Enhancing the Business Environment

For developing countries like Pakistan, where small and medium-size enterprises make up a large share of the economy, the quality of the business environment is a critical policy area for governments to drive economic growth, create jobs, and encourage private sector competition. Subnational analysis of the business environment finds that the regulatory and administrative burden of complying with business regulations varies considerably across cities. The policy focus can therefore benefit from designing, implementing, and analyzing reforms through a subnational lens to enhance that environment. At the provincial and district levels, such an approach can maximize the impacts of reforms; at the federal level, it can monitor, compare, and benchmark subnational performance.

A country’s regulatory environment affects businesses at almost all stages of the business life cycle. Business registration regulations apply when entrepreneurs decide to start an enterprise. Tax and customs regulations apply when firms produce and export goods. Contract enforcement laws apply in almost all areas of business operations. Business regulations, when properly designed and implemented, can be a major catalyst for establishing new businesses and expanding existing ones. Conversely, a regulatory environment that impedes businesses creates more incentives for entrepreneurs to seek loopholes and offer bribes—and thus breeds corrupt economic practices (The Economist 2012). In the private sector, such practices have broader implications on entrepreneurship and innovation; in the public sector, on administrative efficiency and service delivery.

The business regulatory environment is particularly relevant for small and medium-size enterprises (SMEs)—the key drivers of competition, economic growth, and job creation, especially in developing countries (World Bank 2013). Pakistan is no exception: SMEs are a key element of its economic landscape, and up to 99 percent of establishments employ 1–20 workers (Pakistan Bureau of Statistics 2005). Collectively, SMEs in Pakistan provide about 78 percent of nonagricultural employment, contribute almost 40 percent of GDP, and account for some 30 percent of manufacturing exports (Jamil Afaqi and Seth 2009).

Given the importance of SMEs in the private sector, it is important to understand the quality of the business environment, identify opportunities to make reforms with impact, and better position the economy to be more competitive in serving the domestic and external markets. This note highlights the quality of Pakistan’s business environment, as measured by the World Bank’s national and subnational Doing Business indicators. Reform recommendations pinpoint the key areas where policy changes could have the most impact. And the benchmarking of regulations across the globe shows how Pakistan compares with its neighbors and global competitors. The note discusses the impacts of business regulations across Pakistan and suggests national, provincial, and local reforms in six key aspects.
of doing business: starting a business, dealing with construction permits, trading across borders, registering property, paying taxes, and enforcing contracts.

The note uses international and subnational data—the former to highlight how the country compares with the rest of the world on national business environment indicators and reforms, and the latter to highlight how Pakistan’s cities compare with each other on good practice and potential reform programs. But why emphasize national and subnational reforms? Some reforms fall exclusively under the federal government’s purview (such as registering corporations), while others are dealt with exclusively by the provinces (such as registering sole proprietorships). And for federal regulations, provincial and local implementation is critical to their effectiveness. National and subnational reforms are complementary and can have profound provincial impacts, so this note highlights the reform recommendations at all three levels of government—federal, provincial, and district—all of which affect Pakistan’s business environment.

The international comparisons draw from the Doing Business 2013 rankings, and the subnational comparisons are from the Doing Business in Pakistan 2010 report, because subnational reports are produced only at the request of a client government. In 2012, a review of three of the subnational indicators (starting a business, trading across borders, and dealing with construction permits) showed that there had been no changes or reforms since the 2010 report. Today, Pakistan is ranked 107 of 185 economies on the overall ease of doing business rankings, down from 76 of 181 in 2008 (Figure 1). Figure 2 shows Pakistan’s 2013 global rankings on each Doing Business indicator.

A review of global comparators masks considerable variation across Pakistan’s business environments. This variation highlights the importance of subnational laws and regulations as well as the consistent implementation of those at national level. More important, a review of that variation in Pakistan’s provinces and cities can highlight the country’s good practices, the opportunities for peer-to-peer or government-to-government learning, and the potential for committed provincial and local governments to create world-class, competitive business environments in their areas.

Local, district, and provincial reforms are important in many areas of the regulatory environment, though some reforms can of course take place only at the national level, as prescribed by the constitution or relevant legal framework. The 18th Amendment to the constitution, approved in 2010, devolved several powers, rights, and responsibilities to provincial governments and, in turn, to district governments. District governments are closer to the impacts of business regulations and are potentially better suited to design local
reforms and to advocate for—and contribute to—federal reforms.

Several recent enhancements in the regulatory environment focus on implementing current reforms more effectively instead of attempting to introduce new ones. Local reforms allow considerable peer-learning opportunities among districts. Several districts have better approaches to business regulations and more efficient implementation processes than others. Local reform managers can learn from successful practices in other districts to expedite reforms in theirs.

No single city does well on all indicators, and best practices vary by city (Table 1). It is therefore enough to start the reform process by introducing measures that have succeeded in other cities. In fact, Pakistani cities have a lot to gain from adopting the best regulations and practices that are working elsewhere in the country. A hypothetical city, “Pakistana,” adopting all the best practices identified in Doing Business in Pakistan 2010 would have ranked 69 of 183 economies—16 places ahead of the country’s global position in Doing Business 2010.

<table>
<thead>
<tr>
<th>City and province</th>
<th>Ease of doing business</th>
<th>Starting a business</th>
<th>Dealing with construction permits</th>
<th>Registering property</th>
<th>Paying taxes</th>
<th>Trading across borders</th>
<th>Enforcing contracts</th>
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<tbody>
<tr>
<td>Faisalabad, Punjab</td>
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<td>Multan, Punjab</td>
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<td>Lahore, Punjab</td>
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<td>Islamabad, Islamabad Capital Territory</td>
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<td>Sheikhupura, Punjab</td>
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<td>Gujarwala, Punjab</td>
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<td>Sukkur, Sindh</td>
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<td>Peshawar, Khyber Pakhtunkhwa</td>
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<td>Karachi, Sindh</td>
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<tr>
<td>Rawalpindi, Punjab</td>
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<tr>
<td>Sialkot, Punjab</td>
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<td>Quetta, Balochistan</td>
<td>12</td>
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<tr>
<td>Hyderabad, Sindh</td>
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Note: The ease of doing business is calculated as the ranking on the simple average of city percentile rankings on each of the six topics. The ranking on each topic is the simple average of the percentile rankings on its component indicators.

Main Sectoral Issues

Business regulations for paying taxes

Several studies—for example, Bruhn (2011)—have found that lowering corporate tax rates can increase investment, reduce tax evasion by formal firms, promote the creation of formal firms, and ultimately raise sales and GDP. Where lowering tax rates might not be viable (based on the tax regime’s objectives), reducing administrative burdens and compliance costs can also lead to more formal firms and higher sales.

The administrative burden of paying taxes is far higher in Pakistan than in most South Asian economies (although Pakistan’s total tax rate of 35 percent is lower than the South Asian average of 40 percent). This helps explain why Pakistan’s global ranking on the paying taxes indicator is 162 of 185 economies—its second lowest for the Doing Business indicators, after getting  electricity—against a much higher median ranking for South Asian economies of 106. Entrepreneurs have to make about 47 payments, which require almost 560 hours annually on filing, preparing, and paying taxes. By contrast, the South Asian average is about 30 payments, requiring about 311 hours. Just four payments (12 hours) are required in the United Arab Emirates, the best global performer (World Bank 2013).

Historically, most taxes in Pakistan have been imposed by the federal government, leaving very few local variations. But some provincial taxes contribute to differences in businesses’ regulatory burden. Entrepreneurs spend the same amount of time on tax payments (around 560 hours) in most cities (World Bank 2010). The major difference is in Islamabad: with no social security contributions, it is less cumbersome to pay taxes there (35 payments) than in Balochistan, Khyber Pakhtunkhwa, Punjab, and Sindh (47 payments; Figure 3). Islamabad’s total tax rate is also the lowest, at about 26 percent, against nearly 32 percent elsewhere.

Business regulations for enforcing contracts

Pakistani businesses identified courts as one of the top 10 constraints to firms’ investment, and as important as political instability and access to finance in 2007, according to the World Bank’s Enterprise Surveys. Apart from Bhutan and Maldives, South Asian economies are ranked fairly low on the enforcing contracts indicator. South Asia’s median rank is 146, its lowest for any of the 10 Doing Business indicators measured. Frequent case backlogs, long processing times, and high costs are common in the regulatory environment. Pakistan (ranked 155) is ahead of other large South Asian economies—such as India (184) and Bangladesh (182)—but still has considerable potential for improving, through both its current and future reforms.

Resolving commercial disputes through Pakistan’s courts is regulated mainly by a single federal law, the
Civil Procedure Code 1908. It takes 47 procedural steps to enforce a contract, irrespective of the court’s location. However, the time taken and cost incurred for these procedural steps varies widely (Figure 4). In Faisalabad, the process takes 730 days; in Peshawar, 2,190—three times as long. Costs are lowest in Sukkur, at about 21 percent of the cost of claims, and highest in Lahore, at close to 43 percent.

Some cities have introduced alternative dispute resolution mechanisms to expedite contract enforcement. They seem to have worked: according to an impact evaluation study in 2010, the number of pending court cases fell after such mechanisms were introduced for tax appeals (Groppe 2010).

Business regulations for registering property

Burdensome and costly regulations for registering property can dissuade business owners from obtaining valid property titles. Apart from direct risks of fraud and eviction are other disadvantages, such as the inability to use property as collateral for financing. In countries with more secure property rights, firms can better allocate resources, better protect returns on different types of assets, and thus grow faster (Claessens and Laeven 2003). In Pakistan, registering property takes six procedures and 50 days and costs about 8 percent of per capita income, reflecting Pakistan’s rank of 126 of 185 economies.

Although all 13 cities analyzed require these six procedures, the costs and time to register property vary widely. Quetta requires the most days (52) and has the steepest costs (11 percent of the property value); Lahore requires the fewest days (30), and Islamabad the lowest costs (7 percent; Figure 5). Time varies mainly by differences in administrative efficiency across the revenue offices issuing the proof of ownership and transferring the property title. Local cost varies typically by different stamp-duty rates, which are set at the provincial level.1

Property registration is still manual in most cities, but Lahore and Sialkot have implemented reforms to computerize their land-record and deed-registration systems. Doing Business in Pakistan 2010 highlighted two computerization projects, called Land Record Management Information System and Participatory Information System, in selected pilot locations in Punjab and Balochistan. Lahore, as seen above, had the fastest processing time for property registration and Islamabad the lowest cost in Doing Business in Pakistan 2010, both far better than Karachi, which determines Pakistan’s global ranking.2 In fact, processing time in Lahore and registration cost in Islamabad in 2010 were better than Doing Business 2013 estimates for Karachi three years later.

Business regulations for construction permits

Construction permits are an important indicator of a country’s business environment—for two main
reasons. First, the industry often accounts for a sizable share of the economy—in Pakistan roughly 2 percent and employing nearly 7 percent of the labor force (Government of Pakistan 2012). Second, construction regulations help ensure the safety standards for building projects that protect the public while making the permitting process efficient, transparent, and affordable. Doing Business 2013 ranked Pakistan 105 on the dealing with construction permits indicator, slightly better than the South Asian median rank of 109. However, the data measure regulatory impacts in Karachi, the country’s largest business city but among the weaker city performers. As licenses for site development, building permits, and utility connections are governed locally, time, costs, and the number of procedures vary widely (Figure 6).

The number of steps to build a warehouse and obtain utility connections ranges from 11 in Multan, Lahore, and Faisalabad to 15 in Sialkot. The time required, however, varies far more: obtaining all approvals takes 124 days in Peshawar but 223 days in Karachi—almost twice as long. Similarly, the costs are about 422 percent of per capita income in Multan but close to twice as much in Islamabad (798 percent).

For many cities, Doing Business in Pakistan 2010 highlighted provincial and municipal reforms on construction permits that introduced good practices.
Over 2006–09, development authorities and town municipal administrations in Lahore, Faisalabad, and Sialkot adopted uniform building and zoning regulations, such as those already in Multan, Rawalpindi, and Gujranwala. Consequently, the time to obtain a building permit fell 22 days in Sialkot and 15 in Lahore. Over the same period, a pilot program to computerize deed registration in Sialkot cut registration time from 13 days to 6, and computerized land records in Lahore cut the time to register property from 37 days to 30, making it the fastest process among the cities covered in Doing Business in Pakistan 2010.

Multan is another example that demonstrates Pakistan’s potential to compete globally on many Doing Business indicators. The country’s best performer, it adopted uniform building and zoning regulations, specifying processes and documentation requirements. As a result, it would have ranked as high as 56 on the 2010 global rankings, ahead of developed economies like Australia (62), Norway (65), and Italy (85). The variation in time, costs, and number of procedures across Pakistan’s cities offers huge learning opportunities to replicate reforms and improve regulatory efficiency.

Business regulations for starting a business

Reforms making it easier to start a formal business are associated with 5–11 percent increases in the number of newly registered firms and 2–3 percent increases in employment (Motta, Oviedo, and Santini 2010). Such reforms can also improve factor productivity, investment rates, and value added per worker (World Bank 2013). If Pakistan is to continue improving competitiveness, easing business entry will be important. On the starting a business indicator, it ranks 98 globally, close to the South Asian median of 95. And its startup cost of about 10 percent of per capita income is far lower than the South Asian median (about 21 percent). However, its time and number of procedures to register a business are among the region’s highest.

Pakistan’s business registration system is highly centralised, meaning that entrepreneurs have to go through the same 10 procedures across the country. Yet there are differences in the time and costs incurred (Figure 7), due to varying efficiency of local branches and variations in use and availability of online or automated “e-services.” Business startup time varied from 16 days in Islamabad to 24 days in Gujranwala, explained mostly by separate postincorporation registrations for taxes and social contributions. Costs varied from about 13 percent of per capita income in Islamabad to more than 26 percent in Sialkot, stemming generally from differences in incorporation fees for online and offline submissions.

At the subnational level, Doing Business in Pakistan 2010 noted that reforms in the regulatory
environment had made it easier to do business in all major cities for which data were collected previously for Doing Business in South Asia 2007.\(^3\)

The introduction of e-Services, for example, in 2008 reduced the time needed to register a company with the Securities and Exchange Commission of Pakistan by one day to two days in Faisalabad, Lahore, and Peshawar (Box 1). The fees for online business registration were set at half the in-person registration. Karachi reduced the time to import by half over 2006–09 after an electronic data interchange system was introduced. At the provincial level, Punjab cut four days from the business startup process by delegating registration with the Employees Social Security Institution to local districts.

*Entrepreneurs are expected to benefit from the reforms under way.* Coupled with comparatively low startup costs, Pakistan’s regulatory environment for business registration is heading in the right direction. In its next steps, the key reform for Pakistan to leapfrog other countries toward global best performers like New Zealand is a one-stop shop for entrepreneurs (one that fully integrates all business registration and postincorporation procedures on a single platform) to incorporate their business. To develop such an entity, the Economic Reforms Unit of the Ministry of Finance prompted the creation of a working group of officials from the Securities and Exchange Commission of Pakistan, the Federal Board of Revenue, and the Employees’ Old-Age Benefits Institution.

**Business regulations for trading across borders**

Doing Business 2013 marks out Pakistan among the economies that have global good practices in the trading across borders indicator, such as risk-based inspections, electronic submission and processing, and an electronic window to government agencies. On this indicator, Pakistan ranks 85, much higher than the South Asian median, at 133. The costs to import and export in Pakistan are only about 41 percent of the South Asian average.

*Still, the positive impacts of these good practices vary subnationally.* Even though reforms at the ports can help trading businesses across Pakistan, recent data suggest that subnational reforms, such as inland clearance facilities and improved inland transport, can reduce trade costs for cities other than Karachi. Moreover, the cost of trading across borders shows marked differences, particularly due to a poorly mapped trade logistics process and weak inland transport infrastructure. Table 2 illustrates how business regulations affect documentation requirements in Pakistan, as well as the time and cost of importing and exporting a standard container. While time and documentation vary little across cities, inland transportation and relative distance to and from the port of reference (Karachi Port or Port Qasim) are the determining factors in widely dispersed costs.

**Policy Recommendations**

**General recommendations**

*Engage all levels of government in a holistic reform agenda*

The Pakistani government has long recognized the importance of smart regulations. The country became one of the top global reformers in Doing Business 2006: Creating Jobs by introducing reforms in starting a business, registering property, protecting investors, and trading across borders. It has since introduced major regulatory reforms to make it easier for firms to start up and operate in at least five areas of doing business.

<table>
<thead>
<tr>
<th>Box 1 Ongoing Regulatory Reforms to Facilitate Business Registration</th>
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<tbody>
<tr>
<td>Since the Securities and Exchange Commission of Pakistan introduced e-Services in September 2008, the business registration process has become easier—procedures can be completed online; faster—companies can be incorporated in as little as two days; and cheaper—the fees for online registration are about half that of in-person registration. In February 2012, the commission introduced fast-track registration services, which enables same-day incorporation.</td>
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</tbody>
</table>
The comparisons among cities within a large country—such as Pakistan—are even stronger drivers for reform than global comparisons, and they promote peer-to-peer learning. The combination of an intense engagement strategy with subnational clients alongside provincial and national governments is important for creating ownership at all levels of government, which is crucial to enable space for reform.

Learn from subnational peers

Pakistan’s cities can learn from each other and adopt good practices that are already working in the country. As noted in Doing Business in Pakistan 2010, if a hypothetical city in Pakistan were to adopt all the best practices already existing in the six areas of business regulations covered by the report, it would rank 16 places ahead of the country’s global position in Doing Business 2010. Differences across the country’s cities can guide policy makers in areas where improvements are possible, provide for cities to learn from each other, and foster the adoption of good practices already seen in Pakistan.

Indicator-specific recommendations

Reform recommendations for specific areas of the regulatory environment build on the pillars of multilayered engagement and peer-to-peer learning. For some regulations, such as business registration, the onus of reforms falls on the federal government. For others, such as construction permits and property registration, reforms are handled by local districts. In paying taxes, trading across borders, and enforcing contracts, the reform process requires coordination among federal, provincial, and local district governments. In all cases, however, the local district government is a critical stakeholder for three reasons. It can inform policy making and the design of reforms. It is responsible for their implementation. And it can monitor and evaluate their subnational impacts. The following recommendations aim to cut the time, costs, documents, and number of procedures required for each area.

Paying taxes

The administrative burden and compliance costs of preparing, filing, and paying taxes are particularly heavy for entrepreneurs who run SMEs. Even where tax rates are low, the indirect costs of compliance can encourage tax evasion or deter smaller firms from entering the formal sector. The following proposed measures would reduce the administrative burden of tax regulations, address the uncertainty of tax rates, and facilitate tax payments:

- Simplify the tax system and broaden the tax base by eliminating exemptions and
preferential treatments that erode fiscal revenues.

- Improve audit capacity through risk-based audit systems.
- Provide incentives for local governments to develop their local tax bases.
- Expand electronic filing and payment systems to reduce the transaction costs of paying taxes.
- Focus on sequencing and communicating reforms—engage stakeholders, reach out to businesses, and bolster public support.

**Enforcing contracts**

Globally, increasing the specialization of judges, divisions, or courts in commercial cases has been a common feature of reforms to improve court efficiency in recent years. Many reforms have also been aimed at automating case management systems and enhancing procedural efficiency. And some countries, including Pakistan, have adopted and promoted an alternative dispute resolution system so that the private sector can avoid lengthy court trials and the expenses of litigation. The following measures are proposed:

- Set up specialized courts or commercial divisions in existing courts.
- Improve case management, collect statistical data, and monitor impact of reforms.
- Reduce the case backlog by dismissing inactive cases and cases with unresponsive parties.
- Introduce time limits and procedural deadlines.
- Strengthen the alternative dispute resolution system to reduce court burdens and create cheaper, quicker options for resolving disputes.

**Registering property**

Doing Business in Pakistan 2010 noted the considerable potential for regulatory reforms in property registration. Land records and filing systems are predominantly paper-based, local officials have little accountability but high workloads, and property registration involves many taxes and fees. The process in most cities is thus slower than the South Asian average benchmark.

Reforms like computerizing land records in Lahore and Sialkot can serve as models for other districts and cities. Building on existing reforms, the following measures are proposed:

- Simplify or consolidate procedures, eliminating the need for time-consuming nonessential procedures.
- Improve the efficiency of the revenue office through computerization and greater accountability.
- Reduce the number of taxes and fees.
- Introduce a flat fee for stamp duty.

**Construction permits**

The regulatory environment for dealing with construction permits is highly decentralized. Indeed, most powers and responsibilities vested in district and local governments, enabling many of them to lead and introduce several reforms over the years. Over 2006–09, for example, development authorities and town municipal administrations in Lahore, Faisalabad, and Sialkot adopted uniform building and zoning regulations, allowing for greater consistency in the regulatory environment. The following measures are proposed:

- Review the role of the Patwari and introduce modern land management practices.
- Review the internal process flows for requesting and obtaining a building permit.
- Rationalize inspections.
- Issue the completion certificate at the time of final inspection and reexamine its cost.
- Review current building compliance and enforcement regulations to improve their effectiveness.
- Review the implementation of existing state bylaws with a risk-based system for environmental approvals to increase approval efficiency.

**Starting a business**

Doing Business 2013 emphasized three good practices in business regulations for starting a business. They include increased use of online systems, no minimum capital requirements, and one-stop shops. Pakistan’s regulatory environment already allows for online procedures and has no minimum capital requirements. Research
shows that the creation of a one-stop shop is associated with an increase in new firms entering the market of roughly 5–6 percent (Motta, Oviedo, and Santini 2010). Pakistan has many reforms to reduce or improve business incorporation procedures, but to be effective such reforms must be complemented by streamlining postincorporation procedures, such as registering with labor departments and tax authorities. The following measures are proposed:

- Make online incorporation fully functional for approving company names, registrations, and payments.
- Promote use of online incorporation services for approving company names, registrations, and payments.
- Eliminate the company seal requirement.
- Create a single access point for tax registrations and social security requirements.
- Eliminate the requirement for registration with the labor department of the district.
- Create an integrated registration system, combining business, income, and sales taxes as well as a social security contribution.
- Implement a unique ID concept for businesses that can be referenced by multiple stakeholders.

Trading across borders

Pakistan has been highlighted in Doing Business 2013 among the economies that have global good practices for trading across borders, such as risk-based inspections, electronic submission and processing, and an electronic window to government agencies. The following measures aim to build on them:

- Map the trade logistics process between each district and the relevant port to identify issues constraining the efficient movement of cargo, and identify potential areas of collaboration with the federal government to increase efficiency.
- Reduce and streamline documentation requirements.
- Improve the use of prearrival information.
- Strengthen inland clearance facilities.
- Improve the electronic data interchange system.
- Improve inland transportation infrastructure capacity.

Notes

This note draws from Kularatne and Lopez-Calix (2012).

1. While Quetta charges a stamp duty of 5 percent of the property value, Peshawar and the cities in Sindh charge 3 percent. Islamabad and the cities in Punjab charge 2 percent. In Islamabad, where it is cheapest to register property, businesses are exempt from paying the urban immovable property tax.

2. The global series of Doing Business reports measures regulatory impacts in the major business city of an economy.


4. For example, a study cited in Love (2011) finds cost savings of 50–60 percent and time savings of up to 11 months with alternative dispute resolution relative to court litigation in Columbia.

5. The two procedures that take place at the revenue office—obtaining the land record (fard) and transferring the property title—account for an average of 75 percent of the time required to register property in Pakistan.

6. The Patwari is the local official at the revenue office in charge of issuing the land record, or fard, and completing the property transfer.

References


