability in the land registration process.

11. Provide training for land registry and cadaster staff after the introduction of the new land administration system in Karachi.

Developing institutional capacity is crucial to improving efficiency and service delivery. Lack of necessary skills or tools within the implementing agencies is often a key reason for delays, poor service and poor oversight in land registration processes. Given the heterogeneity of offices to be consolidated in Karachi and the Sindh Province, moving towards a client-oriented and efficient administration might require significant changes in the mindset and organizational culture of staff. At the same time, capacity building and training may improve staff motivation and performance. Training will also increase staff knowledge of new procedures and new technologies and help them deliver better quality services. Peer-learning events between the Punjab and Sindh provinces could also assist in disseminating lessons learned and good practices.

12. Reduce the time to obtain decisions on land disputes from the district courts (See also recommendations under Enforcing Contracts).

In Pakistan, obtaining a judgment in a standard land dispute between two local businesses over tenure rights of property takes more than three years in the district courts in Lahore and Karachi. When land disputes end up in court, an efficient legal system should be able to provide a timely resolution. In 34 of the economies benchmarked by *Doing Business*, obtaining a similar judgment from the relevant court takes less than one year (e.g., Denmark, the Republic of Korea, and Malaysia).

To reduce the time needed to resolve land disputes the authorities could introduce a range of measures such as:

- 1) Specific mediation procedures for land disputes.
- 2) Case management techniques in the civil courts, such as pre-trial conference.
- 3) Electronic case management tools for judges and lawyers.
- 4) Establishing a maximum number of adjournments that can be granted or limiting such adjournments to unforeseen and exceptions circumstances in civil cases (See also recommendations under Enforcing Contracts).

6. Getting Credit

Two types of frameworks can facilitate access to credit and improve its allocation - credit information systems and borrower and lender rights in collateral and bankruptcy laws. Credit information systems enable lenders to view and consider a potential borrower's financial history (positive or negative) when assessing risk and they allow borrowers to establish a good credit history that will facilitate their access to credit. Sound collateral laws enable businesses to use their assets, especially movable property, as security to generate capital - while strong creditors' rights have been associated with higher ratios of private sector credit to GDP.

Doing Business covers two aspects of the regulatory framework and infrastructure that affect the availability of credit: (i) the depth of credit information and (ii) the strength of the legal rights of borrowers and lenders. The first aspect, measured by the depth of credit information index, includes the coverage, scope, and quality of credit information available through credit registries and credit bureaus. The second, measured by the strength of legal rights index, evaluates the degree to which movable property can be effectively used as collateral and the protection of creditor rights and priorities in bankruptcy.

In Doing Business 2019, Pakistan ranked 112th out of 190 countries on the Getting Credit area. Pakistan scored 45 percent in the Getting Credit score, slightly below the regional average for the South Asia region (47.5 percent). India leads the ranking at 22nd with a Getting Credit score of 80 points.

A. Credit Information

A credit reporting system is an integral part of a well-functioning credit market. Credit reporting systems help satisfy lenders' need for accurate, credible information that reduces the risk of lending and the cost of loan losses by providing a reliable indication of whether an applicant will repay a loan. The lack of credit information makes checking borrowers' credit history an onerous and uncertain process. It raises transaction costs for banks and, ultimately increases the cost of credit to borrowers. The lack of credit information could also result in the approval of loans based on personal connections, and not necessarily the likelihood of repayment.

Research suggests that bank risk is lower, while profitability is higher, in countries where lenders share borrowers' information through credit bureaus and registries.⁷⁸ Well-functioning credit reporting systems can help to reduce adverse selection and moral hazard. Further, it can contribute to both an expansion of credit and a reduction in lending costs by facilitating the adoption of lending technologies based on credit scoring models. The development of credit information systems is particularly important for smaller firms, given the more severe problems of information opacity and asymmetry in these cases.

Pakistan scores seven out of eight points on the Depth of Credit Information Index. As of May 2018, 10.7% of adults were covered by the credit registry, compared to an average of 4.8% in the region (Table 6.1).

Table 6.1 Credit information ranking and best performers

<i>Doing Business</i> Indicator	Pakistan	Regional Average	Regional best performer	Best global performer
Depth of credit information index (0-8)	7	4	7 (3 economies)	8 (42 economies)

⁷⁸ Joel Houston, Chen Lin, Ping Lin, and Yue Ma, 2010. "Creditor rights, information sharing, and bank risk taking," *Journal of Financial Economics*, Volume 96, Issue 3, Pages 485–512, June.

Private credit bureau coverage (percent of adults)	7.2	18.5	55.9 (India)	100 (25 economies)
Public registry coverage (percent of adults)	10.7	4.8	23.6 (Maldives)	100 (4 economies)

Source: *Doing Business Report 2019*

B. Legal Rights of Creditors and Borrowers in Secured Transactions

This section focuses on aspects measured by the Legal Rights Index which covers the secured transactions and creditor's and debtor's rights. Access to finance remains a problem for SMEs in many countries around the world including Pakistan. Part of the reason is that financial institutions require SMEs to provide real property as collateral for loans, with a preference for commercial real estate. However, small and medium enterprises seldom have real estate as collateral for a business loan. Their concentration of assets is movable property - including inventory, accounts receivables, and equipment. Accordingly, the Legal Rights Index measures the effectiveness with which the current legal and institutional framework facilitates the use of such movable assets as collateral.

Research suggests that in countries where security interests over collateral are enforceable against third-parties in cases of loan default based on a predictable priority system, credit to the private sector represents 60% of GDP on average, compared with only 30% to 32% on average for countries without these creditor protections. In industrial countries, borrowers with collateral receive nine times the level of credit on average as borrowers without collateral, for a given level of cash flow. They also benefit from repayment periods that are up to 11 times longer and pay interest rates that are up to 50% lower.⁷⁹ In countries with registries for movable collaterals, the number of firms with access to finance increases on average by 8%. These countries also showed lower interest rates and extension in loan maturity. The increase was even stronger for small firms, which often find it more difficult than bigger firms to access credit due to a lack of fixed assets to be used as collateral.⁸⁰

In the *Doing Business 2019 Report*, Pakistan scores 2 out of 12 (12 = highest score for strongest protections) on the strength of legal right index. This is significantly below the regional average in South Asia (Table 6.2 and 6.3).

Table 6.2. Legal rights of creditors and borrowers in Secured Transactions ranking and best performers in *Doing Business 2019*

<i>Doing Business</i> Indicator	Pakistan	Regional Average	Regional best performer	Best global performer
Strength of Legal Rights Index (0-12)	2	5.5	10 (Afghanistan; Nepal)	12 (5 economies)

Source: *Doing Business Report 2019*

Table 6.3 Legal rights of creditors and borrowers in Secured Transactions score

Strength of legal rights index (0-12)	Pakistan's score
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⁷⁹ World Bank Group. 2010. Secured Transactions Systems and Collateral Registries. http://www.ifc.org/wps/wcm/connect/industry_ext_content/ifc_external_corporate_site/industries/financial+markets/publications/toolkits/secured+transactions+systems+_+collateral+registries+toolkit

⁸⁰ Love, Inessa, María Soledad Martínez Pería and Sandeep Singh, 2013. "Collateral Registries for Movable Assets. Does Their Introduction Spur Firms' Access to Bank Finance? Policy Research Working Paper n. 6477, The World Bank, June.

Does an integrated or unified legal framework for secured transactions that extends to the creation, publicity and enforcement of functional equivalents to security interests in movable assets exist in the economy?	No
Does the law allow businesses to grant non-possessory security right in a single category of movable assets, without requiring a specific description of collateral?	Yes
Does the law allow businesses to grant non-possessory security right in substantially all of its assets, without requiring a specific description of collateral?	Yes
May a security right extend to future or after-acquired assets, and does it extend automatically to the products, proceeds, and replacements of the original assets?	No
Is a general description of debts and obligations permitted in collateral agreements; can all types of debts and obligations be secured between parties; and can the collateral agreement include a maximum amount for which the assets are encumbered?	No
Is a collateral registry in operation for both incorporated and non-incorporated entities, that is unified geographically and by asset type, with an electronic database indexed by debtor's name?	No
Does a notice-based collateral registry exist in which all functional equivalents can be registered?	No
Does a modern collateral registry exist in which registrations, amendments, cancellations, and searches can be performed online by any interested third party?	No
Are secured creditors paid first (i.e., before tax claims and employee claims) when a debtor defaults outside an insolvency procedure?	No
Are secured creditors paid first (i.e., before tax claims and employee claims) when a business is liquidated?	No
Are secured creditors subject to an automatic stay on enforcement when a debtor enters a court-supervised reorganization procedure? Does the law protect secured creditors' rights by providing clear grounds for relief from the stay and sets a time limit for it?	No
Does the law allow parties to agree on out of court enforcement at the time a security interest is created? Does the law allow the secured creditor to sell the collateral through public auction or private tender, as well as for the secured creditor to keep the asset in satisfaction of the debt?	No
Score (number of "yes" responses)	2

Source: *Doing Business Report 2019*

Getting Credit over time

Pakistan has been engaged in several reform efforts in the area of Getting Credit recently. In 2015, the country enacted the Credit Bureau Act, intended to regulate and continue to develop credit bureaus in the private sector. Under the Credit Bureau Act, credit bureaus may collect and disseminate credit information, as well as provide various value-added services, such as credit scoring or data consolidation. Complementing the existing credit registry, the regulation of credit bureaus contributed to a moderate expansion in coverage, scope, and accessibility of credit information in the country.

Getting Credit was also enhanced by the enactment of two new laws covering secured transactions on movable assets. First, the passage of the Financial Institutions (Secured Transactions) Act 2016 (ST Act) provided a novel legal framework for the creation, perfection, and enforcement of security interests over a movable property. It also included provisions mandating the creation of a registry for security interests. While the passing of the ST Act was a significant development, it only covered transactions where the debtors were unincorporated entities or individuals. Given this limitation, Pakistan passed a second bill, namely, the Companies Act of 2017.⁸¹ While the core of the modification was to the company law regime in Pakistan, it also included amendments to the regulation of secured transactions created over the assets of companies.

⁸¹ The Companies Act of 2017 replaced the Companies Ordinance, 1984 (XLVII of 1984). The reform, aimed to address issues such as the protection of interest of minority shareholders and creditors, as well as to introduce measures against fraud, money laundering and terrorist financing.

In 2018, the Federal Government enacted the Financial Institutions Recovery of Finances Rules, under the powers conferred to it under Section 25 of the Financial Institutions (Recovery of Finances) Ordinance of 2001. This ordinance provides a summary procedure for recovery and enforcement by financial institutions which had been, however, challenged in court on constitutionality grounds. The new rules further simplify the enforcement process, providing for out-of-court enforcement of mortgages by financial institutions.⁸²

Despite these valuable efforts, there is still room for improvement in Pakistan’s secured transactions system. The newly-adopted legal framework remains fragmented, and a collateral registry for the movable property of non-company debtors is not yet in place. Given Pakistan’s good standing on credit information, only Recommendation 1 relates to credit information while the rest of the recommendations focus on how to improve the legal rights of creditors and borrowers in secured transactions.

Short-term recommendations

1. Extend the information covered by credit reporting service providers to include data from retailers or utilities.

Currently, credit bureaus are only allowed to distribute credit information from financial institutions. A comprehensive credit information system should also gather and disseminate information from retailers, trade creditors or utility companies (electricity, water, and mobile phone providers). It would increase the coverage of borrowers in the registry to include individuals or companies who may not have obtained a bank loan but have a lending history with other types of creditors. Moreover, it would align Pakistan’s credit bureaus with the international best practices, as well as improve the depth of credit information index. The Credit Bureau Act 2015 stipulates that one of the functions of credit bureaus is to “collect, process, collate, store and maintain information relating to debtors” (Section 18). It also states that credit institutions shall become a member of at least one credit bureau (Section 11) and shall provide credit information to credit bureaus (Section 10). While the current definition of a credit institution is limited to banking (including microfinance ones), financial institutions, and non-banking financial companies, it could be expanded by the Federal Government to also include or merely enable the inclusion of- any other company (Section 2).⁸³ Similarly, the Federal Government may notify other credit information furnishers of their obligation to become members of a credit bureau (Section 11).

Sharing information among creditors reduces the likelihood of financial crises and increases growth.⁸⁴ Moreover, the ability to rely on a history of reliable credit information is a stepping stone to unlock access to credit for individuals.⁸⁵ A study in Italy found that more than 83% of water customers, who lacked a credit history before repayment information from the utility provider was included, were subsequently able to have a positive account, solely by paying their utility bills.⁸⁶ Utility companies may also benefit. For example, in August 2006, the United States-based DTE Energy, an electricity and natural gas company, began full reporting of customer payment data to credit bureaus. DTE customers with no prior credit

⁸² See Sayyed Qualb-e-Abbas Kazmi “Assessing the Performance of Banking Courts”, Corporate Law Decisions, Vol. XVI, Part 8, August 2017.

⁸³ There may be challenges to address before including data from these sources, such as being able to identify the borrowers correctly and link their information from banks to their data from alternative sources. Also, utilities and retailers would need to become aware of the benefits of sharing their data and then willing to participate in the system.

⁸⁴ See Houston, Joel, Chen Lin, Ping Lin and Yue Ma. 2010. “Creditor Rights, Information Sharing, and Bank Risk Taking.” *Journal of Financial Economics* 96 (3): 485–512.

⁸⁵ See World Bank. 2010. *Doing Business 2011: Making a Difference for Entrepreneurs*. Washington, D.C. <http://www.doingbusiness.org/reports/global-reports/doing-business-2011>.

⁸⁶ See Preliminary findings of ongoing internal study at CRIF SpA, Italy.

history- 8.1% of the total - gained either a credit file or a credit score. Also, customers began to make payments to DTE a priority. Within six months DTE had 80,000 fewer accounts in arrears.⁸⁷

2. Operationalize the secured transactions framework by adopting regulations for the ST Act.

UNICITRAL's Legislative Guide on Secured Transactions - the key source of international best practice in the area of secured transactions - recommends that states adopt a functional approach to regulate secured transactions. It means that the scope of the law should include not only pledges but also other types of transactions that either in form or in substance create security rights over movable properties. These include financial leases, long-term operating leases, sales with retained titles, fiduciary transfer of titles, consignments, assignment of an account receivable.

Pakistan has made strides in this area, especially since the introduction of the ST Act in 2016. The ST Act provides for a modern, functional approach to secured transactions, albeit not unified or integrated, by incorporating a broad definition of security interests (Section 2). Rules on security interests' priorities are also clearly established in Part V of the ST Act, including special priority rules for certain types of transactions - such as sale with retention of title or the priority of an unpaid seller. Other modern forms of secured financing, such as factoring are also regulated (see part VI on the Assignment of Receivables).

While such progress is a welcome development, implementation efforts are still lacking. Indeed, the act gives the Federal Government the power to make rules for carrying the purposes established in the legislation (Section 70), such as the principles of registration. Besides, once appointed, the registrar will have the power to enact regulations (Section 71) covering core aspects of the registry's operation. Without proper implementing regulations, many - if not all - of the sections of the ST Act won't be applicable. For instance, the out-of-court enforcement procedures described in Section 59 - especially relevant in Pakistan given the problems the judicial system faces - will not be entirely applicable until all allowed security interests can be perfected (Section 14).⁸⁸ Pakistan should consider the enactment of the secondary legislation in this area one of its top priorities.

3. Implement a unified geographically, notice-based, searchable electronic secured transactions registry under the ST Act.

Before accepting collateral, creditors need an effective way to find out whether the potential borrower has already granted a security interest in the collateral and, if so, what priority those rights have. It can best be done where there is a centralized collateral registry - one that is unified geographically and recording interests in all types of movable assets. The need to search multiple registries increases transaction costs, but where the registry is centralized, a creditor can immediately check all security interests from one location, by searching the debtor's name or the collateral's serial number. Collateral registries, therefore, support the use of movable collateral to secure loans.

As model laws and legislative guides have evolved with technology over the years, they have encapsulated a set of good practices that serve as generally accepted standards for modern collateral registries. In addition to centralizing registries, these include using notice-based registration and allowing online access to data. While traditional registries usually require a copy of the loan agreement or other documents, notice-based registries require no documentation other than a simple generic form that records the existence or potential existence of a security interest, providing the names of the creditor and the debtor as well as a general description of the collateral asset secured. It avoids the need for a specialist to review lengthy documents,

⁸⁷ See World Bank Conference. Financial Infrastructure Week. Brazil, March 15-17, 2010.

⁸⁸ It should be noted that the operationalization of the ST Act may not be enough to obtain full points on the strength of legal rights index.

which can be costly and time-consuming. It also improves the quality of registration as the potential for errors is minimized when documents are not subject to any registry officials' scrutiny.

Online systems allow users to perform searches and register security interests from anywhere and at any time. Unlike with paper-based systems, there is no need for users to appear before the registrar and wait their turn to enter information in the registry index. Online registration also transfers the burden of preventing errors to the interested party.

The establishment of the secured transactions registry is mandated under part IV of the ST Act, but it has not yet been implemented. When established, such registry should give prospective creditors the ability to file, amend and terminate notices of security rights without requiring the registration or review of additional documents. The registry should also allow for easy searches based on a debtor's name or unique identifier. For these purposes, the government will need to develop a software application in line with best practice, as well as test and launch the system. Eventually, the new registry should be merged with the one for companies, managed by the Securities and Exchange Commission of Pakistan.

Box 6.1. Good practices in collateral registries

Those economies that experience the largest number of registrations of security interests over moveable assets are those that accept a broad variety of movable assets to be registered as collateral, have a unified electronic (web-based) database, do not require submission of loan documents and have low registration fees. This translates into a higher lending volume as each registration represents a loan secured with movable property.⁸⁹

Good practice collateral registries include the following features:

- allow registration of functional equivalents
- register both incorporated and non-incorporated entities
- single data source (centralized) registry for all security interests, including non-consensual liens
- web-based electronic system accessible 24/7
- notice-based system, meaning that only information on the creditor, the debtor (who can be both a legal or natural person), and the collateral are entered, without the need for any documentation to be reviewed to maintain that information
- registrations to be done by creditors or their legal representatives directly into the system
- information available to the general public for searches
- registrar's role to be limited to management, it shall not extend to verifying and modifying information in the registry
- flat and reasonable fees for registrations and searches
- non-cash payments to the registry (debit/credit cards, electronic transfers, or pre-paid accounts)
- clearly defined liability of the registry for errors
- secured and protected registry data, with established disaster recovery sites
- search criteria that include, at least, debtor identifier and serial numbered collateral⁹⁰

⁸⁹ Álvarez de la Campa, Alejandro, Santiago Croci Downes and Bettina Tirelli Henning. 2012. Making Security Interests Public. Registration Mechanisms in 35 Jurisdictions. Washington, D.C.: International Finance Corporation. <http://www.ifc.org/wps/wcm/connect/fbef87804c2ab1dda285eaf12db12449/Registry+survey+report.pdf?MOD=AJPERES>

⁹⁰ For a detailed account of good practices in collateral registries, see IFC.2010. Secured Transactions Systems and Collateral Registries. http://www.ifc.org/wps/wcm/connect/industry_ext_content/ifc_external_corporate_site/industries/financial+markets/publications/toolkits/secured+transactions+systems+ +collateral+registries+toolkit

Examples of modern registries include those in Australia and New Zealand. In Mexico, over 132,000 loans were registered in the first 18 months of the registry's operation. Approximately 30% of the collaterals registered were agricultural products, and 40% were motor vehicles. It is estimated that businesses in Mexico have saved USD 3.8 billion in fees because registrations and searches are free of charge.⁹¹ The registry in China, started in 2007, facilitated over USD 1 trillion in movable financing to SMEs in its first four years of operation. Financing with movable collateral is growing at an annual rate of 21%, and SME lending portfolios in banks are growing at 25-45% as a result of the greater confidence created by the registry.

Medium and long-term recommendations

4. Consider amending the secured transactions legal framework to implement a unified or integrated system.

Good practice economies follow a holistic approach to secured transactions by creating an integrated or unified legal framework that extends to the creation, publicity, and enforcement of functional equivalents to traditional security interests in movable assets. This approach allows the registration of not only traditional security interests, but also other transactions secured with movable property and functional equivalents, meaning rights in movable assets that are created by agreement and secure the payment or other performance of an obligation, regardless of the form of the transaction or the terminology used by the parties. Moreover, UNCITRAL recommends that all transactions secured with movable property, including functional equivalents, should be covered by the same legislation and governed by the same rules of publicity, priority, and enforcement. It means that all mechanisms should be registered within the same collateral registry.

Currently, Pakistan has two major laws covering secured transactions over movable assets. For business entities, Part VI of the Companies Act of 2017 includes the registration of mortgages and pledges. For non-business entities, the ST Act covers all matters related to security interests. While these laws have several aspects in common, they also contain many relevant differences. For instance, a vital concept of the ST Act is that of security interest. In turn, security interests are not mentioned in the Companies Act. Similarly, while the Companies Act was enacted later than the ST Act, any word or expression not defined in the former - e.g., "pledge" - is not assigned the meaning given by the latter.⁹² It is recommended that Pakistan integrates the legal framework regulating all transactions that secure an obligation with movable collateral. Such a system would include security interests regardless of the form of the agreement or the terminology used, whether the secured party or the debtor own the collateral, or whether the debtor is a business entity or not. This integrated or unified framework should apply to the creation, publicity, and enforcement of security rights and all transactions secured with movable property. The same legal framework should apply to both incorporated and non-incorporated entities.

More than 50 of 190 economies have such a functional approach as recorded by Doing Business. Montenegro, for example, has a unified legal framework for secured transactions and requires registration of traditional pledges, fiduciary transfers of title, financial leases, and assignments of receivables at the same centralized pledge registry whether the debtor is incorporated or non-incorporated entity/individual.

⁹¹ Data from the Registro Único de Garantías Mobiliarias (RUG – the Mexican collateral registry. The estimated USD 3.8 billion was done by RUG, and it corresponds to the first two years of the registry's operations.

⁹² See Section 2.2 of the Companies Act referring to the meaning of the Securities Act of 2015, the Securities and Exchange Commission of Pakistan Act of 1997, and the Central Depositories Act of 1997.

5. Amend the Corporate Rehabilitation Act of 2018 to introduce automatic stay, as well as time limits for its duration in reorganization proceedings.

A stay on collection activities during the pendency of a debtor's bankruptcy proceedings serves several purposes. It gives the debtor enterprise the breathing room needed to attempt to rehabilitate. A stay also gives creditors confidence that there won't be a race to the debtor's assets while they analyze and negotiate on possible ways forward. Finally, it allows the liquidator to monetize the debtor's assets and ensure an equitable, pro rata distribution to creditors.

The newly-enacted Corporate Rehabilitation Act 2018 captures the idea behind the benefits of a stay by giving the court the option to pass an order against any imminent adverse action or proceeding "...against the debtor, or its shareholders, directors and guarantors..." (Section 12). Further, Section 12 allows for the court to grant relief from the stay to a creditor in case it is needed to prevent irreparable harm or loss to the interested party.

The stay provision contained in the Corporate Rehabilitation Act 2018 has four main shortcomings. First, stay is not automatic. While a discretionary application of the stay may allow for tailoring to the specific needs of a case, it also brings about the potential to cause unnecessary delays while the court considers the relevant issues.⁹³ Furthermore, an early decision on the stay is fraught with risks as courts often have scant knowledge about a case as it is filed. Second, the stay doesn't only cover the debtor but also third parties, such as guarantors. The stay is designed to protect the value of the insolvency estate. A guarantors' estate need not be protected under the insolvency law, as it cannot be presumed that a third party will need any protection. As a result, the scope of the stay has the potential to be over-inclusive under the act. Third, the timing of the stay is problematic under the act. The existing regulation on the stay procedure does not provide sufficient protection for reorganization efforts as it only applies after the case has commenced. Such a provision allows for early enforcement to preclude effective rehabilitation efforts. Finally, the act does not include a specific duration of the stay. Stays are not supposed to extend indeterminably. Indeed, fixing the length of the stay avoids uncertainty and encourages a speedy resolution of the proceedings.⁹⁴

As a result, Pakistan should consider reforming the stay provision contained in Section 12 of the Corporate Rehabilitation Act to avoid excessively hindering claim holders and to support effective reorganization efforts from an early stage.

6. Amend the Companies Act to assure secured creditors get paid with priority in liquidation.

The existence of overriding interests ahead of secured creditors detracts from the availability of credit in an economy and increases its costs. The government should consider amending the language of the Companies Act to limit, or even eliminate, this option.

It is critical for creditors - or potential creditors - of a business to be able to determine, with a high degree of certainty, where their claims against the business will rank. Given the vital role that secured creditors often play in providing credit to businesses, their claims should have the highest priority possible, both within and outside of insolvency procedures, unless other claims were registered before the secured creditor's claim. Claims that rank higher than secured ones are likely to increase the cost or limit the availability of credit.

⁹³ See Uncitral Legislative Guide on Insolvency Law, pp. 88-9, available at https://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf

⁹⁴ Exceptions to the fixed duration of the stay, such as in case collateral is not needed for reorganization or in case of perishable assets, should also be included in a future amendment to the Corporate Rehabilitation Act.

If secured creditors can predict their ranking vis-à-vis other types of creditors (including statutory creditors) with more accuracy, they will be able to price their risk more efficiently, thereby making credit available more easily and at a lower cost to the borrowers. However, when other types of creditors, such as unpaid wages, have priority over secured creditors - especially if they came into existence after the registration of the security interest - secured creditors will be less able to predict their level of risk. Providing secured creditors with the highest level of priority possible will encourage more credit to be available to entrepreneurs at a lower rate.

Other essential policy objectives may also be served by ranking specific claims higher than those of secured creditors. This is currently the case of Pakistan, where Section 390 of the Companies Act 2017, includes provisions defining priority rights in the winding-up of a company. Besides the costs and expenses of realizing the assets (Section 286 of the Companies Court Rules, 1997), several other claims have priority over secured creditors, such as:

- i) All revenues, taxes, cesses and rates due to federal or local tax authorities.
- ii) Employees' wages, salaries, and unpaid vacation.
- iii) Contributions towards social security.
- iv) Compensation due under Section 14 of the Workmen's Compensation Act (1923).

To provide greater certainty to secured creditors, both the nature and the scope of these priority claims should be very clearly defined. Many countries achieve this by narrowly defining the class of claims that rank ahead of secured creditors and establishing clear limits to the amount of money that can be paid under these prior-ranking claims. For instance, the Argentine Insolvency Law limits the priority given to employees' remuneration claims to a maximum of six months. Pakistan should consider following a similar strategy.

7. Implement an awareness-raising campaign and capacity building activities on the new tools introduced by the ST Act.

The recent secured transactions reform hasn't made a significant impact in practice yet. Much of it is related to the lack of implementation of the ST Act. Local stakeholders report that debtors and creditors resort to mechanisms such as pledges and mortgages, rather than the concept of security interests introduced under the act. Once the legal and institutional frameworks are fully implemented, it will be essential to raise awareness of various public and private sector stakeholders about the provisions of the ST Act to ensure full implementation. Specifically, the following activities can be considered:

- Supporting the public awareness campaign, targeting stakeholders with information on the new act, registry system and their economic benefits.
- Training managers and staff of the government entity that manages the registry.
- Providing training for end-users (e.g., financial institutions), the judiciary, lawyers, trade associations and law school faculty on the new law, and new financial products using movable collateral (accounts receivable, inventory, equipment, investment instruments) as security.

7. Protecting Minority Investors

Access to finance is a crucial driver of private sector growth, particularly for aspiring entrepreneurs. The banking sector and institutional lenders are often the second sources after friends and family. However, vibrant economies offer a third option: equity markets, provided that strong structures are in place for them to develop and inspire confidence. A legal framework and institutions that adequately protect and balance the interests of company managers, majority shareholders and minority shareholders instill the requisite trust and confidence. For example, empowering shareholders with more control over sensitive transactions reduces the risk on their investment and helps entrepreneurs raise the capital needed to grow, innovate, diversify and compete.

Without investor protections, equity markets fail to develop, and banks become the only source of finance. Economies that have dynamic capital markets tend to protect investors effectively. In these economies investors receive financial information they can trust, they participate in major decisions of the company, and directors are accountable for their managerial decisions. Short of these protections, investors may be reluctant to invest, stunting the liquidity needed to fund business ventures.

Corporate governance determines how companies are directed and controlled, balancing between the rights and duties of managers, directors, shareholders and public authorities. It outlines corporate structures and processes, determines who is responsible for what, particularly for making decisions.⁹⁵ Introducing corporate governance requirements - as opposed to giving each company complete discretion over internal rules - guarantees a minimum standard for investors.⁹⁶ When violated, these rules also provide shareholders with judicial recourse. Investors become more willing to finance the business ventures of others without exerting direct control over the affairs of the company. As a result, entrepreneurs can tap into broader sources of financing. With easier access to capital, companies are more likely to grow, generate tax revenues and create jobs.

Protecting and empowering shareholders are increasingly essential policy goals - even more so following the 2008 global financial crisis. Policymakers worldwide are implementing reforms aimed at increasing the involvement of minority shareholders in corporate decisions. *Doing Business* has recorded and documented 213 reforms to aspects of corporate governance in 114 economies between 2005 and 2018.

***Doing Business* measures the strength of minority shareholder protections against directors' misuse of corporate assets for personal gain and shareholder's rights in corporate governance.**⁹⁷ Such protections are vital because gaps in legislation may allow company owners and directors to enter into transactions that are lawful and involve no fraud or deceit, but that nevertheless are unfair to minority shareholders. The existence of disclosure, director liability and shareholder suit provisions that prevent such unfair transactions is of concern both to foreign and domestic shareholders and would help companies in Pakistan to raise capital.

⁹⁵ G20/OECD Principles of Corporate Governance; 2015 available at https://www.oecd-ilibrary.org/governance/g20-oecd-principles-of-corporate-governance-2015_9789264236882-en

⁹⁶ The OECD summarizes corporate governance as a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.

⁹⁷ The company that is measured by *Doing Business* protecting Minority Investors indicators is a publicly traded corporation on the economy's most important stock exchange. If the number of publicly traded companies listed on that exchange is less than ten, or if there is no stock exchange in the economy, it is assumed that the company is a large private corporation with multiple shareholders.

Compared to most world economies, Pakistan’s legislation includes proper protections for minority shareholders. Pakistan’s performance on the Protecting Minority Investors indicator is computed by averaging six indices, each ranging from 0 to 10. In *Doing Business* 2019, Pakistan ranks 26th out of 190 economies worldwide and ranks 2nd out of eight within the South Asia region, while the economy scores 71.67 out of 100 on the Protecting Minority Investors score. Table 7.1 compares Pakistan’s performance at both the regional and global levels, and Table 7.2 gives an overview of the reforms undertaken in this area in South Asia.

Table 7.1 Protecting Minority Investors in Pakistan and best performers

<i>Doing Business</i> Indicator (0-10)	Pakistan	Regional average	Region’s best performer	Global best performer
Disclosure Index	6	5.8	8 (India, Afghanistan)	10 (13 economies)
Director Liability Index	7	5	7 (India)	10 (Cambodia)
Shareholder Suits Index	6	7.4	9 (Afghanistan)	10 (Djibouti)
Shareholder Rights Index	8	6.9	10 (India)	10 (India and Kazakhstan)
Ownership and Control Index	9	5.9	9 (Pakistan, Afghanistan)	9 (8 economies)
Corporate Transparency Index	7	6.1	8 (India)	10 (6 economies)

Source: *Doing Business* database 2019.

Table 7.2 Who strengthened minority investor protection in the region, when and how often?

	DB 2012	DB 2013	DB 2014	DB 2015	DB 2016	DB 2017	DB 2018	DB 2019
Afghanistan								✓
Bhutan							✓	
India				✓			✓	
Nepal							✓	
Pakistan							✓	
Sri Lanka	✓					✓		

Source: World Bank *Doing Business* database

Protecting Minority Investors over time

Pakistan’s legislation includes some of the global best practices in the protection of minority shareholders for both listed and limited liability companies. The main pieces of legislation that provide these protections are the Companies Act of 2017 as well as the Listed Companies Regulations of 2017, issued by the Securities and Exchange Commission of Pakistan (SECP). With the revision of both of these important legal documents in 2017, Pakistan strengthened minority investor protections, which was captured by *Doing Business* 2018. A few other global good practices could be incorporated in the legislation, and the recommendations below provide an overview of these areas for the Government of Pakistan to consider. These changes would need to be instituted through changes in the Companies Act or the Listed Companies Regulations.

Box 7.1 International corporate governance standards

The G20/OECD Principles of Corporate Governance provide a recognized international benchmark to build an environment of trust, transparency, and accountability, necessary to foster efficient capital markets, long-term investment, business integrity, all drivers of economic growth and financial stability. The principles were endorsed not only by OECD countries but also by G20 countries. They have also been adopted by the Financial Stability Board as one of the critical standards for sound financial systems and have been used by the World Bank Group in-country reviews on corporate governance, and they serve as the basis for the guidelines on the corporate governance of banks issued by the Basel Committee on Banking Supervision.

The 2015 version of the principles introduces some new issues on the topic of disclosure and transparency, providing clarity. The key changes in the Disclosure and Transparency Chapter of the principles are summarized below:

- Equitable treatment principles while reporting of material information is emphasized.
- More clarity has been provided on the definition of material information.
- Companies are encouraged to disclose non-financial information in addition to company objectives.
- Greater emphasis is placed on disclosure of beneficial ownership.
- Disclosure of directors' and non-executives' shareholdings are encouraged.
- Recommendations on related party transactions are described in more detail and take international accounting standards into account.
- Disclosure of roles and responsibilities of the CEO and Chair was introduced.
- Recommendations on auditing have been revised taking international developments into account.

Based on the lessons learned from the global financial crisis, other international organizations also accelerated their efforts to foster a fair, efficient and transparent market, which is crucial for investor protection. The International Organization of Securities Commissions (IOSCO) published its revised Objectives and Principles of Securities Regulation in 2010. Timely and frequent disclosure of information material to investment decisions was already enshrined in IOSCO Principle 16. In addition to Principle 16, the three new principles adopted in 2010 include specific policy principles related to disclosure and transparency. The importance of regulations on auditor independence and oversight and the disclosure of conflicts of interest are highlighted in the revised IOSCO principles.

Moreover, IOSCO has two sets of high level principles on disclosure by listed companies: IOSCO Principles for Ongoing Disclosure and Material Development Reporting by Listed Entities (2002) and IOSCO Principles for the Periodic Disclosure of Listed Companies (2010).

Source: OECD Disclosure and Transparency Background Report 2017.

Medium to long-term reform recommendations

Approval and Disclosure of Related-Party Transactions

1. Require independent review of related-party transactions before they take place.

Currently, neither the Companies Act nor the Listed Companies Regulations provide for third-party review of the terms of significant related-party transactions before they take place. Including such practice in the case of listed companies could be particularly useful. Thus, as soon as the board of directors is aware of a potential related-party transaction, it should request the appointment of an external auditor or sector expert to review the terms of the transaction and produce a report to help shareholders make an informed decision when called on to vote as outlined in the previous point.

Having an external auditor review the terms of related-party transactions before they take place increases shareholder protection from self-dealing by allowing them to make informed decisions when voting on such transactions. Top performing economies like New Zealand, Singapore, Hong Kong SAR, China, and the United Kingdom require the review of the terms of related-party transactions by an independent auditor who issues a report before the approval of large related-party transactions.

The World Bank 2017 Pakistan Corporate Governance Country Assessment further identified that:

The 2017 LCR introduced a new requirement that if a majority of the directors have a conflict of interest, the matter shall be placed before the AGM for approval. In general, the letter of the law and regulation appears to be followed in most cases. However, the market also believes that many boards are not always able to remain objective in the face of pressures from controlling shareholders, especially for those transactions which are complex or for which there is no easy basis for making “arm’s length” comparisons.

2. Require the immediate public disclosure of related-party transactions.

Regulation 5.19.13(c) of the PSX Rulebook provides that [emphasis added]:

*“Every listed company shall immediately disseminate to the SECP and the stock exchange on which its shares are listed **all material information** relating to the business and other affairs of the listed company that **will affect the market price of its shares**. The mode of dissemination of information shall be prescribed by the stock exchange on which shares of the company are listed. This information may include but shall not be restricted to any material change in the nature of business of the company; information regarding any joint ventures, merger or acquisition or any material contract entered into or lost; purchase or sale of significant assets; franchise, brand name, goodwill, royalty, financial plan, etc.; any unforeseen or undisclosed impairment of assets due to technological obsolescence, etc.; delay or loss of production due to strike, fire, natural calamities, major breakdown, etc.; issue or redemption of any securities; a major change in borrowings including projected gains to accrue to the company; any default in repayment or rescheduling of loans; and change in directors, Chairman or CEO of the listed company. Explanation: Such information shall be disseminated to the above-mentioned entities **as soon as** any decision about above referred matters or any other significant issue is taken by the board or a significant matter requiring disclosure has come into the knowledge of company’s management.”*

Regulation 5.19.13(c) could be amended or complemented for three reasons. First, it leaves it to the company to determine whether disclosure is necessary, based on a reasonable prediction of impact on the market price of its shares. In other words, if the company believes that a related-party transaction will not affect its market price, it does not have to make any disclosure. Best performing economies set clear bright lines that minimize the need for interpretation. The existing language in the PSX Rulebook could either be replaced or complemented by a specific list of events that trigger its disclosure requirements and expressly include related-party transactions that represent 10% or more of the assets of the company.

Second, even assuming disclosure is required, it is vague as to what must be included in the disclosure. “All material information” may appear to be a demanding standard. In practice, materiality is a concept subject to definition and interpretation. Here again, best-performing economies specify and itemize what must be disclosed about events that trigger this rule.

Third, within what period is disclosure timely on Regulation 5.19.13(c) it could be one hour, one day, one week or another timeframe. “As soon as” may seem prompt but in and of itself carries no precise meaning for companies to plan and act upon. Best performing economies provide a quantifiable period. For example,

24 hours, 72 hours or “before the next day opening of the exchange”, which in practice means less than 24 hours if the event occurred after the opening of the market, around 30 hours if it occurred after midnight, and up to 72 hours if before the weekend or a holiday.

Liability for Prejudicial Related-Party Transactions

3. During a related party transaction, allow shareholders to hold directors (both interested and disinterested) liable also for unfair or prejudicial and not only negligent related-party transactions.

In the case of prejudicial related-party transactions, the legislation should not shield interested directors from liability, even if they did not participate in the vote and shareholders had previously ratified the transaction by way of a resolution of the general meeting.

The duties of directors are spelled out under Section 204 of the Companies Act, 2017. The cause of action for shareholders and the elements that they must prove are spelled out under Section 286:

If any member or members holding not less than ten percent of the issued share capital of a company [...], complains, or complain, that the affairs of the company are being conducted, or are likely to be conducted, in an unlawful or fraudulent manner, or in a manner not provided for in its memorandum, or in a manner oppressive to the members or any of the members or the creditors or any of the creditors or are being conducted in a manner that is unfairly prejudicial to the public interest, such member or members [...] may make an application to the Court by petition for an order under this section.

Per section 286(2) (a), shareholders would prevail if the court is satisfied that the *affairs of the company are being conducted, or are likely to be conducted, in an unlawful or fraudulent manner, or in a manner not provided for in its memorandum, or in a manner oppressive to the members or any of the members or the creditors or any of the creditors or are being conducted in a manner that is unfairly prejudicial to the public interest.*

Existing provisions should be complemented so that shareholders can hold directors liable by merely proving that the transaction caused damages and that a conflict of interest was present. However, shareholders would not have to prove any wrongdoing, negligence, intent or that the company would not have entered into the transaction but for the conflict of interest. Knowledge or intent to cause damages would be implied by the conflict of interest, thus increasing the likelihood of recovery and the level of protection.

Fifty-one economies implement rules which hold interested directors liable when the transaction is unfair or prejudicial to the other shareholders even if the transaction is not fraudulent. Economies such as Brazil, Cambodia, Israel, Malaysia, and New Zealand hold directors liable for the damage caused by the related-party transaction if the company's affairs are being or have been conducted in a manner which is unfairly prejudicial or oppressive to the interests of its shareholders.

The World Bank 2017 Pakistan Corporate Governance Country Assessment further identified that:

Rights of shareholders to formal shareholder action through the courts are available in theory, but (at least to date) not common in practice. Many provisions require 10 percent of shareholders to take action, a relatively high threshold. A key institutional weakness has been the ability of the judicial system to enforce corporate governance rules.

4. Give courts authority to cancel unfair related-party transactions.

In the case of a related-party transaction that is prejudicial to shareholders, or entails a conflict of interest (i.e., not only in cases of fraud or bad faith), the law should offer the possibility of rescinding the transaction.

Here, per Section 287(a) CA 2017, *the termination, setting aside or modification of any agreement, however arrived at between the company and any director, including the chief executive or other officer, upon such terms and conditions as may, in the opinion of the Court be just and equitable in all the circumstances*; is contingent upon a successful demonstration under Section 286 described above. Therefore, the legislation allows courts to void related-party transactions only when negligently concluded. The law should also offer the possibility of rescission when related-party transactions are prejudicial to minority shareholders and entail a conflict of interest (i.e., not only in cases of negligence, fraud or bad faith). Pakistani courts should have the power to void related-party transactions that are harmful to the company based solely on the economic harm that they caused, as established through a comparison test with the financial situation of the company had the transaction not occurred altogether.

In 31 economies including Brazil, Rwanda, and South Africa, for example, courts have the power to rescind not only transactions that are fraudulent or made in bad faith, but also related-party transactions that are harmful or unfair to the company.

Shareholder suits

6. Allow the plaintiff to question the defendant and witnesses at trial directly.

In civil suits in Pakistan, both parties can directly examine any person called to the witness stand. However, under Order X of the First Schedule to the Civil Procedure Code, 1908 (CPC), the defendant is examined by the court. Examination by the parties falls under Order XVI. Rule 21 provides that Order XVI also applies to parties as a witness. Therefore, under Rule 1, the plaintiff would have to propose to the court to summon the defendant as a witness. The court has power whether to grant or set aside this request. If the court allows it and the defendant appears as a witness, under Order XVIII Rule 10, the court has broad discretion to take down any question of its motion.

The CPC could, therefore, be amended to, as in best-performing economies, allow parties to examine one another, without judicial approval directly, and narrowly define the power of the court to take down questions on its motion under specified requirements.

7. Allow plaintiffs to recover legal expenses from the company.

Currently, per Section 35 CPC, allocation of expenses is at the discretion of the court based on the facts of the case. Usually, parties bear their expenses, regardless of the outcome of the case. However, derivative and direct shareholder actions are a specific type of litigation, often referred to as private enforcement of corporate law. It is because the shareholder plaintiff, even when suing the company and its directors, is in principle doing so for the company's best interest. The objective is to see that the company is run under the law. The economic incentives of such actions often do not align with their corrective function. If a plaintiff were to succeed, the entire company should benefit, all shareholders should be compensated, including the plaintiff per his or her stake. If for example a director is found to have harmed the company and must pay a given amount, a shareholder plaintiff representing 10% of the company would see his or her investment appreciate by 10% of that amount. If, however, he or she were to lose, the plaintiff would have to bear 100% of litigation cost.

Good international practices are therefore emerging to charge the legal expenses incurred by the shareholder plaintiff to the company, regardless of the outcome of the legal action. Safeguards should also balance this practice to prevent undue hardship to the company. For example, the case should not be frivolous. The

primary claim and purpose of the lawsuit should be for the benefit of the company as a whole, and the case should be decided on its merits, meaning that the court has established that it had jurisdiction, that the plaintiff had the standing to sue and posed a substantive question of law or fact that needed adjudication.

Shareholders' Rights

8. Require shareholder approval when issuing new shares or new members.

For public companies, shareholders through a special resolution (and the SECP) must approve the increase in authorized capital (Section 85, CA 2017). However, the entire authorized capital need not be immediately and concurrently offered to the public. Outstanding shares represent the company's issued share capital. The board of directors decides the timing volume and whether to issue new shares up to the authorized capital (Section 183, CA 2017).

To mitigate risks of unpredictable share dilution, the Companies Act could be amended to reflect the growing trend of doing away with the distinction between authorized capital and issued capital. Alternatively, it could require a shareholder resolution, in addition to a board resolution, every time a company wishes to issue shares within its authorized capital, and the authorization should be valid no longer than a year. For example, the UK Companies Act 2006, abolished the need for an authorized capital and the board of directors requires shareholder authorization to allot shares.

Ownership and Control

8. In case of limited liability companies, require the buyer to make a tender offer to all shareholders when acquiring 50% of the company.

Section 76 CA provides for the right of first refusal or priority right. It entails that should members receive an offer to sell their shares they must first submit this offer to the existing members and give them an opportunity to match it. The result is that the non-member would not enter the company and the current members would increase their interest stake.

However, the law does not provide an exit mechanism at comparable terms to marginalized members. This means that if an offer is received to purchase a large stake from certain members, and the remaining members cannot match and exercise their priority right, they cannot prevent the major change in the company's control and are potentially stuck with no open market to sell their stake to, given the identity or plans of the new acquirer.

A good practice to protect investors is to set a triggering threshold. It should ideally be 30% but in any case, no more than 50%, upon which a non-member acquiring or reaching this threshold would have to make an offer to all remaining members at comparable terms, giving them an opportunity to exit the company.

Corporate Transparency

9. Increase the protection of investors by requiring disclosure of management compensation.

Pakistan's legislation for listed companies includes provisions requiring disclosure of beneficial ownership stakes as well as disclosure of information about board members' primary employment and directorships in other companies. However, this disclosure does not extend to the compensation of individual managers.

According to Clause 35 of Part III of the Fourth Schedule of the Companies Act 2017, complete particulars of the aggregate amount charged by the company shall be disclosed separately in the financial statements

for the directors, chief executives and executives, together with the numbers of such directors and executives such as fees, managerial remuneration, allowances, commission, bonus, other perquisites and benefits in cash or in kind stating their nature and, where practicable, their approximate money values.

For listed companies only, and therefore the PSX Rulebook could be amended to require disclosure on an individual basis, at least for board members and chief executives (those appointed and removed directly by the board of directors).

Studies show that minority shareholders rights are better protected in economies promoting transparency and disclosure of corporate information. Information asymmetry can result in fraud, financial crisis, adverse selection, and moral hazard. Investors are entitled to receive accurate, useful and sufficient information which would lead to financial stability, reduction of fraud and manipulation and better company governance in general. In countries like Italy and Kuwait, companies must also disclose the compensation of individual managers.

10. Allow shareholders owning 5% of shares or members representing 5% of the capital put items on the meeting agenda for both listed and limited liability companies.

In both listed companies and private companies, Section 140 (2) of the Companies Act, 2017 provides that “[...] members having not less than ten percent voting power in the company may give notice of a resolution and such resolution together with the supporting statement, if any, which they propose to be considered at the meeting [...]”

It is the same ownership requirement as for calling an extraordinary meeting (Section 133 CA). However, these are two very different powers in terms of magnitude and consequence for the company. Adding an item for discussion at an already scheduled meeting is a less invasive initiative that should be available to more shareholders. Therefore, while the 10% threshold is reasonable for calling extraordinary meetings, a good practice would be to lower Section 140(2) threshold to 5%.

8. Paying Taxes

The mobilization of tax revenues is an essential element of state capacity and a contributing factor to economic growth. Many countries are still struggling to collect sufficient revenues to finance their development. Countries collecting less than 15 percent of GDP in taxes, like Pakistan, must increase their revenue collection to meet the basic needs of citizens and businesses. This level of taxation is a critical tipping point to make a state viable and put it on a path to growth⁹⁸. In Pakistan, this ratio was estimated⁹⁹ at 12.5 percent of GDP in 2016-17 and 12.9% in 2017-18¹⁰⁰. Pakistan faces the dual challenge of encouraging businesses to enter the formal economy and thereby become taxpayers while increasing tax receipts to create fiscal space for sustainable government investment in enabling infrastructure and governance.

Tax administration must be predictable, convenient and efficient to encourage business formalization and growth. Global data collected in *Doing Business* demonstrates that countries with excessively burdensome tax administration promotes tax evasion and informality and results in low levels of revenue collection.¹⁰¹ A low cost of tax compliance and efficient tax-related procedures are advantageous for firms. The design of tax compliance systems should not discourage businesses from participating in the formal economy.¹⁰² Literature also suggests that the rates of corporate taxation have implications on firm-level behavior, as evasion may rise with higher tax rates.¹⁰³

The *Doing Business* Paying Taxes indicator benchmarks 190 countries on a series of indicators. Using a standard domestic medium-sized business (manufacturers and retailers) these indicators record the total taxes and mandatory contributions payable, the administrative burden of payment, and the compliance burden of post-filing procedures. Post-filing processes were added to the indicators in *Doing Business* 2017. It includes the time businesses spend obtaining a value-added tax (VAT) refund as a result of a large capital purchase and completing a Corporate Income Tax audit triggered by an error in the Income Tax return and consequently an underpayment of the tax due. This new component is called the “post-filing index.” Post-filing processes such as claiming a VAT refund or undergoing a tax audit can be the most challenging interactions that a business has with tax authorities. Following the *Doing Business* case study, in Pakistan, this VAT is the General Sales Tax (GST) on goods.

In the Paying Taxes indicator of *Doing Business* 2019, Pakistan ranks 173rd out of 190 economies and scores 47.05 percentage points. Paying Taxes is Pakistan’s worst DB indicator in terms of rankings. Regionally, Pakistan ranks 7th out of eight countries in the South Asia region. The standardized case study company would have to make 47 payments, spend 293.5 hours to comply with its tax obligations, and incur a total tax and contribution rate of 34 percent of commercial profit. The time burden and the number of payments are above the average in the South Asia region while the total tax and contribution rate is lower than the regional average (34% and 43.5%). On the post-filing index, Pakistan performs poorly (score of

⁹⁸ International Monetary Fund (2016): “Tax Capacity and Growth: Is there a Tipping Point?”, IMF Working Paper, No. 16/234, November 2016, authored by Vitor Gaspar, Laura Jaramillo and Philippe Wingender.

⁹⁹ Pakistan economic surveys (various years), fiscal database, Finance Division; provincial budget documents; IMF data; and World Bank staff estimates.

¹⁰⁰ Projection for 2017-18.

¹⁰¹ International Tax Dialogue. 2007. “Taxation of Small and Medium Enterprises.” Background paper for the International Tax Dialogue Conference, Buenos Aires, October.

¹⁰² Simeon Djankov, Tim Ganser, Caralee McLiesh, Rita Ramalho, and Andrei Shleifer. 2010. “The Effect of Corporate Taxes on Investment and Entrepreneurship.” *American Economic Journal*, 2(3): 31-64.

¹⁰³ Raymond Fisman, and Shang-Jin Wei. 2004. “Tax Rates and Tax Evasion: Evidence from Missing Imports’ in China.” *Journal of Political Economy* 112 (2): 471–96.

10.49/100) because of the high probability of lengthy Corporate Income Tax audits, and the administrative burden as well as delays in obtaining refunds for the GST on goods.

The findings from the *Doing Business* report are based on a hypothetical and standardized case study. *Doing Business* data measure the total taxes and mandatory contributions payable, the administrative burden of filing returns and paying taxes, and the compliance burden of post-filing procedures under a set of specific assumptions. These findings don't necessarily capture the whole complexity and specificity of a country's tax system but are meant to provide a benchmarking tool.

Table 8.1 Paying Taxes ranking and best performers

<i>Doing Business</i> indicator	Pakistan (Karachi & Lahore)	South Asia average	Regional best performer	Global best performer
Payments (number per year)	47	27.6	11.9 (India)	3.0 (Hong Kong SAR, China)
Time (hours per year)	293.5	274.8	52.0 (Bhutan)	49 (Singapore)
Total tax rate (percent of profit)	34	43.5	30.2 (Maldives)	26.1% (32 economies)
Post-filing index (0-100)	10.49	41.78	95.5 (Bhutan)	99.38 (Estonia ¹⁰⁴)

Table 8.2 Taxes and mandatory contributions in Pakistan as captured by the *Doing Business* Paying Taxes' indicator

Tax or mandatory contribution	Payments (number)	Time (hours)	Statutory tax rate	Tax base	Total tax rate (% of profit)
Corporate Income Tax	5.0	40.0	25%	Taxable profit	18.24
Employer-paid pension contributions	12.0		5% or PKR 700 per employee per month	Gross salaries	7.29
Social security contributions	12.0	40.0	6% up to PKR 15,000 wage ceiling	Gross salaries	6.46
Education cess	1.0		PKR 100 per month	Per worker	0.93
Property tax	1.0		18% (including 10% discount)	Annual rental value of property	0.89
Tax on interest	0.0		10%	interest	0.26
Professional tax	1.0		PKR 10,000	Fixed fee	0.14

¹⁰⁴ Global best performer among the sample of economies that levy both VAT and Corporate Income Tax.

Vehicle tax	1.0		Varies	Fixed fee depending on type of vehicle	0.07
Stamp duty	1.0		Rate based on contract value		0.00
Employee-paid pension contributions	0.0		1% or PKR 140 per employee per month	Gross salaries	0.00
Fuel tax	1.0		25%	Included in fuel price	0.00
General Sales Tax (GST) on goods	12.0	213.5	17%	Value added	0.0
Totals	47	293.5			34

The post-filing index is based on four components - time to comply with GST refund, time to obtain GST refund, time to comply with a Corporate Income Tax audit, and time to complete a Corporate Income Tax audit. If both GST and Corporate Income Tax apply, the post-filing index is the simple average of the distance to frontier scores for each of the four components. If only GST or Corporate Income Tax applies, the post-filing index is the simple average of the scores for just the two components about the applicable tax. If neither VAT nor Corporate Income Tax applies, the post-filing index is not included in the ranking of the ease of Paying Taxes. (Table 8.3)

Table 8.3 Data on the post-filing index

	Answer	Score (0-100)
Post-filing index (0-100)		10.49
GST refunds		
Does VAT/GST exist?	Yes	
Does a VAT/GST refund process exist per the case study?	Yes	
Restrictions on VAT refund process	Carry forward for 6 months	
Percentage of cases exposed to a VAT/GST audit	50-74%	
Is there a mandatory carry forward period?	Yes	
Time to comply with VAT/GST refund (hours)	84.0	0
Time to obtain a VAT/GST refund (weeks)	79.0	0
Corporate Income Tax Audits		
Does Corporate Income Tax exist?	Yes	
Percentage of cases exposed to a Corporate Income Tax audit	25-49%	
Time to comply with a Corporate Income Tax audit (hours)	69.0	0
Time to complete a Corporate Income Tax audit (weeks)	18.6	41.96

Paying Taxes over time

In recent years, the administrative burden of tax compliance has remained high for companies in Pakistan, as recorded by the *Doing Business* report. The number of payments per year has remained unchanged in recent years and is well above the regional average, as companies must submit 47 payments per year. Most of the payments required every year (see Table 8.2) result from the requirements to pay the General Sales Tax (12 payments¹⁰⁵), the pension contributions (12 payments) and the social security contributions (12 payments), followed by the Corporate Income Tax (five payments). Despite small recent improvements¹⁰⁶, the number of hours per year required to file and pay taxes remains relatively high in Pakistan (293.5 hours). Among the different taxes and contributions paid by a firm in a year, the payment of the General Sales Tax (GST) on goods takes most of the time (213.5 hours), followed by Corporate Income Tax (40 hours) and social security contributions (40 hours). The firms indicate that complying with their GST liabilities is time-consuming, as they need to submit monthly returns with FBR for the federal sales tax on goods¹⁰⁷. Additionally, taxpayers must have separate dealings with local tax authorities for taxes collected at the provincial level, such as the sales tax on services, property tax, professional tax, and vehicle tax, which are handled by the provinces' sales tax authorities and the Excise and Taxation Departments. The performance of Pakistan on the post-filing index is weak -10.49 out of 100 possible points – indicating significant issues related to the frequency and length of tax audits, as well as delays in obtaining GST refunds for companies.

The Federal Board of Revenue (FBR) is the primary federal institution in the country responsible for matters of taxation. FBR has more than 20,000 staff, split between the Inland Revenue Service and the Customs Service, and has allocated nearly 3.8 million National Tax Numbers (NTN)¹⁰⁸. FBR operates field offices and facilitations centers across the country. In addition to FBR, taxpayers must have separate dealings with local tax authorities at the provincial level¹⁰⁹. Each province has three tax authorities - the Excise & Taxation Department, the Board of Revenue (collects stamp duty and other taxes on property transactions), and the authority that collects GST on services (Punjab Revenue Authority, Sindh Revenue Board, KP Revenue Authority, Balochistan Revenue Authority).

The Government of Pakistan should build upon FBR's recent achievements in modernizing filing and payment procedures. The Inland Revenue Information System (IRIS) helped in automating the filing procedures for federal taxes, while the invoice-matching sales tax filing system as well as the new Sales Tax Real Time Invoice Verification System (STRIVE) facilitated compliance with GST liabilities. In March 2018, the government also integrated an e-payment module into IRIS (see Recommendation 1).

The Government of Pakistan could consider the following policy and administrative reforms to improve the process of Paying Taxes:

Short-term reform recommendations

¹⁰⁵ That is assuming a company does not provide services. For a service sector company that operates across all provinces, the number of GST (on services) payments would rise to 60.

¹⁰⁶ Reduction of 18 hours from DB2018 to DB2019 thanks to the launch of the STRIVE system for GST. See Recommendation 2.

¹⁰⁷ Firms that sell services – which is beyond the DB case study that measures the compliance burden for manufacturing firms – must submit monthly returns to the relevant provincial tax administration for the sales tax on services. If they have operations in several provinces, they must file with each provincial board of revenue, which further increases the compliance burden.

¹⁰⁸ World Bank Group, Tax Policy Review, November 2018.

¹⁰⁹ The 18th Constitutional Amendment forms the basis for Pakistan's fiscal decentralization.

1. Ensure that e-payment is available in practice for corporate accounts to provide all types of companies with the option to pay Corporate Income Tax and GST through the FBR electronic platform.

In March 2018 the Government of Pakistan launched a system of payment of taxes through “Alternate Delivery Channels” (ADC) through which taxpayers are now able to submit payments online for the federal taxes (GST and Corporate Income Tax). Despite the State Bank’s circular from July 2018 which requested banks to make e-payment available to corporate accounts, private sector representatives were still reporting that e-payment was only available for individual bank accounts at many commercial banks, and not for corporate accounts, which prevented LLCs and partnerships from paying their taxes online through those commercial banks.

In coordination with the State Bank of Pakistan, FBR could increase outreach efforts to commercial banks and private stakeholders to expand the list of commercial banks offering online transfers for corporate account holders¹¹⁰. FBR could also ensure that e-payment and e-transfers are available to all types of companies in practice, and that taxpayers no longer need to submit checks in person at the bank to comply with their federal tax liabilities. Relevant regulations on e-transfers and their limits should be reviewed and amended if needed to ensure that they don’t pose an obstacle to the e-payment of taxes.

From the launch of the new system in March 2018 to November 2018, 20,342¹¹¹ transactions – totaling PKR 18,829.80 million – were processed through the new e-payment channel. It represents less than 5% of FBR’s revenue collection for CIT and GST. As the uptake of the new e-payment is still low, additional efforts to promote its use are needed (see Recommendation 3). Expanding payment options (card, mobile apps, and more commercial banks) would also be beneficial. At a later stage, when taxpayers are ready, FBR could consider making e-payment mandatory (see Recommendation 4).

2. Conduct a review of the tax forms and documentary requirements and streamline the process to file and pay GST while continuing to improve STRIVE.

Among different taxes paid by the standardized case study company in a year, payment of General Sales Tax (GST) on goods takes most of the time (231.5 hours), followed by Corporate Income Tax (40 hours) and social security contributions (40 hours). The firms indicated that complying with their GST liabilities is time-consuming, as they need to submit monthly returns with FBR for the federal sales tax on goods. Despite recent improvements with the introduction of the Sales Tax Real-Time Invoice Verification System (STRIVE) – which reduced compliance time by 18 hours¹¹² - and the launch of IRIS ADX for preparation of invoices for sales tax in offline mode, filing and paying GST remain burdensome for companies in Pakistan. In Sri Lanka, for instance, filing and paying VAT is twice as fast (103 hours per year) thanks to the introduction of a new automated platform to file and pay taxes online.

In addition to implementing the new e-payment module (see Recommendation 1), FBR needs to launch a more comprehensive review of its tax filing forms and procedural requirements to understand better the issues faced by firms when filing and paying GST in Pakistan. FBR could conduct a study of the information

¹¹⁰ Some banks offer online transfers for both individual and corporate account holders (e.g., UBL, Standard Chartered), while others provide them only to individuals (e.g., HBL). Many banks also enable payments to FBR through their mobile apps. See the following FBR link for the list of e-payment options offered by commercial banks: <<https://www.fbr.gov.pk/ADCEnabledBankList.htm>> Taxes can also be paid through ATMs at most commercial banks, which should be convenient for small businesses.

¹¹¹ Source: FBR.

¹¹² Compliance time for GST was reduced thanks to the introduction of STRIVE: 231.5 hours per year in DB2018; 213.5 hours per year in DB2019.

requested in the tax declarations and the additional documents that taxpayers must provide, both of which may reflect the complexity of the tax legislation and the adjustment that is required to be done from accounting to tax calculation. The review of the current tax forms could also be undertaken to identify opportunities to reduce the number of fields, pre-populate them when possible by linking FBR systems, and make the forms more intuitive. Simplified tax forms can speed up tax filing and reduce the need for intermediaries.

In parallel, FBR could continue efforts to improve STRIVE as taxpayers indicate that the cases of data errors or missing information are still frequent. Making sure that all relevant data are properly reflected in the system could significantly reduce the compliance burden for businesses which have to pay the GST on goods.

3. Plan an outreach campaign to familiarize taxpayers with new systems and tax reforms.

Any changes to the tax filing and payment systems should be combined with an outreach campaign to encourage broader usage of the electronic systems (see Recommendations 1 and 5), including by small and medium-sized companies. *Doing Business* only records online filing and payment systems if the majority of such companies uses those. Promotion to encourage widespread use of the system is an essential component in using technology effectively to streamline procedures. For example, while Belize, Colombia, Costa Rica, and Nicaragua had made online filing and payment available since the beginning of 2000, their new systems were not fully implemented until 2010 because taxpayers did not make use of the new technology.

To avoid the same lack of dissemination and awareness in Pakistan, the tax authorities could run a promotion campaign to educate taxpayers on how to use the system. Two of the world's largest economies – India and China, have continually reformed and improved their online operations. For example, in India, the tax authority's website published detailed help manuals and instructions on the tax forms and how to complete them. It provided free software for preparing tax returns on its site and CDs, established a call center to answer taxpayers' queries by phone and e-mail, set up help centers at all field office headquarters, organized regular meetings and seminars with taxpayers and tax practitioners. In China, the tax authority introduced a taxpayer service hotline back in 2005 to explain tax policies and rules. Since then the center was systematically upgraded. Starting in 2013, the Chinese tax authorities introduced several campaigns aimed at informing the taxpayers and helping to publicize initiatives to reduce the number of tax filings and use technology to minimize time and burden for both the taxpayers and the tax collectors. Most recently, in 2017, China introduced a tax consultation and tutorship system, simplified declaration forms for Corporate Income Tax and Value-Added Tax and enabled e-invoices' issuance and delivery.

One of the biggest obstacles in paying taxes for small businesses in Pakistan is the lack of basic knowledge and information. FBR can fill this gap by providing capacity building and training for entrepreneurs to help them better understand the tax rules. FBR could continue organizing regular tax fairs to promote and explain its reforms and keep improving its newly-launched¹¹³ digital help library for taxpayers, the Knowledge Base Portal¹¹⁴. Also, the tax administration could strengthen its education initiatives by:

- regularly updating help manuals on its website
- organizing live phone-in question-and-answer sessions with accountants
- distributing software and help content to accountants, trade bodies, and professional and business associations
- holding meetings and seminars with taxpayers and tax practitioners

¹¹³ Launched in January 2018.

¹¹⁴ For more information, see <<http://help.fbr.gov.pk/>>

- introducing (mandatory) core training for new firms, and refresher courses on new policies and systems for companies that are already registered
- fully operationalize the Customer Relationship Management (CRM) unit to answer and fix taxpayers' issues by phone and e-mail
- establish taxpayers' facilitation centers at various big markets and chambers to assist the taxpayers in resolving day-to-day problems

Medium and longer-term reform recommendations

4. Extend e-filing and e-payment services for all taxes and contributions, including social security and pension contributions as well as provincial taxes.

FBR already allows for e-filing and e-payment of federal taxes, namely the Corporate Income Tax and the General Sales Tax on goods¹¹⁵. The same should be extended for social security and pension contributions¹¹⁶ as well as provincial taxes such as the GST on services¹¹⁷, the professional tax, the property tax, and the vehicle tax. The State Bank of Pakistan, FBR, as well as its service provider, PRAL¹¹⁸ – which has significant experience in automating tax procedures – could assist the relevant administrations if needed.

Currently, the property tax, professional tax, and vehicle tax must be paid in person at the Provincial Excise and Taxation Department or the National Bank of Pakistan. It is an annual requirement and each tax has its timeline and is collected by a different wing of the Excise and Taxation Department, which further increases the number of physical interactions. Except for Punjab province (See Box 8.1), the system is paper-based, and taxpayers don't receive electronic notifications when their taxes are due. They instead receive paper letters or even visits from tax officers who knock on doors to remind taxpayers of their tax liabilities. With the support of the Punjab Information Technology Board (PITB), the Excise and Taxation Department of the Government of Punjab is planning to introduce e-payment solutions to enable taxpayers to pay their taxes and duties online, including the property tax, the professional tax, and the vehicle tax. In the first phase of this project, taxpayers will be able to pay their dues through online banking and ATMs. At a later stage, alternative payment channels such as mobile wallets and debit/credit cards might be available as well.

Box 8.1 – Digitization of records for property tax and motor vehicle tax in Punjab.

Punjab has digitized records for property tax (based on a comprehensive survey with GIS data conducted by a private contractor) and for motor vehicle tax. Property tax invoices are issued electronically and have a bar code, which the taxpayer can use to check his property's assessed tax liability (and the underlying criteria) online. Since the introduction of this system, no tax officers knock on doors, and taxpayer complaints and appeals have declined. Other provinces should be encouraged to do the same.

Companies are also required to pay contributions for their employees. Those contributions – the pension contributions and social security contributions – must be paid in person. While the Employees Old-Age Benefits Institution (EOBI), a federal agency, collects pensions, social security contributions are collected by provincial branches of the social security administration, namely the Punjab Employees Social Security Institution (PESSI) in Lahore and the Sindh Employees Social Security Institution (SESSI) in Karachi. In

¹¹⁵ The sales tax on services is collected by the provincial tax authorities.

¹¹⁶ The Khyber Pakhtunkhwa province has launched an initiative to allow the tax authorities to collect the pension and social security contributions.

¹¹⁷ The GST on services is the largest source of provincial taxes and affects a large number of firms, even though it is not considered in the DB case study, as the 'standardized company' does not provide services.

¹¹⁸ PRAL developed the FBR electronic platform.

Punjab, PESSI, with the support of the Punjab IT Board, has recently¹¹⁹ introduced an “e-filing” system through which employers receive monthly statements and can print a voucher before going to the PESSI center to pay the social security contributions. Additionally, a new initiative should allow employers to pay the social security contributions “over-the-counter” at any commercial bank, starting in late December 2018. For pensions, EOBI has established an electronic platform¹²⁰ but it does not include an e-payment module. According to EOBI officials, introducing e-payment would require reviewing and updating the federal regulations governing EOBI. The current electronic platform provides an e-filing option for pensions, but the uptake is still low¹²¹.

Among the countries measured by *Doing Business*, the countries where paying taxes is the least time consuming are those that have implemented electronic systems for filing and paying taxes. If executed well and used by most taxpayers, an electronic system for filing and paying taxes benefits both tax authorities and firms. For tax authorities, electronic filing lightens the workload and reduces operational costs such as the costs of processing, storing and handling tax returns. At the same time, it increases tax compliance and saves time. For taxpayers, electronic filing saves time by reducing calculation errors on tax returns and making it easier to prepare, file and pay taxes. Additionally, both sides benefit from a reduction in potential incidents of corruption, which are more likely to occur with more frequent contact with tax administration staff.

By 2017, 98 economies had fully implemented electronic filing and payment of taxes. The majority of them adopted or enhanced their systems in the past 13 years. Electronic filing and payment are more widespread in the OECD high-income region where 32 economies out of 34 have such systems in place. Europe and Central Asia (with 21 economies using electronic systems) follow. This trend is likely to continue. In the next few years many other OECD high-income economies, having introduced requirements for electronic filing and payment for larger businesses, plan to extend them to smaller ones¹²².

The simple fact that an electronic system is available does not guarantee that taxpayers will feel a reduction in compliance time. Often, taxpayers can experience issues with using electronic filing and payment systems, either due to glitches and errors in the system or due to lack of taxpayer training and guidance. Many tax administrations tackle issues through ongoing updates to their online networks. Argentina has had electronic filing and payment for all significant taxes for several years but kept improving its systems by introducing regular updates. For instance, the improvements made to the electronic system in 2015 reduced compliance time by 46 hours for businesses.

To further encourage the use of e-services, the Government of Pakistan could introduce joint filing for some taxes or contributions (see Recommendation 6) and also integrate the various online platforms (e.g., for sales tax). If there is enough uptake, another strategy to consider would be to make e-payment¹²³ mandatory. The change would have to occur gradually while making sure that e-services are accessible to all firms.

Previous examples illustrate the need to implement this type of reform gradually. Ten OECD high-income economies have made electronic filing and payment mandatory overtime. In Jamaica, electronic filing was introduced several years ago and was made compulsory for certain taxpayers during 2014. From 2015, electronic filing and payment using the online system were used by the majority of business taxpayers. As a result, Jamaica reduced compliance time by 10 hours and lessened the number of payments by 25. In 2016 and 2017, India further expanded mandatory use of its electronic system, expanding mandatory electronic

¹¹⁹ Soft-launch in March 2018.

¹²⁰ See < <http://fs2e.eobi.gov.pk/Login.iface>>

¹²¹ 15% percent according to EOBI.

¹²² World Bank Group, Investment Climate Advisory Services, Global Tax Team.

¹²³ E-filing is already mandatory for federal taxes collected by FBR.

filing and payment to state insurance contributions (ESIC) and social security contributions (EFPO). India has been introducing electronic compulsory filing for various taxes on a phased basis since 2006.

Finally, the tax authorities in Pakistan could consider expanding the payment options available to taxpayers for paying their taxes remotely. In addition to online transfers, taxpayers should be able to pay their taxes through debit and credit cards and mobile apps. The coverage should be expanded as well to include more commercial banks, as some tax transactions must still go through the National Bank of Pakistan¹²⁴.

5. Conduct a feasibility study of merging the filing and payment of taxes with the same tax base.

According to *Doing Business* 2019, firms in Pakistan must complete as many as 47 payments per year to comply with their tax obligations. It is well above the average in the South Asia region (27.6) and OECD countries (11.2). While the Corporate Income Tax has to be filed on a quarterly basis¹²⁵, companies must submit monthly returns for the federal GST on goods, in addition to the monthly filing obligation for the sales tax on services collected at the provincial level (if applicable¹²⁶). The property tax, the professional tax, and the vehicle tax must be paid once a year in person at different wings of the Provincial Excise and Taxation Departments, or at the National Bank of Pakistan, based on different timelines.

Multiple taxations - where the same tax base is subject to more than one tax treatment - appears to be making tax compliance inconvenient and cumbersome for taxpayers in many economies. It increases the cost of doing business for firms because it increases the number of payments they must make and frequently the compliance time as well. Different forms must be filled out, often requiring different methods for calculating the tax. Tax authorities in Pakistan could consider reviewing the taxes levied on the same tax base or the same transaction to streamline administration. They could also seek more harmonization and stronger integration between the federal and provincial systems and databases, to allow for data sharing and joint-filing where warranted.

In the past 13 years, 57 economies eliminated and merged certain taxes to simplify tax compliance and reduce costs for firms. For example, the Republic of Korea joined property taxes and city planning taxes that were levied on the same base in March 2010. Another way to make compliance easier when firms are subject to numerous taxes is to allow joint filing and payment of taxes levied on the same base. For instance, firms in Germany face five different taxes on salaries - but can meet these tax obligations by filing one form and making one payment for all five different taxes each month. In most of the OECD high-income economies taxes levied on the same base are paid and filed jointly, and as a result, the average number of payments across all economies in this group is only 11, compared with the average of 24 payments across all 190 economies covered by *Doing Business*.

In Pakistan, taxpayers file and pay several taxes separately to the federal and local tax authorities and agencies. For examples, three contributions are based on gross salaries of the employees - the employer-paid pension contributions, the employee-paid pension contributions¹²⁷, and the social security contributions. All three contributions are calculated on the same base and have to be paid monthly.

¹²⁴ Until last year and with the exception of GST on services in Sindh, taxes had to be paid at a branch of the National Bank of Pakistan, which is a state-owned commercial bank. This is no longer the case for most taxes, including provincial ones, but coverage needs to be expanded.

¹²⁵ *Doing Business* records five payments for the Corporate Income Tax, as an extra payment/adjustment occurs at the end of the fiscal year.

¹²⁶ Depending on their operations, some companies might be liable for both the federal tax on goods and the provincial tax on services. For such companies that operate in multiple provinces, the number of monthly returns and payments that they must submit to comply with their sales tax liabilities adds up quickly: 12 per year for the federal GST, and then 12 per year for the sales tax on service per province where the company operates.

¹²⁷ Paid jointly.

However, the administrative requirements are different, and the revenue-collecting agencies are not the same (EOBI for pensions, and SESSI/PESSI for social security contributions). For this reason, employers have to spend additional time each month. In a bid to ease the administrative burden on companies, the Khyber Pakhtunkhwa province recently launched a new initiative to allow the tax authorities to collect the pension and social security contributions on behalf of EOBI and the social security administration.

Given that Pakistan is already introducing new online systems for filing and paying taxes (see Recommendation 1 and 4), simplifying the process by merging the filing forms for some of the taxes and contributions can be considered. Tax authorities in Pakistan could further harmonize tax forms and perhaps consider introducing a unified filing procedure for taxes or contributions with a similar tax base. Under this scheme, a company would submit one return, which would then go to all the relevant authorities through a back-office process governed by inter-agency data-sharing agreements.

6. Review and streamline internal processes at FBR for GST refunds to reduce processing time and introduce good financial management practices.

According to *Doing Business 2019*, completing the GST refund procedure takes 84 hours on average in Pakistan, while receiving the refund takes 79 weeks. GST refunds are subject to a six-month carryforward period. Under the current system, businesses cannot request the refund simultaneously with the submission of their tax returns; they have to submit a separate request to obtain GST refunds. FBR has two different procedures for GST refunds:

- In the case of exports, FBR has put in place a fast-track procedure and clear guidelines for cases where the input tax exceeds the output tax because of exports or other zero-rated supplies¹²⁸ allowing the excess amount of input to be refunded back to the taxpayer within 45 days. This process is entirely automated - exporters submit their request online, which triggers the issuance of a voucher by FBR, and refunds are issued through bank transfers.
- However, for all other cases of excess input tax in the non-export-oriented sectors, there is no fast-track procedure in place. The private sector reported that the process to claim a cash refund in the case of a capital purchase – which is the case scenario measured by *Doing Business* – is cumbersome and can take years or not happen in practice. Businesses in these cases would carry forward the credit and offset against future liabilities.

A long duration of time to obtain VAT refunds can impact a company's cash flow. Reducing the time would ensure that companies can have a sustained cash flow to run their business. There is a correlation between the VAT compliance burden and the time delay in receiving a VAT refund. Typically, where it takes longer to receive a refund, it takes longer to comply. VAT refunds are processed most efficiently in OECD high-income (refund in 15.7 weeks on average). Countries like Estonia are piloting the use of technology and data analytics to reduce the time that companies must spend on preparing documents and filing taxes. It only takes 2.3 weeks in Estonia for the company to obtain their refund.

To reduce compliance time and speed up the GST refund process, FBR could consider the following measures:

- *Conduct a feasibility study of expanding the coverage of the fast-track procedure* that exists for export-oriented sectors (see details above) to other sectors. FBR could conditionally pay the refund within a specific timeframe (45, 60, or 90 days) while keeping the right to amend the refund once FBR finalizes its calculations. Under that scheme, FBR would refund the initial estimation, and if its officers find that

¹²⁸ Examples of zero-rated sectors: textile, cotton, leather.

they should have paid less than the refunded amount, they could go and withdraw the difference from the taxpayer's bank account.

- *Consider including the GST refund request within the standard monthly GST return, making it easier to claim the refund.* Currently, companies applying for a GST refund must do so using a separate claim, adding additional compliance time and burden to the company.

In over 40 economies, the VAT refund due is calculated and requested within the standard VAT return which is submitted for each accounting period and without additional work. The primary purpose of filing a VAT return is to provide a summary of the output and input VAT activities that result in the net VAT payable or due (as credit or refund). For these economies, the compliance time to prepare and request a VAT refund is minimal because it requires merely ticking a box. For example, in Germany, the Netherlands, and the United Kingdom taxpayers request a VAT refund by simply checking a box on the standard VAT return. Taxpayers do not need to submit any additional documents to substantiate the claim, and it is unlikely that this specific case study scenario of a domestic capital purchase would trigger an audit. In all three economies, the standard VAT return is submitted electronically.

- *Strengthen the case management system to track GST refund requests and review internal processes at FBR to identify bottlenecks and opportunities to improve efficiency.*
- *Adopt sound financial management practices by putting aside tax revenues for GST refunds.* Interviews with public and private stakeholders suggested that delays in issuing GST refunds often result from cash flow issues. Setting aside revenues and marking potential refunds as liabilities on FBR's balance sheet would help in preventing delays in issuing GST refunds.
- *Implement a risk-based approach for GST audits.* Section 72B of the Sales Tax Act of 1990 governs the GST audits, and FBR's rules set selection criteria that are published in newspapers. Officially, the percentage of cases that should be selected for audits is 7.5% of the total GST filer population. However, the general experience is that if a company asks for a refund, especially the first time (as is the case in the *Doing Business* hypothetical scenario), there would be an audit conducted before the GST refund is issued. FBR could refine its selection criteria and ensure that GST audits follow a risk-based approach in practice, identifying high-risk refunds that need to be audited, and reducing the overall likelihood of audits. FBR's Computerized Risk-Based Evaluation of Sales Tax (CREST) system could be improved to further automate the selection process, by looking at certain variables, comparing information with other tax returns and flagging risky cases (See Recommendation 7).

7. Strengthen risk-based categorization, improve efficiency, and monitor performance indicators to make sure that targets are met for GST and CIT audits (selection targets, and audit length).

FBR has been working on introducing a risk-based system for audits: it identified risk parameters based on multiple criteria¹²⁹ and set a selection target of 7.5% of the filer population¹³⁰. Also, companies that were cleared by recent audits are granted a two-year grace period. Despite these positive changes, the common perception from the private sector is that audits are still frequent¹³¹, and *Doing Business* records that the likelihood of Corporate Income Tax audits in the case of a minor error in the Corporate Income Tax return and an underpayment of tax liability due is high in Pakistan¹³². The time burden associated with such audits

¹²⁹ The parameters are secret in the case of audits for Corporate Income Tax, and public for GST audits. Yet, it seems that discussions on how to weigh the various parameters are still underway, preventing the 7.5%-target from being implemented in practice.

¹³⁰ Risk criteria should be secret for all taxpayers. Typically, a Compliance Program (annual strategic document) sets the overall strategic direction of a tax administration (e.g., focus on some sectors, large taxpayers, etc.) but this document or the administration should not reveal the specific indicators. They can reveal the mechanism, the algorithm (high level overview), but not the indicator.

¹³¹ Based on interviews with tax officials in Pakistan, it seems that taxpayers confused regular requests for additional documents with full-on audits, which could explain the private sector's perception about the high likelihood of audits.

¹³² Percentage of cases exposed to a Corporate Income Tax audit: 25-49%.

is high: complying with a Corporate Income Tax audit per *Doing Business* case scenario takes 69 hours, while 18.6 weeks are needed to complete the audit.

FBR and provincial sales tax authorities lack effective, centralized, risk-based audit functions – supported by effective planning, staffing, monitoring of results, and adequate training. FBR has been working on implementing risk-based audit techniques. However, audit operations remain distorted by revenue-target policies and the ability of local tax commissioners to select cases on a discretionary basis¹³³.

Audit function needs to be strengthened to promote tax compliance and reduce the scope for discretion¹³⁴. Tax authorities in Pakistan could strengthen their risk-based audit system, further refine risk-based categorization, and also go in automation and computerization for selecting cases. That would enable tax authorities to concentrate their enforcement efforts on the most problematic cases and lighten the compliance burden for most entrepreneurs.

A risk-based approach takes into consideration different aspects of a business such as historical compliance, industry characteristics, debt-credit ratios, and firm size. In a risk-based approach the exact criteria used to capture noncompliant firms, however, should be concealed¹³⁵ to prevent taxpayers from purposefully planning how to avoid detection and to allow for a degree of uncertainty to drive voluntary compliance. Most economies have risk assessment systems in place to select companies for tax audits, and the basis on which these companies get selected is not disclosed. Despite being a post-filing procedure, audit strategies set by tax authorities can have a fundamental impact on the way businesses file and pay taxes.

To reduce the average length of tax audits, FBR could enhance its notification system and better utilize modern means of communication (i.e., phone, electronic and text messages), instead of relying on official letters. Acceptance of soft copies of documents would also cut compliance time for businesses under audit. Authorities should work on integrating the FBR's systems with the databases of other departments and agencies (Customs wing, MOF) to further automate the auditing process and eliminate delays caused by manual queries between agencies.

To improve the efficiency and quality of audits, guidelines and legal documents explaining how audits should be conducted, and what type of tax audits should be applied depending on taxpayer segments, could be developed. Investment in training of FBR's auditors would also increase the quality of audits and reduce delays. Ideally, this training could be informed by a detailed survey of taxpayers, identifying the most common areas of dispute. Finally, a new results framework could be introduced to encourage auditors to conduct audit efficiently: FBR's KPIs could be revised to include not only yield targets but also measures of performance of tax officers. These would include: number of cases resolved in a given tax year, days to completion of audit, days to report issuance for review, and number of cases concluded within a specified statutory time limit (factoring the type and complexity of audits: comprehensive, desk audits), additional assessment vs. declared amount¹³⁶, and audit coverage (i.e. economic sectors, areas)¹³⁷. For example, in New Zealand, the Inland Revenue Department tracks core competencies of customer focus, achievement

¹³³ FBR's field formation and tax commissioners are still selecting audit cases on discretionary basis, which creates harassment for taxpayers.

¹³⁴ Global Corruption Barometer (2017) reports high global public perception of corruption (62 percent) among tax officials in Pakistan, after police (70 percent).

¹³⁵ In Pakistan, following court cases of taxpayers claiming that they were being discriminated by being selected for audits, the courts have made the publication of the risk parameters mandatory. What does not need to be disclosed however, is the weighting of each risk parameter in the risk-management system.

¹³⁶ This helps measure the effectiveness of audits and provides information on the compliance rate.

¹³⁷ OECD Audit Guidelines, 2006.

focus and management via a rating system that reflects the following rating levels: (i) not yet met (ii) partially met (iii) met (iv) exceeded and (v) consistently exceeded.

Tax audits are essential to promote reliable reporting. However, audits are more efficient when they are risk-based and when tax auditors are well trained¹³⁸. El Salvador is an example of a country where a risk-based audit system has been introduced. In 2016, the chance of a Corporate Income Tax audit by the tax authorities decreased to a low probability in case of an underpayment or self-reported error in the returns. This decrease is due to the tax administration's move to different audit assessment criteria focusing on larger-size companies, which the *Doing Business* case study does not consider. Thailand is another excellent example of a risk-based audit system: the system does not flag for audit cases where there is an error in the tax return and an underpayment of tax liability due.

Finally, Pakistan's tax authorities could allow taxpayers who self-report an error in the calculation of their Income Tax liabilities to submit an amended return. It should be supported by any relevant documentation (typically a letter explaining the mistake and, in some cases, revised financial statements) and pay the difference immediately – without being selected for a comprehensive audit of the Corporate Income Tax return. Currently, taxpayers can rectify their return online within two months of the submission, but after that, they need to obtain the approval of the local tax commissioner to amend their return.

Under such circumstances, in countries like Portugal and Estonia, taxpayers must only submit an amended tax return and make the necessary payment at the time of submission. It takes taxpayers half an hour to prepare the amended return and another 30 minutes to submit it electronically. The payment is also made online. In these economies, a minor mistake in the Income Tax return is not likely to be among the companies selected for an audit. In New Zealand, taxpayers must submit a specific voluntary disclosure form - which takes on average three hours to prepare - with the submission and payment being made electronically. Similarly, taxpayers are unlikely to be exposed to an audit in the case measured in *Doing Business*.

¹³⁸ Khwaja, M. S., R. Awasthi, J. Loepnick, 2011, "Risk-Based Tax Audits Approaches and Country Experiences," World Bank, Washington, DC.

9. Trading across Borders

In today’s globalized world, making cross border trade between economies easier is increasingly vital for business and heavily influences many investment and product sourcing decisions. Excessive use of paper documents, burdensome customs and border management procedures, inefficient port operations and inadequate infrastructure adversely affect a country’s competitiveness by raising the cost of imported inputs and saddling exports with dead weight inefficiencies. Countries that facilitate trade are more likely to attract investment and help their private sector participate and compete in the international trading system¹³⁹.

The performance of customs and other government agencies that regulate cross border trade, the quality of trade-related infrastructure, the availability and quality of private sector logistics service providers, and the existence and administration of non-tariff barriers, all impact the ease of Trading Across Borders and the competitiveness of the trading community. A range of factors can impede a firm’s ability to trade internationally, including inadequate infrastructure, excessive documentation requirements, burdensome customs and border management procedures, weak competition and investment policies, excessive inspection regimes, and difficulty in accessing the right information to comply. By simplifying and rationalizing border management systems and procedures, governments can contribute to creating a business environment conducive to trade that enables entrepreneurs to expand business opportunities beyond their national borders.

The *Doing Business* Trading across Borders indicator measures the time and cost (excluding tariffs) required to import and export goods, as reported by domestic business entities. Since its 2016 edition, *Doing Business* has used an updated methodology for measuring the Trading across Borders indicator. Specifically, the updated indicator reports the time and cost associated with the process of importing and exporting for two sets of procedures – documentary compliance and border compliance. The time and cost associated with transporting a shipment between a warehouse and the seaport/land border most widely used by traders located in the central business city of the economy (domestic transport time and costs) is still being reported and published in the report but no longer affects the ranking or the Ease of Doing Business score. The main reason for this is that many external factors influence the time and cost of domestic transport. These include the geography and topography of the transit territory, road capacity and general infrastructure, proximity to the nearest port or border and the location of warehouses where the traded goods are stored and so are not directly influenced by an economy’s trade policies and reforms. Likewise, the number of documents required to comply with regulations is reported but no longer contributes to the Trading across Borders ranking. The case study assumptions have also been updated. The export product is now defined based on the country’s comparative advantage determined by the value of exports (in the case of Pakistan, the export product used is HS 5205: cotton. The import product is HS 8708: parts and accessories of motor vehicles) for the 190 economies measured by *Doing Business*¹⁴⁰. The route and mode of transport are defined based on the most widely used trade pattern for the selected product and the partner. The simultaneity of processes is also taken into account while measuring time spent on document preparation, customs, and other border control inspections, port and border handling. Due to

¹³⁹ Gage, Jonathan and Miroudot, Sebastien, OECD Trade Policy Working Paper, A review of Good Practices, 2006.

¹⁴⁰ The import and export case studies assume different traded products. It is assumed that each economy imports a standardized shipment of 15 metric tons of containerized auto parts (HS 8708) from its natural import partner – the economy from which it imports the largest value (price times quantity) of auto parts. It is assumed that each economy exports the product of its comparative advantage (defined by the largest export value) to its natural export partner – the economy that is the largest purchaser of this product. (To identify the trading partners and export product for each economy, *Doing Business* collected data on trade flows for the most recent four-year period from international databases such as United Nations Commodity Trade Statistics Database (UN Comtrade). For economies for which trade flow data were not available, data from ancillary government sources (various ministries and departments) and World Bank Group country offices were used to identify the export product and natural trading partners.

these recent changes, *Doing Business* data for this indicator in 2016, 2017, 2018 and 2019 cannot be directly compared to results from previous years.¹⁴¹

Trading goods across borders could be easier in Pakistan. Globally, Pakistan ranks 142nd out of 190 economies on the ease of Trading across Borders in *Doing Business* 2019, and 5th out of eight economies in the South Asia region, while the economy scores 60.12 points on the Trading across Borders Score. It takes exporters 55 hours and US\$118 to prepare, obtain, submit and process the required export documents, and 75 hours and US\$356 to comply with border clearance export procedures. The time requirements and costs for imports are even higher. It takes importers 143 hours and US\$250 to prepare, obtain, submit and process the necessary import documents, and 120 hours and US\$476 to clear border import procedures. In keeping with Pakistan’s trade patterns, the *Doing Business* case study measures the time and cost for exporting cotton (HS5205) to China and importing auto parts (HS8708) from Thailand, through Port Qasim. On average, Pakistan’s import figures are higher than the regional averages while its export figures are mostly lower than the regional standards (Tables 9.1 and 9.2).

Table 9.1 *Doing Business* Trading across Borders ranking and best performers

Doing Business Indicator		Unit	Rank / Score			
			Pakistan	Regional average	Regional best performer	Global Best performer
Ease of Trading across Borders		Rank (out of 190)	142	117	27 (Hong Kong SAR, China)	1 (16 economies)
Time to export	Documentary compliance	Hours	55	74.1	9 (Bhutan)	1 (26 economies)
	Border compliance	Hours	75	62.9	5 (Bhutan)	0 (19 economies)
Cost to export	Documentary compliance	US\$	118	160.3	50 (Bhutan)	0 (20 economies)
	Border compliance	US\$	356	347.2	59 (Bhutan)	0 (19 economies)
Time to import	Documentary compliance	Hours	143	100.8	8 (Bhutan)	1 (30 economies)
	Border compliance	Hours	120	95.8	5 (Bhutan)	0 (25 economies)
Cost to import	Documentary compliance	US\$	250	276.7	50 (Bhutan)	0 (30 economies)
	Border compliance	US\$	476	504.6	110 (Bhutan.)	0 (28 economies)

Source: World Bank, *Doing Business* 2019 data

¹⁴¹ Documentary compliance captures the time and cost associated with compliance with the documentary requirements of all government agencies of the origin economy, the destination economy, and any transit economies. The aim is to measure the total burden of preparing the bundle of documents that will enable completion of the international trade for the product and partner pair assumed in the case study.

Border compliance captures the time and cost associated with the economy’s customs regulations and with regulations relating to other inspections that are mandatory for the shipment to cross the economy’s border, as well as the time and cost for handling that takes place at its port or border. The time and cost for this segment include time and cost for customs clearance and inspection procedures conducted by other agencies. For example the time and cost for conducting a phytosanitary inspection would be included here.

Table 9.2. Components of Border Compliance in Pakistan

	Time to Complete (hours)	Associated Costs (USD)
Export: Clearance and inspections required by customs authorities	30.9	150
Export: Clearance and inspections required by agencies other than customs	48	50
Export: Port or border handling	75	156
Import: Clearance and inspections required by customs authorities	34	285.7
Import: Clearance and inspections required by agencies other than customs	0.0	0.0
Import: Port or border handling	120	190

Source: World Bank, *Doing Business 2019 data*

According to the *Doing Business 2019* report, Pakistani traders routinely submit 13 documents to export cotton to China.¹⁴² These reflect legal requirements by authorities of Pakistan, transit economies and destination economies (China), as well as standard practice. The documents include the commercial invoice, bill of lading, customs export declaration, certificate of origin, inspection report, Export General Manifest, price certificate, gate pass, electronic E form, packing list, terminal handling receipt, phytosanitary certificate, and SOLAS certificate¹⁴³. Eleven documents are commonly prepared to import a container of auto-parts to Pakistan from Thailand, including the bill of lading, commercial invoice, customs import declaration, general import manifest, electronic I form, packing list, and terminal handling receipts, delivery order, gate pass and SOLAS certificate. It is relevant to point out that electronic documents in connection with the shipment are also considered to be documents obtained, prepared and submitted during the export or import process (Table 9.3). The time and costs of Trading across Borders are outcomes of the existing legal and regulatory framework and *de facto* practices of all concerned authorities.

Table 9.3. Documents required for Trading Across Borders in Pakistan

Export	Import
Commercial invoice	Commercial invoice
Packing list	Packing list
Certificate of origin	Certificate of origin
Bill of lading	Bill of lading
Inspection report	Import general manifest
Export General Manifest (EGM)	Import declaration
Electronic E form	Electronic I Form
Customs Export Declaration	Terminal handling receipts
Price certificate	Delivery order
Phytosanitary certificate	Gate pass
Gate pass	SOLAS certificate
Terminal handling receipts	
SOLAS certificate	

Source: World Bank, *Doing Business 2019 data*

Difficulties with trade facilitation in Pakistan, compared to regional peers, are also highlighted through the Logistics Performance Index (LPI) in which Pakistan's ranking has dropped

¹⁴² This is provided assumptions of *Doing Business 2019* hold, including destination country and transit border crossings.

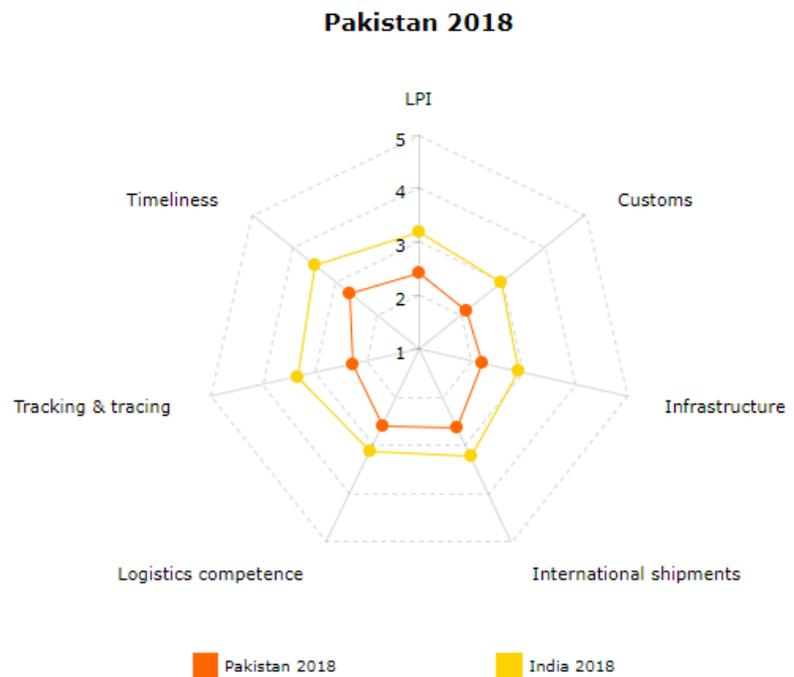
¹⁴³ Safety of Life at Sea certificate established by the International Convention for the Safety of Life at Sea (SOLAS).

significantly from 68 in 2016 to 122 in 2018. LPI calculates the weighted average of the country scores on the six key dimensions:

- 1) Efficiency of the clearance process (i.e., speed, simplicity, and predictability of formalities) by border control agencies, including customs.
 - 2) Quality of trade and transport related infrastructure (e.g., ports, railroads, roads, information technology).
 - 3) Ease of arranging competitively priced shipments.
 - 4) Competence and quality of logistics services (e.g., transport operators, customs brokers).
 - 5) Ability to track and trace consignments.
 - 6) Timeliness of shipments in reaching the destination within the scheduled or expected delivery time.
- Pakistan’s performance with the regional leader India (Figure 9.1) demonstrates the comparative performance of both countries in the six key dimensions of logistics performance.

Figure 9.1. Logistics Performance Index for Pakistan

Year	Ranking
2018	122
2016	68
2014	72
2012	71
2007	68



Country	Year	LPI Rank	LPI Score	Customs	Infrastructure	International shipments	Logistics competence	Tracking & tracing	Timeliness
India	2018	44	3.18	2.96	2.91	3.21	3.13	3.32	3.50
Pakistan	2018	122	2.42	2.12	2.20	2.63	2.59	2.27	2.66

Trading across Borders over time

Since 2003, Pakistan has been continuously endeavoring to introduce reforms to simplify and modernize its imports and exports procedures. During 2003-04, an ambitious initiative under Customs Administrative Reforms (CARE) program was launched to address the high dwell time of cargo, high customs processing time, poor record-keeping and the numerous signatures and verifications required for

each declaration¹⁴⁴. A comprehensive analysis of customs business processes was carried out with the assistance of a team of business process analysts from PRAL (the IT wing of the Federal Board of Revenue). During the next two years, business processes were re-engineered from paper-based to paperless and changes proposed in the Customs Act of 1969 to make it suitable for the introduction of electronic customs procedures. Following some reform impasse, Pakistan Customs succeeded in developing a paperless customs system, called WeBOC, towards the end of 2011. WeBOC has since been rolled out at the seaports, container terminals, off-dock terminals, airports, dry ports, warehouses, and border posts. WeBOC now has more than 81,500 users from the public and private sector registered with it.

Pakistan's efforts have led to an improvement of its standing in the *Doing Business* report through the years. Since 2008, the *Doing Business* report has recorded four reforms in Trading across Borders in Pakistan. In 2009/2010 Pakistan reduced the time to export by improving electronic communication between the Karachi Port authorities and private terminals, which also boosted efficiency by introducing new equipment. In 2013/2014 *Doing Business* recorded the introduction of WeBOC, a fully automated, computerized system for the submission of the process of export and import documents. WeBOC was further enhanced in 2015/2016. Finally, in 2016/2017 Pakistan made importing and exporting easier by developing a new container terminal and improving its customs platform for electronic document submission.

Short-term reform recommendations

1. Analyze port processes to eliminate duplicate regulatory activities and shorten the time to export and import.

As shown in Table 9.2, port handling takes up most of the time for border compliance for both exports and imports in Pakistan. Even for those consignments falling under the green channel, some of the port processes, both for import and export, continue to take an unnecessarily long time. In the short-term, it is essential that port processes are mapped, analyzed and streamlined to reduce port dwell time.

In 2017, a Trading across Borders Survey¹⁴⁵ was conducted to validate time and cost for import and export of selected commodities from Karachi and Bin Qasim Seaports. The survey clearly shows that port processes take up most of the time of importers and exporters:

- For imports of HS 8708 (auto parts etc.) from Thailand, nearly 68% of the time is consumed in physically moving consignments from the port after clearance from the customs control.
- For imports of HS 8415 (air-conditioners etc.) from China, nearly 35% of the time is consumed in physically moving consignments from the port after clearance from the customs control.
- For exports of HS 5205 (cotton) to China, nearly 67% of the total time is consumed after the consignment is allowed to load on the vessel after customs clearance.
- For exports of HS 6203 (readymade garments) to USA, nearly 85% of the total time is consumed after the consignment is allowed to load on the vessel after customs clearance.
- Regulatory activities performed by customs in the clearance process on average consumes less than 18% of the total clearance time for both imports and exports.

In the more medium-to-long-term, the establishment of a robust Port Community System at Karachi ports is also highly recommended (see Recommendations 10 to overcome these issues permanently).

2. Review and improve the customs Risk Management System to achieve greater efficiency.

¹⁴⁴ Presentation to the Collectors' Conference by the Collector of Customs, MCC PaCCS in September 2008.

¹⁴⁵ Trading across Borders Survey was carried out by Acrux Technologies (Pvt.) Limited in 2017.

Presently, the customs Risk Management System (RMS) selects over 40% of import's consignments for physical examination, which is a high percentage and adds to the overall port dwell time. There is a necessity to examine the existing risk profiling and targeting system within WeBOC to reduce the need for time-consuming physical inspections in case of low-risk consignments and ensure that the Risk Management System is compliant with best-practice approaches.

The current RMS within WeBOC involves six key steps which are: establish the context, identify risks, analyze risks consequences, evaluate risks, treat risks and review risks. It is a data-driven intelligent system that performs the functions of determining which consignments can be trusted and which are suspected. A trader's profile is maintained and continuously updated which plays a crucial role in deciding whether any shipment is to be processed in the green, yellow or red channels. WeBOC follows an internationally accepted practice of clearing green channel consignments without physical examination and documentary verification whereas yellow channel consignments undergo desk audit and only suspected batches are marked for a physical examination. Lastly, red channel consignments are required to be physically examined. Within Pakistan Customs, the Directorate General of Risk Management System has been established with a mandate to continuously review and configure the criteria impacting the number of consignments to be cleared under a specific channel.

Requiring imports and exports to undergo inspections - for tax, security, environmental, border control, and health and safety reasons - is often necessary. How these inspections are carried out, including how cargo is selected for examination, however, varies across economies. If done with a heavy hand, checks can be a serious obstacle to efficient and predictable trade. Over the years, customs' administrations around the world, working in tandem with other border control agencies, have developed systems for establishing risk profiles that allow them to apply physical inspections corresponding to the potential risk of consignments. Investing in equipment is another way to help expedite the processing of cargo. Many economies use scanners to limit the need to open containers physically. This is not the case in Pakistan. The country should consider investing in X-Ray machines at the ports to implement risk-based approaches properly. In some economies, however, inefficient use of scanners led to an additional burden on traders because customs agents scan all containers, creating delays and imposing mandatory scanning fees on traders. Efficient use of scanners in conjunction with risk-based profiling can strike the right balance in inspection, contributing to the efficiency of the trading process.

3. Review the necessity of issuing price certificates for cotton and other export consignments and consider their automation through the customs' WeBOC system.

FBR may like to examine the mandatory requirement of price certificates in terms of the valuations rules under the WTO regime¹⁴⁶ (specifically, the WTO Agreement on Implementation of Article VII of the GATT 1994). More specifically, every cotton (HS 5205) export consignment requires a price certificate to be issued by the All Pakistan Textile Mills Association (APTMA). The existing system at APTMA is paper-based and needs exporters to physically visit their office to make an application and pick up the paper-based certificate the following day. It adds at least 24 hours to the overall documentary compliance for cotton exports.

The authorities may, in the first place, review the necessity of issuing a price certificate for the export of cotton and eliminate this requirement if it is not adding any value to the export process.

If the certificate is retained, then the government should consider the electronic issuance of the price certificate to reduce documentary compliance time further.

¹⁴⁶ https://www.wto.org/english/tratop_e/cusval_e/cusval_info_e.htm

As customs has already integrated several modules in WeBOC to link other institutions to its systems such as Quarantine and Plant Protection, it may consider introducing a WeBOC module to connect APTMA for online issuance of this certificate.

4. Reduce the processing time for the issuance of the bill of lading.

As per the existing procedure, the bill of lading cannot be issued unless the export goods declaration of those consignments marked for the yellow channel, is assessed by customs. Sometimes, exporters have to persuade relevant customs officials to complete the assessment of pending export goods declarations to expedite the issuance of bills of lading. This process should be reviewed with an aim to delink the assessment steps from the issuance of bill of lading, for those export consignments marked for the yellow channel.

5. Remove obstacles in the electronic issuance of Certificate of Origin to reduce processing time from eight to two hours.

The Trade Development Authority of Pakistan (TDAP) is the successor of the Export Promotion Bureau, and it operates under the Ministry of Commerce. TDAP is in charge of issuing preferential Certificates of Origin for those export consignments that require them. Though it is now possible to electronically apply for the issuance of the Certificate of Origin, TDAP still needs exporters to visit their office to get a printed copy of the document. Fully automating the issuance of the Certificate of Origin would contribute towards a lower documentary compliance time and decreased time to export. TDAP may carry out automation of its back-end processes to allow full online issuance of certificates of origin, without the need for physical interaction.

Box 9.1. Georgia's trade facilitation reforms

From the period of September 2015 to February 2016 the Tax and Customs Administration, SPS Border Control Agency, in collaboration with the International Finance Corporation and several external counterparts have implemented some reforms aimed at facilitating international trade practices:

- 1) The Tax and Customs Administration has designed a new distance clearance method. Truck drivers entering Customs Clearance Zone (CCZ) can send scanned documents mandatory for import declaration via mail to the importer. After the review, documents may be uploaded by the importer to Revenue Service website www.rs.ge where a customs officer at CCZ finalizes clearance. The new service helps save the time of economic operator and complete customs clearance from his/her office or Service Center without having to go to CCZ.
- 2) With the assistance of International Finance Corporation and in collaboration with Swedish experts, Georgia has adopted the new Customs Risk Management Strategy as of January 2016. As a result, the process of development, amendment, and application of risks profiles improved. Now, only 2% of cargo undergoes risk inspections.
- 3) As of January 2016, the railway e-waybill system was introduced for electronic information exchange between Georgian Railway and GRS for the goods subject to customs control. The system provides railway waybill data in advance, and therefore the document for internal (internal transit declaration) movement under customs control has been abolished. This initiative significantly reduces the time for entering information into the system by customs.
- 4) As of December 2016, the e-registration of containers form-222 has been introduced. Now arriving containers do not have to be registered manually. The new regulation speeds up the border handling of goods shipped by sea.

Medium to long-term reform recommendations

6. Improve the system of the electronic issuance of I-Form and Form-E.

For each export consignment, Pakistani exporters should obtain Form-E from their bank at the time of export. It is a declaration that this export is being processed against foreign exchange. Similarly, for imports the I-Form is required to screen the source of foreign remittances. Customs has incorporated the issuance of the I-Form and Form-E under the WeBOC system, and this is playing a pivotal role in the implementation of checks and balances on the foreign exchange movement. However, in light of feedback received from the traders and detailed assessment, the following areas require improvement for the system to work better:

- Since banks use WeBOC as external users to receive and process the electronic I-Form and Form-E, there is an inherent dependence of banks on WeBOC for user management functions. For example, if a particular bank staff member registered with WeBOC is transferred out then the delegation of the same authority to another staff member can only be done through the WeBOC system. Similarly, the creation of a new bank user who could perform I-Form and Form-E related functions requires customs intervention which is a time-taking process.
- Every electronic I-Form issued by the bank is expected to be settled, for which its corresponding Bank Debit Advice (BDA) information should be entered in the WeBOC system. Similarly, every electronic Form-E issued by the bank is settled against its corresponding Bank Credit Advice (BCA). In such cases, banks face limitations concerning monitoring of the status of settlements made. Banks are also not able to monitor the performance of their staff concerning the number of forms approved or rejected.
- Banks face limitations for tracking the progress of under-process applications for the issuance of I-Form and Form-E.
- Although I-Forms and Form-E are issued electronically, banks do not have the data of the process applications and therefore cannot perform data analytics to improve their strategies.

The authorities may consider generating electronic I-Form and Form-E automatically from the goods declarations submitted by the importers/exporters. Additional fields may also be introduced in the goods declaration system of WeBOC to capture such data elements which are required to fulfill the data requirements of I-Form and Form-E. This activity will, however, require detailed business process analysis to be carried out.

7. Introduce a smart examination system for red channel consignments.

Within the WeBOC system, decisions for the physical examination of consignments are taken by the Risk Management System, and all the examination tasks directly forwarded to the respective inboxes of customs examiners. Since the examination yards are not connected with WeBOC, therefore, a manual process of recording the results of the physical examination takes place. This manual system has the following inherent problems:

- A substantial time lag between the physical examination and feeding of the examination report in the WeBOC system.
- Chances of inaccuracies are high as the examination results are recorded on paper and then fed into the computer at a later stage, sometimes during the next day.
- Delays in the examination process increase port charges for the businesses.

A smart examination system specifically built for mobile devices/smartphones can provide the capability of connecting examination yards with the WeBOC system. Such a system would bring transparency into

the examination process as it will make use of high-resolution cameras of the mobile devices to take photographs of the commodities being examined, record short videos as evidence to support the examination findings, scan documents found inside the containers. Such an app will be able to communicate information to the WeBOC system over 4G or WiFi network. It will improve customs capability to enhance controls and transparency while facilitating trade also.

8. Take administrative measures to discourage use of port as a free storage area.

The survey for measuring the effectiveness of Trading Across Borders, which was carried out during the last quarter of 2017¹⁴⁷, found that the free storage/warehouse facility provided by the ports is used by importers/brokers to leave cleared shipments/GDs in the port for extended periods after clearance. This facility negatively impacts the release time since shipments/GD are treated as cleared only after delivery is taken, and goods leave the port (Gate Out).

The government may, therefore, consider introducing tiered-tariffs incentivizing importers to take their cleared consignments out of the ports soon after the electronic message for completion of clearance by all agencies including customs is communicated to them. For example, standard port tariffs may be applied for the first 36 hours, after that, a certain percentage in port tariffs should be charged additionally for each additional 24 hours. For customers who wish to use the terminals' container yard as a storage facility for convenience, the terminal, in agreement with customs could demarcate areas within the terminal as bonded facility and deliver customs cleared containers to the bonded zone. Such containers will be understood to be customs-cleared and should cut down the time substantially. The port authority, customs, the terminal, and the concerned importers would have to hold consultations on this issue.

9. Deploy useful business intelligence and data analytics tools.

WeBOC is a paperless customs management system which generates loads of electronic data daily. Presently, customs does not have tools to analyze this wealth of data on a real-time basis to effectively counter sophisticated, evolving threats and trade patterns, which affects national security and revenue. It is, therefore, imperative to make the best use of electronic data with the help of business intelligence and data analytics tools to make informed decisions at the right time. This capability will also act as a performance monitoring tool which will bring further efficiency in the import and export processes. It will ultimately enable Customs to enhance the ratio of consignments cleared under the green channel.

10. Implement the Port Community System (PCS).

The Port Community System would provide a comprehensive, wide-ranging, highly scalable solution offering a single electronic window for all port community actors across port operations to submit and access required information readily and securely. Port Community Systems are developed to meet the complex and evolving requirements of port and shipping operations so that repetitive elements of the same data are eliminated. Such systems consolidate and synchronize information from relevant stakeholders in the landward and sea-ward processes to achieve efficient and reliable supply-chain management. PCS will, therefore, simplify and integrate the complex processes involved in the movement of ships and cargo/containers in the ports of Pakistan. The scope of PCS can also be extended to airports to deliver similar results for airborne cargo.

Pakistan has already initiated practical steps for developing Port Community System with an objective of integrating it with the Pakistan National Single Window to achieve the sharing of data, its reuse, and speedy dissemination of information required by multiple stakeholders operating at the ports.

¹⁴⁷ Trading across Borders Survey was carried out by Acrux Technologies (Pvt) Limited in 2017.

11. Implement the Pakistan National Single Window System (PNSW).

The development of the PNSW has already been initiated. Pakistan Customs is selected as the lead agency and the PNSW Blueprint and Implementation Program have been developed and approved.

Box 9.2. Consistent with good global practices, the World Bank Group has developed a series of National Single Window (NSW) guiding principles to shape its work on assessing and supporting NSW systems.

Fully operational NSW should provide the following capabilities:

- Traders (either directly or through a broker or agent) interact with government online in real-time through the NSW for all stages in the import/export process (registration, license/permit issuance, goods declaration and release, and payment).
- The trader uses the NSW to monitor and track the progress of transactions.
- Physical visits to government agencies are eliminated or reduced to a minimum, and data required by any government agency for a trade transaction would be submitted only once using a standardized and harmonized data format.
- Once provided, data would be available to all authorized government officials involved in regulating the transaction.
- Requirements for paper documents are eliminated or reduced to the minimum required by law and to the degree needed to ensure adequate controls are maintained.
- Border agencies co-locate officials and coordinate, and where feasible, integrate their processing and inspection processes.
- Risk management techniques will be applied at all stages in the registration, permit and license approvals and border clearance operations by all agencies in a coordinated, transparent manner, making maximum use of ICT.
- An inter-agency approach to risk management will be in operation (including an automated Risk Management System in the NSW).
- Inter-agency Memoranda of Understanding (MOUs) and related Service Level Agreements (SLAs) among the NSW operator, the lead agency (TCD) and participating government agencies will be in place.
- An integrated enforcement database incorporating information on all enforcement actions and results from inspection and verification activities will be in operation.
- Traders will be able to submit customs declarations in advance of goods' arrival (allowing pre-arrival processing by all relevant government agencies).
- Electronic payment of duty taxes and charges processed by banks/treasury will be linked directly to the NSW. Payment options will be offered to traders.
- Timely, accurate and comprehensive trade-related statistics will be readily available to all authorized parties.

Source: World Bank Group internal documents

When fully implemented, the PNSW will allow parties involved in trade and transport to lodge standardized information and documents with a single entry point to fulfill all import, export, and transit-related regulatory requirements. The PNSW will provide an opportunity to bring together customs and other government agencies (OGAs) to work together on a single platform, underlying the need for effective communication, increased collaboration, and coordinated interventions to keep the balance between trade facilitation and border control. The PNSW will play a vital role in the development of efficient information systems and procedures of stakeholder agencies which can significantly increase the speed at which consignments can get cleared, reduce costs, improve business efficiency, and enhance the overall economic performance of the country.

Box 9.2 contains good global practices to be considered when developing National Single Windows.

International examples in this area are plenty. Singapore, for instance, has been a global leader in the implementation of a single window platform. Its TradeNet system handles 20,000-30,000 trade declarations per day, processes 99% of permits in 10 minutes, and receives all collections through interbank deductions. This was made possible by linking 35 government controlling units.

Korea has implemented an online NSW, where importers and exporters can submit documents and obtain approvals from customs and different agencies. This electronic window has brought together 69 agencies as well as private participants - including traders, banks, customs' brokers, insurance companies and freight-forwarders. It allows them to exchange information in real-time, thus considerably speeding up approvals. The Korea Customs Service estimates that the introduction of its single window system brought some \$18 million in benefits in 2010 alone, part of the overall economic benefits that year of up to \$3.47 billion from the agency's trade facilitation efforts.

In Europe, the computerization of the German Port of Hamburg started in 1983 when the first harbor order was sent electronically from a haulage company through its port community system (DAKOSY). Thirty-five years later, the Port of Hamburg is a 100% "paperless port" and DAKOSY has become its single window platform. All logistics companies and authorities involved in the export, import and transit processes communicate their business data through its data center. Transport orders, customs applications, hazardous goods notifications, harbor orders, bills of lading, and manifests are transferred electronically through DAKOSY, which currently has more than 2000 customers including haulage companies, shipping lines, rail transport companies, trucking companies, feeders, international trade firms, and industrial enterprises.

10. Contract Enforcement

Research in various countries around the world suggests that, in the absence of efficient courts, firms make fewer investments and formal business transactions while informal transactions become more attractive. A study of 27 economies found that the informal sector’s share in overall economic activity decreased with better Contract Enforcement quality, evaluated by a countrywide measure of the rule of law, as well as by the firm’s perception of the fairness of courts.¹⁴⁸ Improvements in court efficiency are associated with a lower share of the informal sector in the overall economic activity, increased investor confidence and with increased bank financing of firms for new investment.¹⁴⁹ For example, reforms in other areas, such as creditors’ rights, can increase bank lending only if contracts can be enforced before the courts.¹⁵⁰ Besides, alternative methods of dispute resolution (ADR), such as arbitration and mediation of commercial disputes, have become preferred dispute resolution mechanisms for many investors and entrepreneurs.¹⁵¹

Doing Business measures the efficiency (time and cost) of the judicial system in resolving a standardized commercial dispute before both the Karachi District Court and the Lahore District Court, as well as the quality of legal processes in both courts. Pakistan ranks 156th out of 190 economies on the ease of Enforcing Contracts indicator. The country’s Enforcing Contracts Score is 43.49.¹⁵² According to the *Doing Business* 2019 report, resolving a simple commercial dispute takes 1096 days at the Karachi District Court and 1025 days at the Lahore District Court. In both cities it costs 18.1% (25%) of the claim value. Besides, Karachi scores 6 out of 18 possible points in the quality of judicial processes index, while Lahore scores 5 out of 18 (Table 10.1). Unlike the improvement in other areas of the *Doing Business* report, the *Doing Business* dataset shows steady low performance in the enforcing contracts indicator, as Pakistan also ranked 156th out of 190 economies in *Doing Business* 2018. Currently, Pakistan ranks 4th out of eight economies in the South Asia region. The best performing South Asia countries include Bhutan, Maldives, and Nepal.

Table 10.1. Enforcing Contracts ranking and best performers

<i>Doing Business</i> Indicator	Pakistan	South Asia average	Regional best performer	Global best performer
Time (days)	1071.2	1101.65	225 (Bhutan)	164 (Singapore)
Cost (% of claim)	20.5	29.81	18.5 (Maldives)	9 (Iceland)
Quality of judicial processes index (0-18)	5.7	7.02	10.5 (India)	16 (Kazakhstan/China - Beijing)

¹⁴⁸ Dabla-Norris, Era, and Maria Gabriela Inchauste Comboni. 2008. “Informality and Regulations: What Drives the Growth of Firms?” IMF Staff Papers 55 (1): 50–82. <http://www.palgrave-journals.com/imfsp/journal/v55/n1/full/9450030a.html>

¹⁴⁹ Among other papers, see G.B. Ramello and S. Voigt, 2012. “The economics of efficiency and the judicial system,” International Review of Law and Economics; Mehnaz Safavian and Siddharth Sharma, 2007. “When Do Creditor Rights Work?” *World Bank Policy Research Working Paper No. 4296*; John Ahlquist and Aseem Prakash, 2010. “FDI and the costs of contract enforcement in developing countries,” *Policy Sciences*, Springer, vol. 43(2), pages 181-200, June; Inessa Love, 2011. “Settling Out of Court: How Effective is Alternative Dispute Resolution,” Viewpoint Note No. 329, The World Bank Group, October.

¹⁵⁰ Mehnaz Safavian and Siddharth Sharma, 2007. “When Do Creditor Rights Work?” *World Bank Policy Research Working Paper No. 4296*.

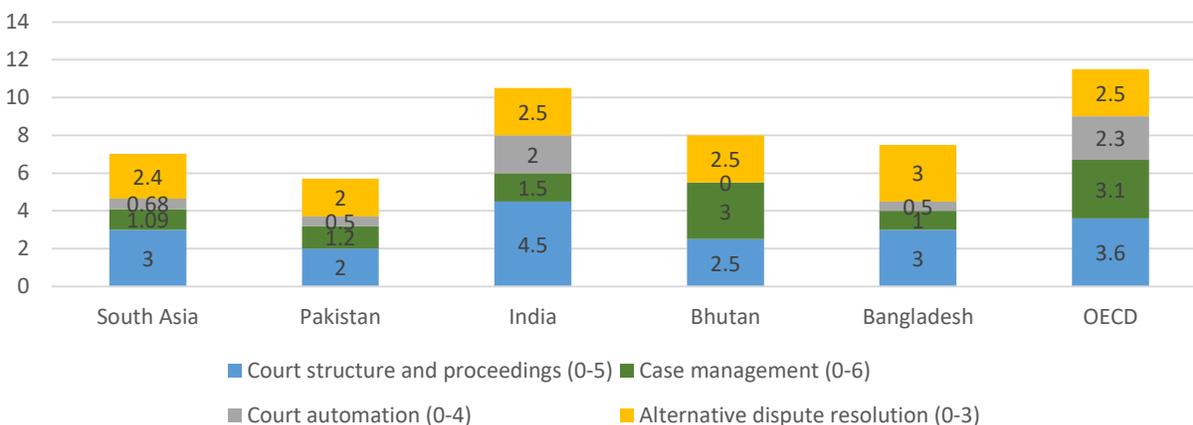
¹⁵¹ McLaughlin, Joseph. 1979. Arbitrating and developing countries. *International Law* 13: 211–232.

¹⁵² The Enforcing Contracts Score captures the gap between an economy’s performance and a measure of best practice. In the case of Pakistan, the score is calculated as the population-weighted average of the distance to frontier scores for Karachi and Lahore.

Source: World Bank Doing Business 2019

Enforcing Contracts in Pakistan is significantly cheaper than in the South Asia region. In terms of case duration, it is slightly faster than the regional average but still lags considerably behind the global best performer. In terms of the quality of the judicial process index, Pakistan scores worse than the regional average. According to *Doing Business* data, Pakistan follows some good practices in the area of alternative dispute resolution. Court automation remains a relatively weak area, as the country currently only received half a point on the publication of judgments rendered in commercial cases at the appellate and the Supreme Court level (Figure 10.1).

Figure 10.1. Quality of judicial processes index (0-18) in Pakistan and comparator economies



Source: World Bank Doing Business database

Enforcing Contracts over time

Despite some early efforts, Pakistan has not made any significant improvements on the ease of Enforcing Contracts in the past decade. The time and cost required to enforce a commercial dispute have remained mostly unchanged as measured by the *Doing Business* report. However, some reforms have been introduced at the federal and provincial levels. At the federal level, the government introduced the Financial Institutions (Recovery of Finances) Ordinance (FIO) in 2001. The FIO looked to facilitate the recovery of finances in the country by introducing specialized Banking Courts and a novel procedure separate from the one established by the Civil Procedure Code (CPC) of 1908. Also, the Small Claims and Minor Offences Courts Ordinance was passed in 2002. Through this ordinance, a specialized court - and a simplified procedure - was established to deal with small claims. Furthermore, through Ordinance XXXIV of 2002 the CPC was amended to allow judges to refer a case to alternative dispute resolution - including mediation and conciliation - (Section 89-A) and to conduct preliminary proceedings and issue orders for expediting case processing (Order X.1.A).

At the provincial level, some reforms are also worth highlighting. Punjab has taken strides with the development of an ADR center specially geared to commercial disputes in the Lahore Chamber of Commerce and Industry, the LCCI Mediation Centre. Besides, the Lahore High Court recently enacted ORDER IX-B which mandates courts to refer cases to mediation at the outset of the case, unless the court believes that there is no possibility of conciliation or that intricate questions of fact or law are at stake. The mediation procedures may take up to 30 days and if no settlement is reached the court shall proceed with the case. In turn, the province of Sindh has made significant technological progress. Since 2012, the state's judiciary has been developing a modern Case Flow Management System. This system currently allows for

the creation of reports, tracking several activities in a case and assessing the performance of judges in real-time.

Short-term recommendations

1. Conduct an in-depth assessment of court processes as well as the legal framework for handling commercial cases to identify and address the underlying causes of delays.

Enforcing Contracts in Pakistan takes more than 1000 days on average to resolve a commercial dispute. During this time, plaintiffs in Karachi must wait over three months and in Lahore over two months from the time they decide to sue until the process is served on the defendant. Furthermore, in Karachi going through the trial and obtaining a judgment takes 700 days (in Lahore it takes 600 days), a large part of which is often spent waiting for the first hearing and the subsequent adjournments. Once a judgment has been issued, a judgment in Karachi takes approximately 10 more months to be enforced through the public auction of the losing party's assets, while in Lahore it takes 12 more months.

It is highly recommended to map out the procedures required by the law in conjunction with the steps needed in practice by the court to take a case from filing through enforcement. This exercise, which would need to be conducted in Karachi and Lahore's district courts, would help to identify bottlenecks as well as to zero in on unnecessary administrative tasks required by court staff, judges and court users. Furthermore, mapping out the procedures would allow discovering opportunities for improvement with (and without) legislative changes.

Speeding up judicial proceedings and the enforcement may also help reduce legal fees in the cost of dispute resolution, as legal costs are often associated with the length of judicial procedures. Furthermore, the suggested mapping could also help identify needs for resource allocation to enhance efficiency and cost-effectiveness, especially if used with other workload assessment techniques. Such an assessment can be conducted upon the government's request and may support the ongoing efforts to gear up the efficiency of court proceedings.

Medium and long-term reform recommendations

2. Consider the creation of specialized commercial courts, divisions or benches.

Dedicated systems for commercial cases can make a big difference in the effectiveness of a judiciary. Having specialized commercial courts or divisions tends to reduce the number of cases pending before the main first-instance court and thus can lead to shorter resolution times within the main trial court - one reason that economies have sometimes introduced specialized courts as a case management tool. However, the benefits do not end there. Commercial courts, divisions or benches tend to promote consistency in the application of the law, increasing predictability for court users. Also, judges in such courts develop expertise in their field, which likely leads to faster and higher quality dispute resolution.

Specialized courts tend to improve efficiency and are becoming more widespread in jurisdictions around the world.¹⁵³ Most of the best performing economies have a specialized commercial court or a section dedicated solely to hearing commercial cases in place. For example, Australia or Hong Kong have Commercial Lists at the first instance courts. The data show that 101 of the 190 economies covered by *Doing Business* have a specialized commercial jurisdiction — established by setting up a dedicated stand-alone commercial court, a specialized commercial section within an existing court or specialized judges within a general civil court. Economies with stand-alone commercial courts include Austria, Belgium,

¹⁵³ Botero and others 2003

Benin, Côte d'Ivoire, Mali, and Sri Lanka. Those with a commercial division within their courts include Kenya, Nigeria (Lagos), Uganda, the United Kingdom and the United States (New York). Out of the 11 economies where two cities are measured, China, India and the Russian Federation are the only ones where commercial courts or divisions have been established in both cities. In several economies that have introduced commercial courts or sections since 2005, the average time to resolve commercial disputes has been reduced. For example, in Côte d'Ivoire, the reduction was more than six months. In 2011 resolving a commercial dispute in Abidjan took 770 days. In 2013, after the creation of a specialized commercial court, it took 585 days. Today, time has been further reduced to 525 days.

Court specialization can also help to advance the quality of decisions issued, something that is especially important in the commercial realm. In the Pakistani context, further commercial specialization could provide additional benefits. Even though some focalized courts exist (including the Banking Courts, Taxation Courts and Intellectual Property Courts) most first instance judges in Pakistan are not specialized and routinely rotate among different jurisdictions - ranging from family matters to criminal ones - preventing litigants to have judges with specific knowledge in their areas. Private sector interviewees raised several times concerns about the understanding judges have of the commercial transactions that underlie judicial disputes. The government should consider specializing a court in a variety of commercial matters, perhaps expanding the jurisdiction of the Banking Courts. Importantly, specialized courts should only hear cases of commercial nature. Such a proposal would be in line with India's creation of dedicated divisions to resolve commercial cases within the High Courts of Delhi and Mumbai in 2016.

The creation of specialized sections, divisions or courts needs to be matched by a commitment of sufficient resources as demand for their services expands.

3. Introduce case management practices to address delays during the trial process – such as limiting excessive adjournments and enforcing time standards.

While the case management principles adopted by courts vary depending on their needs and the local legal culture, some principles have been applied so consistently worldwide that they have evolved into a set of internationally recognized core principles. These include early court intervention, establishing meaningful events such as the filing of a plea or the submission of the final judgment, establishing time frames for these events and for disposition, creating realistic schedules and expectations that events will occur as scheduled, introducing early options for settlement, pre-trial conferences to settle non-contested issues, early evidence disclosure, establishing firm and realistic appearance dates and developing mechanisms that control frivolous adjournments.

Pakistan's CPC sets time standards for key court events. Nevertheless, interviewees consistently reported that time standards are not followed. One of the critical drivers of delays is the liberal granting of adjournments. A myriad of causes leads to adjournments, including real or alleged double-booking of practitioners,¹⁵⁴ parties requiring more time, and insufficient time allocated to a hearing by a judge. The liberal granting of adjournments, especially if requested by litigants as a delaying tactic, has been shown to slow down court proceedings. The accumulation of cases generated by these tactics may strain court resources. Clarity on when, why and for how long adjournments should be granted will help keep cases on track.¹⁵⁵ Besides, strict adherence to time standards favors the timely flow of cases through the court from initial filing to disposition. Both techniques enhance processing efficiency and promote early court control of cases. When well implemented, case management techniques can improve record-keeping, reduce delays

¹⁵⁴ Fines applicable to lawyers for not appearing in court were reported to be quite low – PKR 1000 or 2000 - and rarely imposed. Furthermore, judges are said to be very reluctant to proceed *ex parte*.

¹⁵⁵ Anecdotal evidence collected during the mission suggests that the limitation of adjournments has improved case management in criminal cases in Pakistan.

and case backlogs and provide information to support the strategic allocation of time and resources - all of which generally encourage better services from courts. They can also improve the predictability of court events, which can ensure accountability, increase public trust, reduce opportunities for corruption and enhance the transparency of court administration.

Several economies in Asia have such provisions in their laws. For instance, Shanghai (China) has a developed case management system. The Civil Procedure Law sets time limits for important several court events and lists the causes for adjournments. The provisions are respected in practice in a majority of cases which makes the trial and judgment phase fast. According to *Doing Business* data, the trial and judgment phase of resolving a standardized commercial dispute in Shanghai takes approximately 210 days.

4. Introduce pretrial conferences as a critical element of case management.

Initially developed in the United States in the first half of the 20th century with the introduction of the Federal Rules of Civil Procedures, the use of pretrial conferences has become widely recognized as an effective way for assisting courts in managing and promptly resolving cases.¹⁵⁶ Generally, a pretrial conference is an informal meeting of the judge (or in some countries, a court registrar) and the parties following the filing of a claim that aims to define and narrow down the issues in dispute, thus clarifying evidentiary matters to be tendered by the parties and working toward a settlement. It is at the pretrial conference that a judge obtains detailed information allowing him to determine how best to dispose of a case and to create a realistic and firm roadmap for how it will be processed.

Pretrial conferences help to reduce the risks that the parties will be able to manipulate the process to their advantage, causing unnecessary delays, reducing the likelihood of settlement or prolonging trials. In essence, pretrial conferences serve to empower courts, giving them early control over the process. Conceptually, they signal a movement from purely adversarial procedures to more cooperative ones. An example of a pretrial conference can be found in the Norwegian District Courts, where planning meetings in all civil cases are scheduled within days after the lawsuit is filed. To facilitate the scheduling, lawyers are allowed to participate by phone. The meetings aim to plan all steps necessary to process the case until its disposition; clarify the claims and supporting arguments and evidence; set deadlines for case events; and set the date of the final hearing (trial).¹⁵⁷

Pretrial conferences are used by 92 economies benchmarked annually by *Doing Business*. Reforming the CPC to mandate pretrial conferences - thus aligning it to good international practices - should be a priority of the government. Also, it would complement some preliminary efforts introduced by the Lahore High Court in 2018 by reforming the First Schedule to the CPC.¹⁵⁸

5. Support the introduction of electronic filing of initial complaints and other court automation elements in commercial cases.

Pakistan should also consider introducing e-filing of initial complaints, as well as other subsequent documents. This would allow the transmission of trial documents and court notices by electronic means,

¹⁵⁶ See “Good Practices for courts: Helpful Elements for Good Court Performance and the World Bank’s Quality of judicial Process Indicators,” Heike Gramckow, Omniah Ebeid with Erica Bosio and Jorge Luis Silva Mendez, World Bank Group, 2016.

¹⁵⁷ See Act of June 17, 2005, No. 90 relating to mediation and procedure in civil disputes <http://app.uio.no/ub/ujur/oversatte-lover/data/lov-20050617-090-eng.pdf>

¹⁵⁸ In the reformed First Schedule, Order I, rule 11 allows the court to give the conduct of suit to the party that it deems proper for expeditious adjudication.

Box 10.1. The computerization of Korean courts

Today Korean courts are fully computerized, but this did not happen overnight. The process started in the late 1970s with the creation of a database of cases flowing through courts. In the early 1980s, a word processing software was introduced to support judges in writing judgments. In 1986 a case management system was launched, enabling clerks and judges to search all civil cases in the database and deal more efficiently with their caseloads. Soon after, a master plan for creating e-courts was conceived -followed by steps to make the case management system accessible to external users, add electronic signatures and digital certificates to the system and make real-time national data on court activities available. Finally, in 2010 Korea launched an electronic case filing system. The system enables some judges to adjudicate up to 3,000 cases a year, manage up to 400 a month and hear up to 100 pleas each month.

Approaches to computerizing and automating systems at courts vary by economy depending on the capacities and priorities of the judiciary and the ability of court users to use such solutions. The tools available to court users in Korea have gradually expanded over time. Currently, the country ranks first in the world on the E-Government Readiness Index, a composite measure of the capacity and willingness of economies to use e-government for development.

The first case management system, launched in the mid-1980s, enabled internal court users to search for civil cases in the database. Now the system encompasses many features, most of which are dedicated to helping judges (case management system and judge support system), facilitate the filing of cases for litigants (e-filing) and inform the public (publication of cases).

To further streamline procedures, a system facilitates payment of all submission fees electronically using a credit card or wire transfers at the time of filing. Besides, users are notified by e-mail or text message of any submission of additional documents by the opposing party. Moreover, after the case allocation system assigns cases, the designated judge and the attorneys can view all their cases online, including PDFs of all documents filed in a given lawsuit.

For judges, the support system includes four main features:

- The case management system, which allows judges to organize their work based on the status of procedures and to separately manage cases for which special measures are needed.
- “My case history,” which allows judges to track cases they have disposed of and the final determination of the cases.
- A scheduling system to organize cases by day, week or month that is integrated with the court registry.
- A writing support system with features such as automatic document formatting, multiple judgment editing in small cases and collaborative decision writing in panel cases. This system automatically creates a draft of the final judgment after the relevant case, and the desired template has been selected. Once completed, judges enter a digital signature and register the decision in a searchable database of judgments.

In the first two months after the launch of the e-filing system for civil cases, approximately 5% were filed electronically. This number almost decupled in 18 months. Two years later, in June 2013, that share had soared to more than 45%.

In many countries, concerns about budget and technology limitations are among the most common reasons for not implementing e-court features. That should not prevent less developed economies from looking into e-court opportunities. E-court options may provide for cost savings in the long run, and up-front costs for development of such options can be implemented with donor assistance, supported by peer learning from courts in leading economies such as Korea.

If implemented carefully, e-courts can improve court document security and decision-making transparency. In the long run, they also help countries save money. The implementation of Korea’s e-court system, for example, resulted in savings of \$221 per e-filing. These savings result from a reduction in the use of paper, the time spent in court, cheaper service of process, lower transportation costs, easier archiving of documents, and easier payment of fees.

Sources: Doing Business research

alleviating the administrative burden on the courts. Online access to courts saves time and money, as lawyers no longer need to go to the courthouse to pick up or submit forms or receive the judge's order.

These features streamline and speed up the process of commencing a lawsuit. However, they also have broader benefits. Electronic records tend to be more convenient and reliable. Reducing in-person interactions with court officers minimizes the chances for corruption and results in speedier trials, better access to courts and more reliable service of process. As a result, electronic filings also tend to reduce Contract Enforcement costs - court users save in reproduction costs and courthouse visits, while courts save in storage costs, archiving costs and court officers' costs. Also, studies show that after the introduction of electronic filing in courts, the accessibility of information increases and access to and delivery of justice improve considerably.

According to *Doing Business* data, 36 countries have recorded reforms focused on introducing an electronic filing system for commercial cases and allowing attorneys to submit the initial complaint online since 2008. Even so, electronic features, including electronic case management, remain the least common of the good practices covered by the quality of judicial processes index.

The Republic of Korea and Singapore are two of only eight economies worldwide that receive full points on the court automation index; they also score points for the availability of electronic case management systems for both judges and lawyers. Unsurprisingly, both of these economies introduced improvements in this area in the past few years. Korea launched an electronic case filing system in 2010 that allows electronic document submission, registration, service notification and access to court documents (Box 10.1). Singapore introduced a new electronic litigation system in 2014. The system allows litigants to file cases online - and it enables courts to keep litigants and lawyers informed about their cases through e-mail, text alerts, and text messages; to manage hearing dates, and even to hold certain hearings by video conference.

6. Provide continuous training to judges with jurisdiction over commercial matters.

District court judges in Lahore and Karachi are generalists. They frequently rotate among different posts, leading to a scant focus on commercial matters. To counter this institutional setting, Pakistan should consider training judges in commercial law as well as in specific legal skills needed to deal with those cases, such as the preparation of decisions. If commercial courts or divisions are established, this training should be a prerequisite for any judge to be eligible for appointment to such position.

A systematic approach to training judges and court staff should be considered to improve predictability for decision-making in commercial matters. A recent study from the European Bank for Reconstruction and Development found that programmatic initial and ongoing training of judges in commercial law, as well as in specific legal skills such as the preparation of decisions can increase court predictability. Also, it leads to more efficient and effective courts. Similarly, in the United Arab Emirates, training in commercial matters has led to faster resolution times, lower appeal rates and higher-quality judgments.¹⁵⁹ Such training can also contribute to better isolating judges from improper influences. In the long term enhanced predictability of court decisions leads to more security for investors and a better business environment.

7. Strengthen efforts to promote mediation and conciliation.

Alternative Dispute Resolution (ADR) has proven a valuable pillar in enhancing access to justice, bringing rapid consent-based dispute resolution to businesses in many economies. Promoting ADR measures could

¹⁵⁹ See *Doing Business* 2019, Enforcing Contracts and Resolving Insolvency, Training, and Efficiency in the Judicial System, available at http://www.doingbusiness.org/content/dam/doingBusiness/media/Annual-Reports/English/DB19-Chapters/DB19-Enforcing_Resolving.pdf

help reduce the volume of cases at the district courts. In Pakistan, a consolidated law governs domestic commercial arbitration – the Arbitration of Act of 1940 - that substantially encompasses all its aspects.¹⁶⁰ Unfortunately, the same cannot be said for mediation and conciliation.

The *Doing Business* data show that more than half of the economies have a stand-alone consolidated law regulating mediation and conciliation practices. Pakistan should consider developing a new mediation and conciliation law which may help strengthen the efforts to implement mediation already underway in Sindh and Punjab. Besides, the government should consider incorporating financial incentives for parties to engage in mediation or conciliation - such as waiving court fees - into the new law.

ADR, along with other measures aimed at speeding up judicial proceedings and their enforcement can increase efficiency and reduce the cost of legal fees entrepreneurs have to pay for dispute resolution. Inefficient processes often result in repeated and additional appearances in court and add up to the lawyers' bill. Limiting the time attorneys spend in court (or preparing for court) will lower the cost to clients but also free up their time to serve more clients. Furthermore, if mediation is fast and can be carried out efficiently without the use of lawyers, it can become an attractive option for litigants (an option that does not carry the burden, including the psychological burden, of having to go to court).

8. Evaluate increasing the minimum amount a claim must have to trigger the original jurisdiction of the Sindh High Court.

High courts' original jurisdiction is typically reserved for very limited circumstances. For instance, the United States Supreme Court has original jurisdiction over suits between two or more states or cases involving ambassadors and other public ministers.¹⁶¹ The limitation on their original authority is grounded in practical terms, as a high court would be unable to hear many cases. Furthermore, if the number of cases to be heard increases significantly, it may detract from the error correction function high courts have.

For historical reasons, the Sindh High Court has original jurisdiction triggered by the amount of the claim set in the local constitution. Currently, the claim amount triggering the high court's original jurisdiction is set at PKR 15 million. Because claimed amounts often surpass this limit - sometimes because of plaintiffs inflating the amount claimed - the high court is flooded with complaints. Consequently, the high court is said to be much more congested and to suffer from bigger backlogs than district courts in Karachi. Delays in the high court proceedings are also much more common and extended. To remedy this situation, the Sindh High Court should consider assessing the possibility of increasing this minimum amount. Relatedly, the high court should consider tying firmly the filing fees charged for original civil jurisdiction to the claimed amount, as a way to discourage the practice of inflating them.

¹⁶⁰ It should be mentioned, though, that best practices have substantially evolved in this area since 1940.

¹⁶¹ See "Supreme Court Procedures", available at <https://www.uscourts.gov/about-federal-courts/educational-resources/about-educational-outreach/activity-resources/supreme-1>

11. Resolving Insolvency

A well-functioning insolvency framework is essential for the healthy circulation of credit - where insolvency regimes are effective, creditors are more likely to lend, both in higher volumes and at lower interest rates. A balanced insolvency system also operates as a filter that promotes economic efficiency by providing a framework for the rehabilitation of viable companies and the swift liquidation of unviable ones, thereby preserving jobs and enterprise value in the former situations and freeing up capital and assets in the latter cases to be put to better use elsewhere. By facilitating the efficient business exit and liquidation of nonviable companies, an insolvency framework supports the efficient reallocation of resources across the economy.¹⁶²

Improvements to insolvency systems require sustained and continuous efforts. In the wake of the 2008-2009 financial crisis, many countries around the world focused their attention on insolvency laws and started a reform process that led to an unprecedented number of insolvency reforms since 2010. Often, the effects of changes were not immediately evident, and only several years later, when insolvency cases under the new regimes were filed and completed, did their impact become apparent and measurable. The absence of instant results should not discourage economies from continuing to improve the insolvency framework. A good example is the Czech Republic, where a new insolvency law was adopted in 2008 and further enhanced in 2009 and 2012. By 2013, the time to complete insolvency proceedings had fallen by 4.4 years compared with 2008. Also, the recovery rate of creditors increased threefold (from 20.9 cents on the dollar in 2008 to 65.0 cents on the dollar in 2013). In 2017/18 the *Doing Business* report recorded 15 reforms making insolvency easier (Table 11.1).

Table 11.1. Reforms in Resolving Insolvency in *Doing Business 2019*

Making it easier to resolve insolvency		
Improved the likelihood of successful reorganization	Afghanistan; Djibouti; Egypt, Arab. Rep.; Kenya; Morocco; Pakistan; Rwanda; Turkey	Morocco established the possibility for the debtor to receive new financing after the commencement of insolvency proceedings and introduced corresponding priority rules.
Introduced a new restructuring procedure	Afghanistan; Egypt, Arab. Rep.; Malaysia; Pakistan	Pakistan introduced the option of reorganization for commercial entities as an alternative to previously available option of liquidation.
Strengthened creditors' rights	Afghanistan; Djibouti; Kenya; Kyrgyz Republic; Morocco; Rwanda; Sudan; Turkey	Kyrgyz Republic granted an individual creditor the right to access information about the debtor's business and financial affairs.
Improved provisions on treatment of contracts during insolvency	Afghanistan; Azerbaijan; Kenya; Kyrgyz Republic; Pakistan; Sudan	Kenya allowed for the continuation of contracts supplying essential goods and services to the debtor, giving the administrator the power to continue or disclaim contracts of the debtor.
Streamlined insolvency procedures	Belgium; Burundi	Belgium unified its insolvency legal framework and streamlined provisions related to liquidation and reorganization procedures.

Source: World Bank *Doing Business 2019*

The *Doing Business* Resolving Insolvency indicator measures the time, cost and outcome of insolvency proceedings for domestic companies as well as the strength of the legal framework applicable to the liquidation and reorganization proceedings. The rankings are based on two equally weighted indicators - the recovery rate (recorded as cents on the dollar recouped by secured creditors through reorganization, liquidation or debt collection - foreclosure or receivership - procedures) and the strength of the insolvency framework index. The recovery rate is influenced by the time, cost and outcome of resolving an insolvency case, as well as the lending rate in the country. The indicator does not deal with situations where a business owner voluntarily winds up a company, but rather where businesses become

¹⁶² See Djankov, Simeon. 2009. "Bankruptcy Regimes during Financial Distress." Mimeo, World Bank Group; Funchal, Bruno. 2008. "The Effects of the 2005 Bankruptcy Reform in Brazil." *Economics Letters*, 101: 84–86; Klapper, Leora 2011. "Saving Viable Businesses." *Viewpoint* 328, September 2011, World Bank Group; Visaria, Sujata. 2009. "Legal Reform and Loan Repayment: The Microeconomic Impact of Debt Recovery Tribunals in India." *American Economic Journal: Applied Economics*, 1(3): 59-81.

“insolvent” under one of the two definitions: (1) the business is unable to pay its debts as these become due; or (2) the business has more liabilities than assets. The strength of the insolvency framework index is based on the provisions of the insolvency law, as measured by four component indices: commencement of proceedings index, management of debtor’s assets index, reorganization proceedings index and creditor participation index. The data are based on feedback from local experts who analyze the country’s most common type of insolvency proceedings, as well as the readings of the law.

Globally, Pakistan ranks 53rd out of 190 economies and scores 59.86 percent on the Resolving Insolvency indicator. Pakistan ranks 1st out of eight economies in the South Asia region on the Resolving Insolvency indicator. Other good performing South Asian economies include Afghanistan, Nepal, and Sri Lanka.

Resolving Insolvency in Pakistan is significantly cheaper than the average of the South Asia region. In terms of case duration, Pakistan takes a similar amount of time to resolve insolvency than the regional average. Table 11.2 shows that it costs 4 percent of the value of the bankruptcy estate to settle an insolvency case in Pakistan, less than half of the cost of the average South Asia economy and four times the cost of Norway, the global best performer. In turn, it takes 2.6 years to work out an insolvency case. This duration is more than six times longer than that of Ireland, the global best performer.

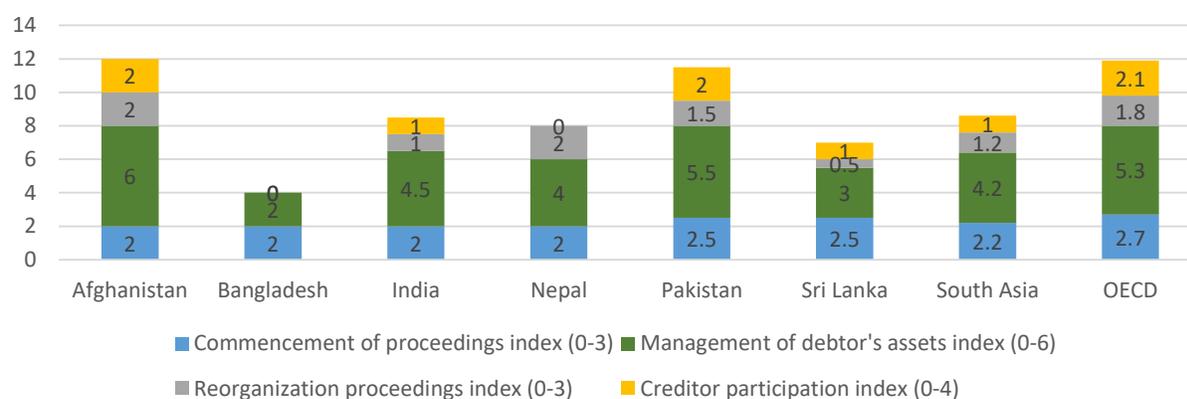
Given that it is expected that the case study would be resolved through a piecemeal sale - in the context of a foreclosure proceeding - Pakistan’s recovery rate is calculated by *Doing Business* 2019 to be 44.5 percent. This recovery rate is higher than the South Asia regional average. In turn, it is less than half of the recovery rate of Norway, the global best performer in this area.

Table 11.2. Resolving Insolvency ranking and best performers

<i>Doing Business</i> Indicator	Pakistan	South Asia Average	Regional best performer	Global best performer
Time (years)	2.6	2.6	1.5 (Maldives)	0.4 (Ireland)
Cost (percent of estate)	4.0	9.9	4.0 (India; Pakistan)	1 (Norway)
Outcome	Piecemeal sale	-	-	-
Recovery rate (cents on the dollar)	44.5	37.4	50.6 (Maldives)	93.1 (Norway)

Source: World Bank *Doing Business* 2019

Figure 11.1. Strength of insolvency framework index (0-16) in Pakistan and comparator economies



Source: World Bank *Doing Business* 2019

Generally, the legal framework for Resolving Insolvency in Pakistan provides a good foundation, scoring 11.5 out of 16 in the strength of the insolvency framework index. The insolvency legislation in Pakistan allows the economy to score well in two of the four indices, namely, the commencement of procedures' index and the management of debtor's asset index. In turn, there's room for improvement in the creditor participation's index and the reorganization proceedings' index. There's also ample room for improvement in practice, as suggested by the piecemeal sale outcome reported in Table 11.2.

Resolving Insolvency over time

In recent years, Pakistan enhanced its insolvency process through the enactment of the Corporate Rehabilitation Act. The 2018 Corporate Rehabilitation Act (the Act) is a landmark piece of legislation which introduced reorganization procedures in the country. It applies broadly to all types of business enterprises registered under the companies' legislation, provided that their debts are PKR 100 million—about USD 715,000¹⁶³ - or more. The Act provides a mechanism to allow for the continuation of the debtor's business during insolvency proceedings. It created a role for professional bankruptcy experts to act as mediators between debtors and creditors (Section 10) or to assume managerial and operational responsibility for the bankrupt enterprise during the reorganization procedure (as per Section 20).¹⁶⁴ Besides, the Act also allows for the appointment of creditors' committees - referred to as administration committees - to oversee the process (Section 26). Furthermore, it also codified post-commencement financing, which may be obtained in an unsecured or secured manner (Section 29). The Act complements the liquidation or winding-up procedures already contained in Part X of the Companies Act of 2017.¹⁶⁵

While the introduction of the Act has signified a significant improvement, opportunities exist to further strengthen the insolvency framework in Pakistan, and especially its implementation. The following sections address some of the insolvency system's shortcomings and provide short and medium-term recommendations to improve its performance.

Short-term reform recommendations

1. Enact secondary legislation to facilitate the operationalization of the Corporate Rehabilitation Act, including a regulatory framework for professional insolvency practitioners.

The Act has not yet been implemented in practice in Pakistan. Insolvency rules and regulations are explicitly permitted by the Act (Sections 40 and 41), but they haven't been taken up by the government yet. Indeed, the minister in charge of the Federal Government may create any rules necessary for carrying out the Act. Furthermore, the Securities and Exchange Commission of Pakistan (SECP) is charged with introducing the regulations prescribed under the Act. The introduction of such rules would serve to clarify practical issues of the insolvency system, such as insolvency practitioners' qualifications and licensing requirements which have an important impact on the outcome of cases. Finally, the Act authorizes the SECP to issue any directives, circulars, and guidelines as deemed necessary to operationalize the Act. Pakistan should make the creation of secondary legislation for the operationalization of the insolvency framework one of their insolvency priorities.

¹⁶³ As of January 16th, 2019.

¹⁶⁴ The Act contains several conditions which may trigger the appointment of an administrator, mostly concerned with improper management by the debtor or its agents.

¹⁶⁵ There are three ways to wind up under the Companies Act, namely, winding-up through the court, creditors' voluntary winding-up, and winding-up subject to court supervision. It should be noted that neither the Act nor the Companies Act contains language explicitly authorizing the conversion of a winding-up case into a rehabilitation one.

A common and significant aspect of insolvency regulations relates to insolvency practitioners (referred to as experts under Section 5 of the Act). In many economies, professional insolvency practitioners play a crucial role in the operation of a swift and efficient insolvency system. A rehabilitation or winding-up procedure of the sort regulated in the Act and the Companies Act 2017 is a proceeding that involves not only a legal but also substantial economic, accounting and even management components. Courts are of course needed to supervise the proceedings and make judicial decisions, but they do not have the technical expertise to, for example, restructure a struggling enterprise or run a company with the aim of maximizing the liquidation value of its assets. Therefore, many countries - such as the United Kingdom, Canada, Australia, China, Japan, Korea, Brazil, Saudi Arabia, Mexico, India, and Russia - have facilitated the development of a professional insolvency practitioner profession whose members manage the economic and operational aspects of a proceeding. Aside from their function, the defining characteristic of insolvency practitioners is that they should form a cadre of (mainly) private sector professionals - much as lawyers or chartered accountants do - with strict qualification, training, monitoring, and licensing or registration requirements specific to insolvency matters. With time, insolvency practitioners can be expected to significantly improve the efficiency of insolvency procedures, by decreasing the duration and cost of proceedings, maximizing the value of company assets, increasing the likelihood that a business will continue to operate, and raising creditors' recovery rate. All these factors reflect in the Resolving Insolvency indicator.

To play their role effectively, professional insolvency practitioners need an enabling regulatory framework that sets the following elements:

- qualification and experience requirements
- method of appointment
- legal powers and duties
- remuneration
- licensing or registration system
- monitoring, supervision, and discipline
- training and continuing education requirements
- performance and ethics standards

It is therefore vital that the SECP develops regulations for insolvency practitioners, in line with best international practices and with the provisions of Sections 5.2 and 5.3 of the Act. These regulations should encompass the whole universe of insolvency practitioners, including those covered by the Companies Act (i.e., official liquidators).¹⁶⁶

2. Create an insolvency registry where information about insolvency cases can be accessed.

The insolvency of a debtor is a common occurrence in market economies. Also, it has the potential to introduce disruptions to a well-functioning market. The problem and risks associated with the failure of a debtor must be addressed by informing present and future stakeholders. Through this mechanism, any damage that may occur can be contained, and investment decisions adopted based on adequate information. Traditionally, information about insolvent debtors was shared in newspapers, official gazettes and other similar means of communication. These mechanisms have been relatively ineffective.

Countries like Serbia, Poland, Australia, the United Kingdom, and the Netherlands, have created a system that is based on the universal access to relevant information, at no or little cost, in an efficient and streamlined manner. Through an insolvency registry, stakeholders learn of the insolvency of debtors, and

¹⁶⁶ See section 315 of the Companies Act. The SECP is charged with maintaining a panel of persons from whom the court shall appoint an official liquidator.

the developments of their proceedings through an easily accessible, up to date online system. The information contained in such registries saves transaction costs and facilitates adequate decision-making by creditors and possible investors. Importantly, these registries merely give notice of certain decisions and the presentation of specific documents, without being constitutive of any rights.

Electronic insolvency registries are a good international practice currently being implemented in several countries. Pakistan should consider moving in this direction to improve the information available on insolvent debtors.

Medium and long-term reform recommendations

3. Introduce special simplified procedures for Small and Medium Enterprises (SMEs) insolvency.

Small and Medium Enterprises (SMEs) tend to represent a particularly significant segment of a country's corporate sector. They often are the largest providers and creators of jobs in an economy and often have low survival rates over their first five years of existence. As it relates to insolvency, SMEs face a number of legal, financial, and regulatory challenges that differ from those of larger corporates. For instance, the impact of a rigid and costly insolvency regime is more significant for SMEs than larger companies. Furthermore, SMEs face a higher fixed cost to loan restructuring, and often lack alternative sources of financing (Box 11.1).

As mentioned above, restructuring proceedings are limited in Pakistan to debtors owing PKR 100 million or more (Section 6.c of the Act). That effectively impedes the use of restructuring procedures by many of the smaller SMEs, leaving liquidation as the only option those companies have available. Pakistan should look to remedy this situation that negatively affects the uptake of reorganization proceedings in the country, and better outcomes in liquidation. SMEs, because of the scale of their operations often do not require full-fledged bankruptcy proceedings. The introduction of procedures directly catered to SMEs - as recently done by Saudi Arabia and South Korea - would be an essential step in this direction. The government should consider developing simplified restructuring and liquidation procedures specifically geared to address the many challenges SMEs face.

Box 11.1 The Importance of Insolvency Law for MSMEs.

Insolvency regimes that are responsive to the needs of MSMEs are particularly important. Insolvency law is broadly recognized as an essential tool in a well-functioning economic framework. A balance of mechanisms that allow for timely and effective liquidation, but also a "fresh start" for entrepreneurs and rehabilitation of viable businesses tend to enhance creditor recoveries and confidence. In turn, they can stimulate more significant volumes of lending, at more extended maturity periods, at lower cost and lower levels of collateral. Such mechanisms can also offer a practical framework for the creation of new business activity. Credible restructuring schemes can ensure that businesses with viable going-forward business plans can survive, in turn preserving jobs, supply contracts, customer goodwill, and economic stability more generally.

From a macro-financial perspective, effective insolvency laws enable financial institutions to resolve problem assets more efficaciously, thereby freeing up provisioning resources, strengthening investors' perception of financial sector stability, pro tanto improving banks' ability to lend, and thus mainly benefitting small and medium enterprises in many economies where such businesses are particularly dependent on bank funding. The World Bank has observed that effective insolvency systems enhance predictability and thus lender confidence in loan recovery on default, which encourages more lending and leads to financial inclusion for more businesses. Of significance for MSMEs globally are both the formal legal rules and informal societal rules and practice norms that affect entrepreneurs, including the design of bankruptcy laws, the structure of capital markets, and the perception of stigma related to personal responsibility. Cost-effective insolvency proceedings can encourage inefficient firms to exit, encourage greater entrepreneurial activity and new firm creation, and can result in higher returns to creditors.

Timely resolution of financial distress can reduce uncertainty for entrepreneurs, creditors, and management, and improve asset value and transparency. A well-functioning MSME insolvency regime can heighten the salience of the downside risk of a venture, in turn increasing the number and variety of people pursuing entrepreneurial activities. It can benefit lenders because of the certainty in recovery rules, in turn increasing confidence in lending. The efforts of organizations such as UNCITRAL and the World Bank have contributed significantly to creating model insolvency legislation, best practice guidance, and to help governments implement reforms. The effectiveness of insolvency laws nevertheless varies among countries around the world. According to a survey on debt enforcement in 88 countries, referenced by a World Bank Research Paper, bankruptcy procedures are time-consuming, costly and inefficient in being able to preserve the business as a going concern. In only 36 percent of countries is the business preserved as a going concern; and an average of 48 percent of the business's value is lost in debt enforcement.¹⁶⁷

The World Bank Group *Doing Business* report 2014 found that among 38 selected indicators/measures of the regulatory and institutional environment, the secured creditor recovery rate in distress scenarios was the single most valuable measure.¹⁶⁸ The World Bank also examined MSMEs that had defaulted on bank loans and found that differences in the strength of creditor rights in bankruptcy in the different jurisdictions had an impact on lending terms, particularly those used by bank creditors; and that legislative reform regarding liquidation led to a decrease in interest rates, although reorganization reform had the opposite effect. Moreover, a research study for the International Monetary Fund reports that six years since the global financial crisis, the problems of high levels of corporate debt and non-performing loans ("NPLs") persist in several European countries. It found that SMEs, in general, are more leveraged and reliant on bank financing than large firms and have significantly higher non-performing loan ("NPL") ratios. It also found that given the large number of SMEs, their small size and heavy reliance on collateral, SME loan restructuring is more costly and riskier for large firms than for banks, and current frameworks are ill-suited for SMEs, both in the ways, they limit restructuring options and how they prevent speedy liquidation and exit.

Source: World Bank Group Report on the Treatment of MSME Insolvency, 2017

4. Extend the possibility of granting post-commencement financing to non-administration proceedings.

A struggling company that may yet be viable in the long run might need additional financing (also called "post-commencement financing") to pay its employees, suppliers and operating expenses while it is being rehabilitated or prepared for sale as a going concern. As a result, it is essential not only that insolvency laws allow an insolvent business to obtain additional financing, but also that lenders who provide such funding are granted priority over other creditors in the distribution of assets. Without such a provision, lenders would be unwilling to extend credit to an insolvent business, and this, in turn, would undermine the success of rehabilitation or a going-concern liquidation.

While Section 29 of the Act allows the administrator to obtain new financing after the initiation of restructuring proceedings, the provision has shortcomings. The most relevant limitation refers to the architecture of the Act. Section 29 is part of Chapter III - Administration of Debtor - which is a chapter designed to regulate those situations where the management of the business affairs is taken away from the debtor. Furthermore, obtaining post-petition financing is only permissible to the extent allowed by the administration committee which, in turn, is just formed under Chapter III proceedings (Section 26). Hence, standard debtor-in-possession rehabilitation procedures do not afford the possibility to access post-commencement financing. International good practice in this area involves allowing for post-commencement financing in all rehabilitation procedures, not just when an administrator is appointed. Such

¹⁶⁷ Elena Cirmizi, Leora Klapper, and Mahesh Uttamchandani. 2010. "The Challenges of Bankruptcy Reform." Policy Research Working Paper 5448, World Bank, Development Research Group Finance and Private Sector Development Team, Washington, DC, 6

¹⁶⁸ Ibid, 4

practices balance the prospect of preserving going concern value against the risk of interfering with the rights of pre-existing creditors. Following good international practices, the Act should be amended to extend the option of post-commencement financing to all rehabilitation procedures.¹⁶⁹

5. Revise the Corporate Rehabilitation Act to enhance creditors' rights in insolvency proceedings.

Creditors' rights in insolvency are vital as they determine their ability to monitor and actively participate in the proceedings effectively.¹⁷⁰ It has been claimed that "unless creditors are involved in the insolvency process the law will seem irrelevant."¹⁷¹ A lack of meaningful participation can affect creditors' confidence in the system, making them less cooperative (an essential element of successful reorganization procedures) and more litigious, thus unnecessarily prolonging the proceedings. Studies have shown that effective reforms of creditor rights are associated with lower costs of credit, increased access to credit, improved creditor recovery, and strengthened job preservation.¹⁷² Further, if creditors are not protected or allowed to participate in insolvency proceedings, they will have less of an incentive to lend in the future.¹⁷³ As a result, credit markets may become less developed.

In its current form, the Act excludes creditors from participating in important decisions during insolvency proceedings. Among the first and most important decisions made after insolvency proceedings begin is the appointment of an insolvency representative. In the case of the Act, the insolvency representatives are "mediators" (Section 10) or "administrators" (Section 20). Mediators and administrators have vital roles to play in the proceedings, such as determining the value of the claims and interests against the debtor. Sections 10 and 20 of the Act limit creditors' participation in the process of choosing these insolvency representatives who are appointed by the court. Selection by courts - which is expected to be based on a lottery basis - may result in sub-optimal outcomes compared to selection on the basis of relevant expertise.

Besides, the Act does not explicitly provide for the right of a creditor to request information from the insolvency representative (either mediator or administrator). It is the mediator (Section 10) or the administrator (Section 23) themselves who report on the information the Act deems *a priori* relevant. It is an important shortcoming as creditors are charged, through the voting mechanism, with deciding the fate of the reorganization proceedings. With no right to obtain information at their initiative, the likelihood of outcome errors increases. Best practices suggest that individual creditors should have the right to request information about the financial state of the debtor continuously throughout the insolvency proceedings without significant impediments. The most common way to gain access to such information is through a request to the insolvency representative who manages the business affairs of the debtor.

As a result, the Act should be amended to raise the level of information at the disposal of creditors and to increase the degree of creditor participation in key decisions of the insolvency proceedings. If the Pakistani insolvency system were to follow this path, it would move closer to maximizing the value of the assets in

¹⁶⁹ Please note that the Companies Act doesn't include provisions on post-commencement financing for winding-up companies either. Hence, amendments geared to preserve going-concern value should be considered there too.

¹⁷⁰ This is recognized by both the World Bank's Principles for Effective Insolvency and Creditor/Debtor Regimes and UNCITRAL's Legislative Guide on Insolvency Law.

¹⁷¹ Asian Development Bank (2000), "Insolvency Law Reforms in the Asian and Pacific Region: Report of the Office of the General Counsel on TA 5795-Reg: Insolvency Law Reforms", Law and Policy Reform at the Asian Development Bank, Edition, Vol. 1, April 2000, pp. 10-86. (R.W. Harmer prepared the report).

¹⁷² Armour, John; Menezes, Antonia; Uttamchandani, Mahesh; and Van Zweiten, Kristen. "How Creditor Rights Affect Debt Finance" in Research Handbook on Secured Financing in Commercial Transactions (Dahan, F., ed.), 2015, Elgar Publishing.4. Simeon Djankov, "Bankruptcy Regimes during Financial Distress," World Bank, Washington, DC, 2009.

¹⁷³ Claessens, Stijn, and Leora Klapper. 2003. "Bankruptcy around the World: Explanations of Its Relative Use." *Policy Research Working Paper 2865, World Bank, Washington, DC.*

reorganization or liquidation, while boosting the score on the strength of the insolvency framework index. Several economies have recently moved in this direction. For instance, Azerbaijan and Grenada reformed their insolvency laws in 2017 to provide creditors with the right to request information on the financial affairs of the debtor.

6. Extend the power to assume or reject executory contracts to debtor-in-possession rehabilitation and liquidation procedures.

The power to enforce, modify or terminate existing contracts can be a crucial way to ensure the success of insolvency proceedings. For example, suppliers whose contracts are essential to the functioning of business might otherwise decide to terminate their relationship with a company that is the subject of a rehabilitation proceeding, or that needs to continue operations in anticipation of a going-concern sale. Similarly, it may be necessary to reject certain contracts whose completion would be detrimental to the survival of business - although the termination could give rise to an unsecured claim in the form of a breach of contract action.

Several countries recognize the importance of assuming or rejecting executory contracts. For instance, the Law on Economic Insolvency of the Republic of Belarus allows the insolvency administrator to decide whether to continue or terminate the debtor's contracts not yet fully executed. The administrator may choose to end the debtor's contracts only in specific cases, such as when the performance of the contract will lead to significant damages to the debtor or if the performance of the contract is more burdensome than similar contracts concluded in comparable circumstances.

The Pakistan Act also recognizes the importance of these type of provisions under Section 30 giving the administrator the power to assume or reject executory contracts and unexpired leases, subject to court approval.¹⁷⁴ Such provisions facilitate the continuation of the debtor's business and improve chances of successful reorganization. However, this provision is only applicable to administration and not to debtor-in-possession rehabilitation, where no administrator is appointed. Furthermore, the rule does not cover liquidations. In cases of liquidation, the continuation of debtor's business may result in a higher sale price, as the business is worth more than its parts. Therefore, it is advisable to extend the provisions under Section 30 to cover other insolvency procedures already existing in the legal regime.

7. Incorporate a pre-packaged restructuring option to the Corporate Rehabilitation Act to enable the fast and swift court processing of out of court restructurings.

To combine the advantages of out of court workouts with the obligatory force of an agreement or plan obtained through a formal reorganization proceeding some countries have been gradually implementing hybrid procedures. This combination makes such agreements binding on all creditors, once the legally defined majority of creditors has approved it and confirmed by the competent court. These procedures are commonly known as pre-packaged or expedited reorganization procedures (as opposed to the traditional "formal" or "full" reorganization proceeding). A pre-packaged system generally permits the expedited court processing of an agreement made out of court, allowing for the introduction of much sought-after speed to the process. The absence of pre-packaged restructurings deprives creditors of tools to work around coordination problems as they engage in out of court restructuring, negatively affecting resolution prospects.

The Pakistani insolvency system does not regulate abbreviated or expedited procedures, designed to quickly process an informal, pre-negotiated agreement and convert it in a binding plan for all creditors. The World

¹⁷⁴ It should be noted that Section 30 does not contain any guidance for the court to decide when to accept the proposed assumption or rejection of executory contracts. The SECP should consider including this issue on the regulations to be enacted.

Bank Principles for Effective Insolvency and Creditor Rights recognize expedited restructurings as best international practice: “Where the informal process relies on a formal reorganization, the formal proceeding should be able to quickly process the informal, pre-negotiated agreement.”¹⁷⁵ The UNCITRAL Legislative Guide on Insolvency Law also has a favorable view on this type of procedure, drawing up a considerable number of recommendations for its legislative establishment. An amendment to the Act incorporating the institution of pre-packaged restructurings would improve the restructuring prospects of debtor companies and increase the number of cases which could benefit from the advantages provided by the insolvency system.

8. Improve the judicial capacity to handle insolvency cases.

Many of the shortcomings of the insolvency systems around the world are institutional. Courts administer insolvency cases and are the principal institution through which debtors and creditors’ rights are protected. For implementing any new insolvency law, the courts need to develop the knowledge and capacity to administer it adequately. The favored approach according to international best practice is to allow some judges to specialize in commercial law and - whenever possible - in insolvency, to develop experience and competence in this complex area of law, and to foster consistency of the decisions.

The current practice in Pakistan is for district court judges to handle insolvency cases. District court judges in Pakistan typically rotate between different posts having different subject matter jurisdiction through the years. This fact severely limits judges’ ability to specialize in a given area of law. For a highly specialized subject like insolvency, this is problematic - a view shared by different stakeholders interviewed in Lahore and Karachi. Building capacity through judicial pieces of training would be of particular importance given the recent enactment of the Act, and the fact that it is yet to be tested in courts.

To increase their capacity to deal with insolvency cases, judges who preside over them should receive initial training on insolvency matters. Additionally, every time legislative amendments are passed - as with the recent Act - these judges should receive extensive training on its application. Afterward, continued training is recommended to ensure that judges learn from each other’s experience and keep atop the latest regulatory developments. Evidence shows that economies that have introduced training programs for judges tend to perform better in the *Doing Business* Resolving Insolvency indicator.¹⁷⁶

Finally, judicial capacity refers not only to judges but also to the administrative framework within the court system. The government should ensure that courts are staffed with an appropriate number of judges and administrative staff to guarantee the timeliness of insolvency proceedings.¹⁷⁷ Also, automation of case management and court operations is a priority for many economies, as these tools help speed up the judicial process and increase predictability and transparency.

¹⁷⁵ Principle B4.2 – World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes

¹⁷⁶ See *Doing Business* 2019, Training for Reform, available at http://www.worldbank.org/content/dam/doingBusiness/media/Annual-Reports/English/DB2019-report_web-version.pdf

¹⁷⁷ Pakistan should not be oblivious to the pernicious effects of understaffing or overworking certain actors within the insolvency procedures. This is important for insolvency also, as one interviewee mentioned that liquidators sometimes preside over more than 80 liquidation cases at the same time.

Acknowledgments

This memorandum was prepared by Sagita Muco (Senior Private Sector Specialist - Macro, Trade and Investment, World Bank Group), Jean Arlet (Private Sector Specialist - Macro, Trade and Investment, World Bank Group), Sergio Muro (Consultant - Finance, Competitiveness and Innovation, World Bank Group), and Lucas Menut (Consultant – Macro, Trade and Investment) under the general supervision of Sylvia Solf (Global Product Specialist - Macro, Trade and Investment, World Bank Group) and Catherine Masinde (Manager - Macro, Trade and Investment, World Bank Group).

Valuable contributions were received from Amjad Bashir (GFCS1), Herve Kaddoura (DEC), Daniyal Mansur (GFCS1), William John Gain (GMTRI), Reshma Aftab (GMTIS), Satya Prasad Sahu (GMTRI), Anjum Ahmad (GEE06), Mary Lisbeth Gonzales (GSULN), Khawar Saeed Ansari (IFC CEGME), Clelia Rontoyanni (GGOAP), Irum Touqeer (GGOEP), Joey Raymond Ghaleb (GGOAP), Nina Pavlova Mocheva (FCI), Fred Meunier (DEC), Nadia Novik (DEC), Marie-Lily Delion (DEC), Jayashree Srinivasan (DEC), Maria Antonia Quesada Gomez (DEC), Maksym Iavorskyi (DEC), Edgar Chavez (DEC), Joanna Nasr (DEC), Marilyne Florence Mafoboue Youbi (DEC), Erick Tjong (DEC), Viktorya Ereshchenko (DEC), Nadine Abi Chakra (DEC), Joseph Antoine Lemoine (DEC).

The team is grateful for the guidance from the Pakistan Board of Investment as well as the Planning and Development Departments in Lahore and Karachi for the information received from officials at the federal and state level as well as private professionals during the preparation of this memorandum.

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