

U4 Helpdesk Answer 2018:19

Integrity risks for international businesses in Pakistan

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Corruption remains a major obstacle to companies operating in Pakistan, along with macro-economic uncertainty and lingering security risks.

While companies are likely to encounter corruption across all sectors, certain industries and firm profiles are more at risk. Collusive contracting and kickbacks remain widespread in the energy and infrastructure sectors, while industries driven by fast-moving consumer durables, such as telecommunications, seem to be becoming more resistant to such practices.

Larger firms are generally less vulnerable to coercive corruption, and the positive effects of foreign bribery laws can be gradually felt as local firms become increasingly sensitive to the compliance requirements of foreign companies.

U4 Anti-Corruption Helpdesk

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Query

Please provide an overview of the most pressing integrity risks affecting international businesses operating in Pakistan.

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Global evidence of the impact of corruption on business and investment

A sizeable and growing body of evidence has provided clear indication that, at the aggregate level, corruption is bad for business.¹ While cross-country panel data have shown that corruption adversely affects economic growth and market demand, firm-level studies have established corruption's detrimental effect on firm growth, innovation, productivity and return on investment.

¹ Corruption has been shown to have a detrimental effect on:

- growth (Aidt 2009; Anoruo and Braha 2005; Glaeser and Saks 2006; Knack and Keefer 1995; Méndez and Sepúlveda 2006; Méon and Sekkat 2005; Rock and Bonnett 2004; Ugur and Dasgupta 2011)
- international trade (Ali and Mdhilat 2015; De Jong and Udo 2006; Dutt and Traca 2010; Horsewood and Voicu 2012; Musila and Sigue

Main points

- Pakistan is a sizeable trading partner for the United Kingdom, and offers opportunities for investment in infrastructure, telecommunications, natural resources and textiles.
- Firms view corruption as the most significant obstacle to business in the country, ahead of macro-economic uncertainty and lingering security concerns.
- Key areas of integrity risks include public procurement, political exposure, bureaucratic corruption and fraud.
- The forms of integrity risks vary significantly by firm profile, sector and the extent of interaction with government. Larger firms are generally less vulnerable to coercive corruption.

- 2010; Thede and Gustafson 2012; Zelekha and Sharabi 2012)
- market openness (Hakkala et al. 2008)
- return on investment (Lambsdorff 2003)
- foreign investment inflows (Javorcik and Wei 2009; Thede and Gustafson 2012; Mathur and Singh 2013; Zurawicki and Habib 2010)
- business competitiveness and productivity (Fisman and Svenson 2007; Hall and Jones 1999)

Corruption in a given country or market is harmful in two mutually reinforcing ways: in highly corrupt settings, aggregate firm growth and performance is lower, while markets perform poorly when corporate corruption becomes commonplace compared to markets in which firms typically refrain from corrupt behaviour.

Effect on markets

High levels of background corruption have adverse effects on a country's economic performance by reducing institutional quality, undermining competitiveness and entrepreneurship, distorting the allocation of credit and acting as a barrier to trade (Ali and Mdhillat 2015; De Jong and Udo 2006; Horsewood and Voicu 2012; Musila and Sigue 2010; Rodrik, Subramanian and Trebbi 2004; Zelekha and Sharabi 2012).

Corruption has a long-term deleterious impact on the regulatory environment and the efficiency of the state apparatus as it creates incentives for politicians and public officials to create more regulations, restrictions and administrative procedures to have more opportunities to extort payments from citizens and companies. This, in turn, is likely to exacerbate rent-seeking behaviour and breed inefficiencies across the public sector (Argandoña 2004; Dzhumashev 2010).

Unsurprisingly, studies show strong associations between corruption, protectionist regimes and opaque bureaucratic systems (Bjørnskov 2009; Bandyopadhyay and Roy 2007). This is particularly problematic for the business environment, as corruption subverts the fair awarding of contracts, reduces the impartiality and reliability of public

services and skews public expenditure (Transparency International 2011).

Corruption also acts as a non-tariff barrier to trade, raising transaction costs and obstructing foreign investment (Zurawicki and Habib 2010; Ali and Mdhillat 2015; Dutt and Traca 2010; De Jong and Udo 2006; Thede and Gustafson 2012; Mathur and Singh 2013). It is no surprise, therefore, that corruption is positively and significantly correlated with lower gross domestic product (GDP) per capita, less foreign investment and slower growth (Ades and Di Tella 1999; Anoruo and Braha 2005; Kaufmann et al. 1999; Knack and Keefer 1995; Hall and Jones 1999; Javorcik and Wei 2009; Méndez and Sepúlveda 2006; Méon and Sekkat 2005; Rock and Bonnett 2004). In fact, some studies have found that in transition economies,² corruption is the single most important determinant of investment growth, ahead of firm size, ownership, trade orientation, industry, GDP growth, inflation and the host country's openness to trade (Asiedu and Freeman 2009; Batra, Kaufmann and Stone 2003).

Effect on firms

Corruption imposes a clear burden on companies, and surveys show that business leaders almost unanimously agree that corruption undermines a level playing field to the benefit of less competitive firms (KPMG 2011).³

On average, enterprises operating in countries with high levels of background corruption have relatively lower firm performance than those operating in markets with lower risks of corruption (Donadelli and Persha 2014; Doh et al. 2003;

stock market volatility and discourages long-term investment, and 99% agree corruption undermines the level playing field to the benefit of corrupt competitors.

² Transition economies as taken to refer to countries in Central and Eastern Europe, as well as the Commonwealth of Independent States (Asiedu and Freeman 2009; Batra, Kaufmann and Stone 2003).

³ 51% of business people felt corruption makes an economy less attractive to foreign investors, 90% felt it increases

Faruq and Webb 2013; Gray et al. 2004; Mauro 1995; Wieneke and Gries 2011). Recent empirical research has, for instance, found a significant negative correlation between background levels of corruption in US states and the value of firms located in those states (Dass, Nanda and Xiao 2014).⁴

Firm-level data on informal payments from the 2010 World Bank Business Environment and Enterprise Performance Survey found that, in some countries, bribery imposed an additional tax on businesses, representing as much as 10% of their sales (OECD 2016). Worldwide, 14% of firms expect to have to pay a bribe to get an import licence, a figure that rises to 27% in South Asia and 30% in East Asia (World Bank 2018). Corruption in foreign trade can therefore act as a severe deterrent to market entry. This is especially the case for UK firms; a 2015 survey found that 43% of UK compliance and legal professionals indicated they had decided against doing business in a particular country due to high corruption risks (Control Risks 2015).

Even where foreign companies are able to gain a foothold in a corrupt market, studies have shown that greater levels of corruption are associated with higher firm exit rates, suggesting that corrupt environments are highly unstable for businesses (Hallward-Driemeier 2009). Revealingly, 55% of 1,400 CEOs questioned in a recent PwC (2016) survey identified bribery and corruption as a threat to their business's growth prospects.

Nonetheless, when operating in highly corrupt markets, foreign firms unfamiliar with local practices may be inclined to engage in corruption, or succumb to public officials' efforts to solicit

bribes in the name of short-term profit maximisation. Doing so is likely to be counterproductive, as corruption commonly affects business growth and productivity, lowering performance, innovation and long-term growth prospects (Fisman and Svenson 2007; Starosta de Waldemar 2012; Rossi and Dal Bo 2006).

Moreover, corruption begets corruption; firms with a propensity to pay bribes not only find themselves spending more time and money dealing with the bureaucracy but also suffering from the indirect costs, such as lower productivity and more expensive access to capital (Nichols 2012: 334; Wrage 2007; Almond and Syfert 1997; Earle and Cava 2009; Krever 2008). Finally, a lax corporate culture can inculcate unethical and unsustainable business practices or lead to internal fraud. If detected, the costs and sanctions, as well as reputational impact, can be extremely costly for companies.

UK exports and overseas investment

Both the nature of the UK's top exports (mechanical appliances, precious metals, motor vehicles, mineral fuels and electronic equipment [HMRC 2018a: 6]) and the kinds of export markets in which UK firms operate entail corruption risks. A number of the UK's top trading partners include countries like Russia, India, China, Vietnam and Saudi Arabia (HMRC 2018b), in which UK companies can be exposed to elevated risks of coercive or collusive corruption (Transparency International 2014).

Alongside the trade in goods, the UK has rising stock of foreign direct investment (FDI) in markets and industries with high associated risks of corruption. Between 2005 and 2014 alone, UK

⁴ Dass et al. assessed Tobin's Q as an indicator of firm value against local corruption using a proxy of corruption-related convictions of public officials between 1900 and 2011.

Tobin's Q provides a means of estimating firm value by dividing the total market value of the firm by the total asset value of the firm.

outward FDI to African countries doubled from £20.8 billion to £42.5 billion (ONS 2016). Over half of this investment in Africa was in mining and quarrying (ONS 2016), a sector judged to be the most corrupt in an OECD (2014) study, which found the extractives industry accounted for 19% of all foreign bribery cases.

Encouragingly, a 2015 survey (Control Risks 2015) found that business leaders in economies such as Nigeria, Mexico, Brazil, India and Indonesia largely welcome measures to level the playing field and address the inconsistent enforcement of domestic anti-corruption laws.

Why tackle corruption?

Corruption stacks the deck against competitive, innovative and entrepreneurial companies seeking to expand their overseas operations. This is increasingly recognised by business leaders: a survey of 390 senior executives revealed that 70% believed a better understanding of corruption would make them more competitive, help them make smarter investment decisions and enter new markets (PwC 2008).

Transparency is fundamental to reduce information asymmetries in complex markets; it underpins the ability of companies to fully understand the conditions and constraints for entering and operating in a given market (OECD 2016). Anti-corruption initiatives that reduce the necessity of “insider knowledge” of bribery patterns, middlemen and intermediaries have the potential to lower business costs, reduce uncertainties and reputational risks, lessen vulnerability to extortion and make access to capital easier (Transparency International 2009). Targeted efforts to curb corruption have been

shown to yield significant benefits to improve the regulation of the business environment (Breen and Gillander 2012).

As well as helping to make the business environment more conducive to inward investment and market entry by foreign firms, measures to reduce corruption in key markets have the potential to stimulate greater market demand by unleashing greater economic growth and increasing disposable income (Aidt 2009). A 2010 study found that more effective control of corruption in sub-Saharan Africa had the potential to dramatically increase trade volume in general and imports in particular (Musila and Sique 2010).⁵

Ultimately, efforts to reduce corruption in high-risk markets have the potential to edge out competitors from countries with higher incidences of corruption. As Belgibayeva and Plekhanov (2016) show, there exists kind of a virtuous cycle between investment flows and control of corruption:

- there are greater investment flows between countries with good control of corruption
- as corruption decreases, investment from countries with lower incidences of corruption increases
- as the quality of a country’s institutions and control of corruption improves, the country may even attract less investment from countries with widespread corruption
- greater investment volumes from less corrupt countries can further reinforce the strengthening of economic and political institutions that keep corruption in check

⁵ The authors estimate that if a country with the same corruption perception index as the African average of 2.8 were to improve its corruption level to Botswana’s 5.9, its

exports would improve by about 15% and imports by about 27%.

The Pakistani economy and international investment

Pakistan is the second largest economy in South Asia after India and accounts for 9.3% of regional gross value added, with a GDP in 2017 of US\$305 billion (World Bank 2018a). GDP growth in 2017 was 5.4%, which is comparably low for the region (Asian Development Bank 2018a). Agriculture accounts for 24.4% of GDP and employs the bulk of the total workforce, industry makes up 19.1% of GDP, while the share of the service sector in GDP reached 56.5% in 2017 (Asian Development Bank 2018b; Government of Pakistan 2017).

The country has a number of comparative advantages, including a strategic geographical location, a growing middle class, a young population, a vast diaspora network, a strong commercial and consumer base, and low production and labour costs (UK Department for International Trade 2018).

Nonetheless, Pakistan's turbulent past and historically low levels of investment have hindered the country's economic development (Central Intelligence Agency 2018). Foreign investors have traditionally been deterred by a tumultuous political and security environment, widespread corruption, and a burdensome investment climate with high regulatory barriers, red tape and poor commercial dispute resolution mechanisms (Central Intelligence Agency 2018).

One major on-going development initiative is the China-Pakistan Economic Corridor, which will channel over US\$60 billion towards investments in energy and infrastructure (Central Intelligence Agency 2018). While the partnership is seen as laying the groundwork for increased exports, it has raised concerns, notably at the IMF, about the sustainability of the country's capital outflows and

external financing needs in the medium term (Rana 2018a).

Such macroeconomic concerns are not unfounded. In 2013, Pakistan was forced to turn to the IMF Extended Fund Facility for a US\$6.6 billion loan to avert a balance of payments crisis and give the country space to rebuild its foreign currency reserves (IMF 2013). Part of the problem was that the current account deficit was not adequately covered by capital inflows from abroad, as foreign direct and portfolio investment was very low (IMF 2013). The IMF programme concluded in 2016 and, although Pakistan failed to meet several criteria of the agreed structural reform programme, it was able to restore macroeconomic stability and improve its credit rating (Central Intelligence Agency 2018). Low interest rates, a sharp drop in oil prices and the improved domestic security situation during this period helped to spur growth (UK Department for International Trade 2018; GAN Integrity 2017).

However, the Pakistani economy has been affected by the political uncertainty that followed the disqualification of former Prime Minister Nawaz Sharif by the supreme court in July 2017 (Siddiqui 2018). Following revelations as part of the Panama Paper leaks, Sharif came under investigation for failing to comply with disclosure rules for his offshore assets. The supreme court judged that, by not disclosing certain assets in his nomination papers, Sharif had violated a constitutional clause requiring members of parliament to act in an honest manner. Some observers nonetheless viewed the case as part of an effort by the country's military establishment to undermine Sharif and his party (Freedom House 2018).

After Sharif was replaced as prime minister by the former minister of petroleum and natural resources, the Pakistan Muslim League (N) saw out

the remainder of its mandate until the July 2018 elections. The victory of Imran Khan's Pakistan Tehreek-e-Insaf (PTI) party marked only the second time in the country's history that a civilian government transferred power to another civilian administration (BBC News 2018a). During the election, Khan stressed that his initial focus would be on stabilising the economy (BBC News 2018b).

Structural economic challenges remain, however, as over the past year the value of the Pakistani rupee has fallen sharply, inflation has risen and the current account deficit now stands at 5.9% of GDP (World Bank 2018b). While exports and remittances grew somewhat in the 2018 financial year, they have not been able to keep pace with stronger import growth driven by domestic demand for foreign consumer goods, machinery imports for the China-Pakistan Economic Corridor and the rising price of crude oil (Hussain 2018). As a result, the country's trade deficit is once again widening. By September 2018, the country's official international reserves had dwindled to US\$9.6 billion, the equivalent of one and half months of imports (World Bank 2018b). Moreover, the fiscal deficit has now grown to 6.6% of GDP, as a result of pre-election spending, higher rates of recurrent spending and low revenue growth (World Bank 2018b).

The upshot of the renewed balance of payments crisis is that the new government has entered into negotiations with creditors including Saudi Arabia and China to stave off a default (Haider 2018). Despite securing substantial support from these countries, a thirteenth IMF bailout since the late 1980s looks increasingly necessary (Haider 2018). A sticking point in the negotiations is the IMF's insistence that Pakistan fully discloses the terms of

the loans extended under the China-Pakistan Economic Corridor programme (Bokhari 2018).

Pakistan's proclivity for cyclical macroeconomic crunches as a result of fiscal and balance of payments issues has acted as an impediment to economic and social development (Ahmed 2018). The country's inability or unwillingness to tackle structural issues, such as its underdeveloped export base and low tax take, mean that underlying weaknesses resurface with every new external shock or period of internal economic mismanagement (Ahmed 2018). These issues are compounded by the country's political economy, as entrenched vested interests obstruct attempts to raise revenue, thereby depriving the government of the means to deliver public services and much-needed infrastructure without accumulating unsustainable fiscal deficits (Ahmed 2018).

Thus, while economic growth is projected to continue and poverty rates are expected to decline, Pakistan remains one of the lowest performers in South Asia in terms of human development indicators (World Bank 2018b). Government spending on health, nutrition and education is notably lower than most other countries, at a mere 3% of GDP (World Bank 2018b).

Public debt has remained relatively constant since 2012, at around 65% of GDP, while unemployment figures are also stable at around 6% (GAN Integrity 2017; Asian Development Bank 2018b). However, these figures may not tell the whole story, as recent analysis estimates the shadow economy to be about 26% of Pakistan's total GDP (Mughal and Schneider 2018).⁶ Outside of agriculture, the World Bank estimates that 71% of Pakistan's workforce labours in the informal sector (World Bank 2018c). This is of concern given that there is some evidence

⁶ Some estimates for the size of the informal economy as a share of GDP range up to 71% (Khan and Khalil 2017).

that, in low income countries, the size of the shadow economy is positively associated with higher levels of corruption (Dreher and Schneider 2006).

A further problem is the very low tax base; it is estimated that only about 1% of the population pays income tax (Kleeven 2018), and the country's tax revenue gap is thought to be equivalent to 10% of national GDP (Cevik 2016). Of the total tax revenue, only 60% is collected through indirect taxes, meaning that the tax burden falls disproportionately on poorer households (Ahmed 2018).

Against this backdrop, over the past year, foreign investors have remained cautious, waiting for the political dust to settle (Siddiqui 2018; The News 2018), the new government to set its economic priorities and the country's creditors and international partners to react (Abi-Habib 2018).

Trade

The combined value of exports and imports equates to 25% of Pakistan's GDP, and the average applied tariff rate is 9.5% (Heritage Foundation 2018).

Since 2015, there has been a substantial growth in demand for foreign goods and services, with a 16% growth in demand in 2016 compared to 2015, and a further 21% growth in demand in 2017 compared to 2016 (Asian Development Bank 2018b). The same period has witnessed a stagnation in demand for Pakistani exports, which are dominated by textiles, leather goods and cereals (International Trade Centre 2018a).

Pakistan's total exports for 2018 are estimated to be in the range of 25 billion USD (Workman 2018a), representing about 8.2% of the country's

GDP, a much lower rate than most other middle-income countries (Ahmed 2018). Asia is the destination for 37.2% of Pakistan's exports, while around 35.5% and 17.8% arrive in Europe and North America respectively (Workman 2018a).

Pakistan's total imports in 2018 are estimated to be worth US\$64.4 billion, resulting in a trade deficit of approximately US\$40 billion (Workman 2018b). Pakistan's top imports include mineral fuels, machinery, electronics, iron and steel, vehicles, organic chemicals and plastics cereals (International Trade Centre 2018b). Suppliers from Asia provide 74.2% of Pakistan's imports, while 12.7% and 6.2% of the country's imports come from Europe and North America respectively (Workman 2018b).

The UK is the seventeenth largest supplier of goods to Pakistan, while being the second most significant destination for Pakistani goods (International Trade Centre 2018c). Pakistan's major imports from the United Kingdom are metal ores and scrap, textile fibres, mechanical power generators, medicinal and pharmaceutical products, and chemicals (UK Office of National Statistics 2018).⁷ Total bilateral trade is worth £2.9 billion (UK Department for International Trade 2018). In total, Pakistan imported £1,130 million worth of exports from the UK in 2017, of which 59.2% were goods and 40.8% were services (UK Department for International Trade 2018).⁸ Of the £1,771 million of UK imports from Pakistan in 2017, 68% were goods and 32% were services (UK Department for International Trade 2018).

Investment

Total foreign direct investment (FDI) into Pakistan in the 2018 financial year was US\$3,092 million

⁷ For a detailed breakdown of goods, see International Trade Centre (2018d).

⁸ For a detailed breakdown of goods, see International Trade Centre (2018e).

(State Bank of Pakistan 2018a), which accounted for around 0.8% of GDP (Bertelsmann Stiftung 2018). FDI inflows are primarily concentrated in the power, construction and energy sectors (The News 2018).

The UK Department for International Trade (2018) notes that in recent years the volume of UK investment into Pakistan has been on the rise, with a 34.1% increase from 2015 to 2016, resulting in a total UK FDI stock in Pakistan of £1.4 billion.

According to the latest data from the State Bank of Pakistan (2018a), in 2017 the UK overtook the Netherlands to become Pakistan's second largest source of FDI after China. In the 2018 financial year, 10.3% of Pakistan's FDI originated in the UK, with a total inflow of UK investment worth US\$320.9 million (State Bank of Pakistan 2018a; State Bank of Pakistan 2018b). During the same period, there was an outflow of US\$13.4 million in FDI from Pakistan to the UK, resulting in a net FDI inflow of 307.5, up from US\$215.8 million in the 2017 financial year (State Bank of Pakistan 2018a).

The 2018 net foreign portfolio investment between the two countries was US\$93 million in the UK's favour (State Bank of Pakistan 2018a). This means that while UK investors have far greater levels of direct ownership of financial assets in Pakistan than Pakistani investors in the UK do, Pakistani investors hold more securities, bonds, stocks and other liquid financial assets in the UK than vice versa.

Business environment and corruption

Background

While Pakistan has long operated as a market economy, the Bertelsmann Stiftung notes that, although competition laws were first introduced in

the 1970s, they are inconsistently enforced (Bertelsmann Stiftung 2018).

Historically, economic power in Pakistan has been highly concentrated, with the country's most prominent 22 families and military playing a preponderant role in the economy (Bertelsmann Stiftung 2018). Well-connected businesspeople are known to flout competition laws for personal gain, while weak institutions and a lack of transparency benefit special interests at the expense of smaller and less influential firms (Bertelsmann Stiftung 2018).

There a number of other non-tariff barriers that impede trade. Government openness to foreign investment is below average, banks are vulnerable to state interference and capital markets are underdeveloped (Heritage Foundation 2018). Moreover, Pakistan's legal system is judged to provide incomplete protection for the acquisition and disposition of property rights, as well as inadequate commercial dispute resolution mechanisms (Heritage Foundation 2018).

In general, the UK Department for International Trade (2018) notes that there is a high level of red tape, and interacting with government officials can be "costly and time consuming". Starting a business, for instance, takes 10 steps in Pakistan, several more than the regional average (World Bank 2018d). The time to taken for importers and exporters to comply with border requirements and documentation is also higher than in most South Asian countries (World Bank 2018e).

Nonetheless, over the past few years, international indexes show that Pakistan has been gradually improving its business environment. The country has risen from 122 out of 138 countries in the 2016 Global Competitiveness Index to 115 out of 137 in 2017 and 107 out of 140 countries in 2018 (World Economic Forum 2017a; World Economic Forum

2018). While the country scores highly in the areas of shareholder governance, the availability of venture capital and inflation, it is one of the worst performers in terms of trade tariffs and the incidence of terrorism (World Economic Forum 2018).

Pakistan has also improved its ranking on the World Bank's Ease of Doing Business Index, moving from 147 out of 190 countries in 2017 to 136 in 2018 (World Bank 2018d). This improvement is linked to a number of reforms, including an updated online one-stop business registration system, enhanced information exchange with tax authorities and increased transparency in land administration (World Bank 2018f). However, the country still scores poorly in the area of obtaining electricity connections and dealing with construction permits, where the time and cost involved is much higher than elsewhere in the region (World Bank 2018f).

Effects and extent of corruption

The background investment risks generated by macroeconomic uncertainty and lingering security concerns are exacerbated by widespread corruption. In fact, the World Economic Forum reports that business executives view corruption as the biggest obstacle to business in Pakistan, ahead of crime, insecurity, tax rates and government instability (World Economic Forum 2017a).

Pakistan has consistently performed poorly on international indicators measuring corruption. Pakistan has featured in Transparency International's Corruption Perceptions Index since 1995, and has typically been among the countries perceived to be most corrupt, though the country's score has been gradually improving since 2012. In the 2017 edition, Pakistan was ranked 117 out of 180 countries (Transparency International 2018).

The World Bank's Worldwide Governance Indicators (WGI) show similar results. The country's percentile rank on the control of corruption indicator has improved from 14.2 in 2012 to 22.6 in 2017, while the absolute score has likewise been progressively improving, from -1.06 in 2012 to -0.78 in 2017 (World Bank 2018g).

Nonetheless, there remains a high risk of corruption for firms operating in Pakistan, and irregular payments and bribes are common when obtaining public services and licences (GAN Integrity 2017). Over the past few years, a number of western companies have pulled out of Pakistan, citing rampant corruption in the country as a threat to their business (Pakistan Herald 2015). Corruption arises not only in international companies' dealings with government but a number of these companies point to substantial losses incurred from dishonest business associates in Pakistan, coupled with inaction from law enforcement (Pakistan Herald 2015).

The Global Corruption Barometer (GCB) conducted by Transparency International represents a snapshot of public opinion in Pakistan and reveals that 54% of citizens believe the government is handling anti-corruption efforts poorly (Transparency International 2017). The GCB showed that 59% of people felt most or all government officials were corrupt, 62% thought the same of tax officials, while 44% believed most or all business executives were corrupt. The most corrupt sectors were found to be the police, the courts and the utilities, with 75%, 68% and 61% respectively of citizens who came into contact with those services reporting paying a bribe (Transparency International 2017).

Corruption risk by firm profile

The type and extent of corruption that firms encounter in Pakistan will likely vary by firm

profile. Unlike large multinationals, small- and medium-sized enterprises (SMEs) have neither the purchasing nor selling power to refuse coercive corruption in the form of demands for bribes. As SMEs' commercial strategies are likely focused on specific countries, they are also less able to cut their losses and withdraw from a market that has become excessively risky. Moreover, SMEs tend to lack the resources needed for due diligence, legal defence, and audit and compliance obligations. Finally, their governance structures are often inadequate to effectively police their employees and business partners (Horowitz and Dauman 2018).

Results from the World Bank Enterprise Survey show that medium-sized firms in Pakistan employing between 20 and 99 employees reported the highest incidences of corruption, with 35.7% of medium-sized firms experiencing at least one bribe request, whereas this figure was 28.3% for small firms and 25.2% for large firms (World Bank 2015a).

For many processes, small firms seemed the most exposed to corruption, notably 96.2% of firms with fewer than 20 employees expected to give gifts in exchange for a government contract as opposed to 74.6% of large firms who employ more than 100 people. In general, a lower percentage of large firms expected to give gifts in exchange for government services, and larger firms were marginally less likely to point to corruption as a major constraint on their business (63.5% versus 68% for small and medium firms).

This suggests that larger companies in Pakistan who can point to their global compliance obligations may be better placed to rebuff demands for bribes than small- and medium-sized companies. Such a view was echoed by experts interviewed for this Helpdesk answer, who argued that, not only do larger international companies

enjoy greater political leverage due to their economic clout, but also that their compliance obligations under anti-bribery legislation such as the FCPA and UKBA are increasingly understood by officials on the ground. This is corroborated by the fact that firms for whom direct exports are worth 10% or more of sales are notably less likely to experience bribe requests than companies who do not export (20% vs 31.9%) (World Bank 2015b).

Interestingly, however, in terms of ownership type, firms with 10% or more foreign ownership are dramatically more likely to experience bribe requests than domestic companies (52.5% versus 30.4%) (World Bank 2015c).

Finally, there is some regional disparity: firms operating in Baluchistan and Islamabad are more affected by corruption than their counterparts in Sindh, Khyber-Pakhtunkhwa and Punjab. However, as covered in the section on sectors, the key variable of corruption risk seems to be the industry rather than the province.

Anti-corruption framework

In Pakistan, anti-bribery and corrupt practices are not regulated exclusively by a single piece of legislation but rather by a range of national and local government acts (LexMundi 2018). Despite the complexity, the country's legal anti-corruption framework is relatively sound (GAN Integrity 2017). There are nonetheless a few shortcomings. While the act of bribing domestic government officials is prohibited, the bribery of foreign officials is not specifically regulated (LexMundi 2018). There is also no criminal liability for corporate entities that pay or receive bribes, although sponsors, chairpersons, executives, directors or guarantors of a firm implicated in bribing domestic officials are criminally liable (LexMundi 2018).

In practice, the Bertelsmann Stiftung (2018) describes anti-corruption efforts in Pakistan as “weak and politicised”. The National Accountability Bureau (NAB) has often been accused of politically motivated investigations, and is seen by the Pakistan Institute of Legislative Development and Transparency as vulnerable to political interference (Bertelsmann Stiftung 2018). A common view among the media is that the country’s oversight institutions are unable to hold corrupt politicians, civil and military bureaucrats and business professionals to account (Abrar 2018). The Bertelsmann Stiftung (2018) further notes that a member of the Tax Reform Commission – established to prevent revenue leakage, expand the tax base and improve tax administration – was implicated in the Panama Papers leaks.

The Securities and Exchange Commission of Pakistan (SECP) is a regulatory body responsible for the incorporation and registration of companies. In July 2018, the NAB launched an enquiry into former prime minister Shahid Khaqan Abbasi’s appointment of Shaukat Hussain Abbasi as the SECP chairman just 18 days before the end of his government’s mandate. A complaint to the NAB alleged that Hussain was appointed not on merit but due to his political relationship with the prime minister (Shah 2018). After Shaukat Hussain was forced to step down in October 2018, he was replaced as SECP chairman by Tahir Mehmood (Khan 2018). Mehmood has been implicated in a scheme involving corruption, kickbacks and registering front companies with the SECP, during which he reportedly acted as a middleman between front companies and private banks (Cheemar 2018).

Such cases underline how entrenched governance and integrity issues are even within the country’s oversight institutions. The next section looks at a

range of corruption risks that could affect trade and investment across all sectors.

Cross-sectoral integrity risks

Grand and political corruption

Pakistani politics is often characterised by abuse of office, as politicians seek to extract resources from the state to distribute these rents to their patronage networks (Lieven 2012). Such networks, particularly those based on kinship, are often deeply ingrained, and election victories are frequently used to hand out roles to loyal supporters, leading to a lack of professionalism and partisan politicisation of public institutions (Bertelsmann Stiftung 2014).

In the higher levels of the bureaucracy, political interference and personal connections influence transfers and postings (Bertelsmann Stiftung 2018). The World Economic Forum’s Global Competitiveness Report 2017-2018 confirms the prevalence of an extensive system of patronage, giving Pakistan a score of 3.2 out of 7 (1 = worst; 7 = best) for favouritism in decisions of government officials (World Economic Forum 2017a).

Under previous governments, economic regulatory decisions were often taken by the Economic Coordination Committee (ECC), a body formed as an emergency wartime measure in 1965 (Bertelsmann Stiftung 2018). The ECC is composed of prime ministerial appointees and has played a key role in setting industrial and trade terms, often intervening in the market on an ad-hoc basis.

Critics allege such actions distort price signals and benefit favoured enterprises (Bertelsmann Stiftung 2018). The country’s largest firms are either engaged in manufacturing for the domestic market or in the service sector, and some of these rely on “explicit or implicit protection in the form of

import barriers or administered prices for inputs and outputs” (Ahmed 2018). The ECC operates in an executive manner, with little parliamentary oversight, and its decision-making processes are generally opaque (Bertelsmann Stiftung 2018). The influence of the ECC in the new PTI administration remains to be seen.

Successive governments have been rocked by corruption scandals (Bhatti 2018). In 2015, the country’s leading anti-corruption body, the National Accountability Bureau, submitted a report to the supreme court detailing over 150 major corruption cases involving embezzlement, fraud, money laundering, land scams and various kickbacks (Khan Shakoor 2015). The list reportedly included a number of cases against high-profile figures, including former president Asif Ali Zardari, prime ministers Nawaz Sharif, Raja Pervaiz Ashraf and Shujaat Hussain, ministers such as Ishaq Dar and Aftab Sherpao, and other top bureaucrats like Hussain Haqqani (Khan Shakoor 2015; Ahmadani 2018).

The military plays a prominent role in the country’s politics and is seen by some observers as acting as a “kind of giant patronage network, extracting a huge share of Pakistan’s state resources via the defence budget and other concessions, and spending them on itself” (Lieven 2012). Indeed, 23% of the 2018-2019 budget is accounted for by defence spending alone (Government of Pakistan 2018). In many areas of economic activity, the military plays a dominant role, distorting competition. The military controls almost 50 commercial entities in sectors including housing developments, energy, and industrial and agricultural inputs and consumer goods. The army is also permitted to expropriate land in the name of national security (Bertelsmann Stiftung 2018).

Political connections

Many Pakistani politicians have considerable business portfolios. Experts consulted for this Helpdesk answer emphasised that political connections can be very helpful for international investors, as having a political sponsor can facilitate bureaucratic processes such as the obtainment of licences, zoning approvals, import and export prices.

Sources interviewed stressed that Pakistan’s changing political economy, with its growing middle class, greater media awareness and larger consumer base, means that the old fashioned relationship, whereby international companies typically had to bribe politicians to enter the Pakistani market, is no longer the case. With the rapidly growing demand for foreign goods and services in the country, the domestic market is large enough to sustain companies, and politicians who can attract further foreign investment expect to bolster their political capital.

As a result, the reciprocal relationship between businesses and politicians has become more subtle. Rather than demanding monetary reward for helping firms to navigate the landscape, politicians may direct companies to channel investments in a way that will benefit their core constituency, such as investing in a certain part of the province or hiring members of their kinship group.

However, while such relationships can be useful as a way to cut through red tape without resorting to outright corruption, partnering with politically connected local firms can expose international companies to accusations of influence peddling or implicate them in illicit activities. The current trend of politicised corruption investigations exacerbates the risk that foreign investors could become entangled in costly legal proceedings.

Judiciary

Pakistan's judiciary is technically independent, but in practice the justice system is characterised by corruption, delays and inefficiency (Bertelsmann Stiftung 2016). According to a recent Transparency International (2017) survey, 41% of respondents in Pakistan perceived the judiciary to be corrupt, and 68% of citizens who came into contact with the courts reported paying a bribe. Companies also report low levels of trust in the independence of the judiciary and its efficacy and impartiality in settling legal disputes (World Economic Forum 2017b). Lower level courts are especially exposed to nepotism, undue influence from influential political and religious figures and outright corruption (The Express Tribune 2013; US Department of State 2017). Property cases in particular are known to drag on for years (Bertelsmann Stiftung 2018).

Backlogs in both civil and criminal cases are the result of antiquated procedural laws, unfilled positions, poor case management and inadequate legal training (US Department of State 2017). To compound these structural issues, Pakistan's judiciary has historically been split along political lines, especially with regards to military rule (Bertelsmann Stiftung 2014). While the country's senior courts, notably the supreme court, have frequently launched high-profile proceedings against senior officials accused of corruption, such interventions have been viewed by critics as politically motivated (Boone 2013).

As a result of the justice system's endemic problems, companies in need of judicial recourse can be exposed to corruption, intimidation and delay (Heritage Foundation 2018). Of firms surveyed in Pakistan, 34.6% identified the court system as a major constraint to their business (World Bank 2015d). Consequentially, many foreign investors include contractual provisions providing for international arbitration to avoid

costly and drawn-out disputes in local courts (US Department of State 2018a). The Pakistan Arbitration Act offers a channel to arbitrate commercial disputes, and Pakistan is a member of the World Bank's International Centre for the Settlement of Investment Disputes (ICSID 2018).

Organised crime

There is large scale money laundering in Pakistan, which is driven by the need to launder profits generated by illicit activities including fraud, corruption, smuggling, the drug trade, human trafficking, terrorist financing and tax evasion (Qureshi 2017; Hindustan Times 2018; US Department of State 2018b). In June 2018, the country was included on the Financial Action Task Force's grey list for failing to act on "strategic deficiencies" in its anti-money laundering and counter-terrorist financing regime (Rana 2018b).

Money laundering operates through three primary channels. First, people travel out of Pakistan with large amounts of cash far beyond the legal limit of US\$10,000. In a case in December 2018, two passengers were caught smuggling thousands of dollars out of the country on a flight to Bangkok (Pakistan Today 2018). There have even been cases in which staff employed by Pakistan's national airline were involved in bulk cash smuggling (US Department of State 2018b).

Second, in the absence of supervision, regulation and sanctions against illicit activities, there is a thriving informal financial system parallel to the formal banking sector (US Department of State 2018b). The *hawala* system of remittances is a common means to transfer illicit money into and out of Pakistan (UK Foreign and Commonwealth Office 2017).

Third, fraudulent trade invoicing is a common ploy to transfer illicit funds. Criminals are also known to

use import/export firms, front companies and charities to disguise illegal transfers (US Department of State 2018b).

In addition to money laundering, smuggling is a widespread problem, especially along the country's porous borders with Afghanistan, Iran and China (US Department of State 2018b). Chinese electrical goods, Iranian carpets and Afghani narcotics are among the most common items smuggled, along with fuel and alcohol from the Gulf states (UK Foreign and Commonwealth Office 2017).

Public procurement

Collusive contracting is commonplace in Pakistan, and companies competing in state tenders are frequently confronted by requests for illicit payments or other methods to circumvent procurement regulations. According to a World Bank survey of 1,247 companies, an astonishing 88.2% of firms expect to have to give gifts to secure a government contract, and the value of the gift was on average expected to be worth 8.2% of the contract's value (World Bank 2015d). It has been estimated that corruption in procurement processes alone accounts for 15% of Pakistan's development budget (OECD 2010).

In principle, the Public Procurement Regulatory Authority (PPRA) rules provide for open and competitive bidding in the award of government contracts. The procurement framework notably requires the use of integrity pacts for public purchases worth more than 10 million Pakistani rupees (Asian Development Bank and OECD 2006). However, while procurement agencies generally follow the rules, there have been cases where rules have been flouted (Abbas 2018). A 2016 investigation into the state-owned Pakistan Railways found that corruption had cost the enterprise nearly US\$95 million, and that of one

the major problems was that the PPRA rules had been ignored (Times of India 2016).

The situation is complicated by the fact that different procurement regulations apply at federal and provincial level, and wide-ranging powers to define rules and policies are left to individual procuring agencies (Asian Development Bank and OECD 2006). The UK Department for International Trade (2018) observes that procurement processes are marked by a lack of transparency and unclear procedures. Such high levels of opacity and discretion could be abused to eliminate unwanted competitors or favour certain bids (Asian Development Bank and OECD 2006). In addition, while procurement rules are generally adequate, the capacity of procuring agencies to adhere to them needs to be improved (Shabbir 2014).

Encouragingly, TI Pakistan notes that the National Accountability Bureau has intensified its efforts to prosecute cases where PPRA rules are found to have been violated and the Supreme Court has directed that affected contracts be cancelled. Moreover, where TI Pakistan becomes aware of irregularities, it also notifies the relevant agency and in most cases it finds that violations are rectified. For instance, although some observers have noted that in some instances tender documents have been drawn up on the basis of drafts provided free of charge by firms who intend to compete for the contract (Mahmood 2017), TI Pakistan has found that where it has lodged a complaint, procurement agencies typically take remedial measures to ensure that tender documents do not favour a particular bidder.

Corruption risks in defence procurement are especially acute as the military is entitled to bypass procurement regulations where these are not deemed to be in the public interest (Transparency

International 2015). In 2014, the US Securities and Exchange Commission charged gun manufacturer Smith & Wesson with bribing Pakistani officials as part of an attempt to win contracts to supply firearms to the country. The Securities and Exchange Commission depicted the action as a “wake-up call for small and medium-sized businesses that want to enter into high-risk markets and increase their international sales” (US Securities and Exchange Commission 2014).

Bureaucratic and administrative corruption

While Pakistan has adopted a number of codes of ethics for its public institutions, reform has been piecemeal and so far proven ineffective in curbing corruption in the public sector (Transparency International Pakistan 2014). State agencies remain affected by political interference, chronic low wages and a lack of transparency, as well as an absence of appropriate mechanisms for supervising staff (Transparency International Pakistan 2014).

As such, bureaucratic and administrative corruption is a prevalent risk for all companies operating in Pakistan. Companies report coming under pressure to make facilitation payments to complete basic transactions, such as to obtain visa and work permits, pass inspections by officials and obtain project approvals from national or local government authorities (Pakistan Herald 2015).

Such reports are corroborated by the latest available data from World Bank Enterprise Survey. Based on a study of 1,247 firms from 2013 to 2015. 45.8% of firms reported that they expect to give gifts to public officials “to get things done”, almost double the regional average. In total, 68.3% of firms identified corruption as a major constraint to their business (World Bank 2015d).

Particular bureaucratic processes highlighted from the survey as most plagued by corruption include

obtaining an electricity connection, where 57.8% of firms expected to have to give gifts, obtaining an operating licence (31.0%), meeting tax officials (28.8%) and getting a construction permit (28.7%) (World Bank 2015d).

Tax administration

Tax administration in Pakistan is generally seen as inefficient and plagued by corruption (Ahmed 2018); 62% of Pakistan citizens surveyed believed that most or all tax officials were corrupt (Transparency International 2017). Similarly, 28.8% of companies report that irregular payments and gifts are expected during interactions with tax officials (World Bank 2015d). Foreign investors indicate that tax regulations at both federal and provincial level are difficult to navigate, with companies being required to make 47 tax payments per year, much higher than the regional average of 28 (US Department of State 2018a; World Bank 2018h). On average, it takes businesses 312 hours per year to calculate their tax obligations, and the lack of transparency during tax assessments creates opportunities for corruption (US Department of State 2018a).

Tax collection in Pakistan is notable for two main characteristics: the high proportion of indirect taxation, which accounts for 60% of total tax revenue and the small number of individuals who file income tax returns (Ahmed 2018). Tax avoidance is also commonplace among firms, with less than half of the 72,500 companies registered with the SECP in 2016 filing a tax return. Even among those firms who filed a tax return, half claimed to have had zero returns (Ahmed 2018).

Commentators point to corruption in tax administration and the large role of the informal sector in the economy as twin obstacles to meaningful tax reform (Ahmed 2018).

Land administration

There are further corruption risks in the administration of property rights, which are exacerbated by the complex and time-consuming procedures required to register property (World Bank 2018e). Businesses report low levels of trust in the protection of land rights, and although the legal system supports the enforcement of property rights in principle, in practice investors are confronted with a lack of clarity regarding land titles and insufficient judicial protection (World Economic Forum 2017a; US Department of State 2018a). The real estate sector also provides a means to launder money as most transactions are cash-based and poorly documented (US Department of State 2018b).

Apart from the agricultural sector, there are no specific restrictions on foreign or non-resident investors owning or leasing land (US Department of State 2018b). Moreover, foreign direct investment is protected from expropriation under the Protection of Economic Reforms Act and the Foreign Private Investment Promotion and Protection Act.

Customs administration

Compared to other procedures in Pakistan, the World Economic Forum finds that obtaining import licences is much less affected by corruption, as only 6% of firms expected to give gifts to secure a licence (World Bank 2015d). Nonetheless, business executives view corruption at the border as the third most problematic factor when importing goods after burdensome procedures and tariffs, and report that irregular payments in connection with imports and exports are relatively common (World Economic Forum 2016). USAID (2014) likewise argues that corruption, revenue leakage and fraud are key weaknesses in the customs agency.

Fraud

Businesses operating in Pakistan can suffer losses from fraud within their operations in addition to the problems that occur in the interaction between the private and public sectors. Given Pakistan's large informal economy, foreign firms investing in or partnering with local SMEs or family-owned businesses may experience widespread fraud and tax evasion in their supply chains. In one case in Faisalabad, an organised racket produced fake invoices and committed identity theft to perpetrate tax fraud across the supply chain in the city's textiles industry (Business Recorder 2014).

Experts consulted for this paper pointed to the common practice among Pakistani SMEs of maintaining two sets of books to hide financial transactions from tax inspectors and international partners. Without frequent and robust auditing of local suppliers or business partners, international companies may find themselves ensnared in illicit accounting practices.

Additional commentary by key sectors

There are some telling distinctions when it comes to integrity risks for foreign investors operating in different sectors in Pakistan. In general, manufacturing firms seemed to be notably more likely to encounter corruption than firms operating in the service sector (World Bank 2015e). Interestingly, however, manufacturing firms are *less likely* to report corruption as a major constraint on their business.

Within the manufacturing sector, companies operating in textiles and non-metallic mineral products are noticeably more likely to experience requests for bribes (in about 40% to 45% of all interactions with public officials). Again, firms operating in textiles and non-metallic mineral

products are nonetheless the least likely to identify corruption as a major constraint to their business, suggesting these companies factor corruption into the cost of doing business and their dealings with government (World Bank 2015e).

The type of service requested also affects which industries are most affected. To secure a government contract, 98.1% of service sector firms expect to give a gift, versus 74.9% of manufacturing firms. When it comes to securing an electrical connection, on the other hand, only 7.5% of service sector firms expect to give a gift, as opposed to 75.6% of manufacturing firms (World Bank 2015e).

According to a study by TI Pakistan, the infrastructure, energy and utilities sectors are the most affected by corruption (The Daily Journalist 2013).

Infrastructure

Pakistan scores only three out of seven in terms of its infrastructure in the World Economic Forum's latest Global Competitiveness Index (2017b). Oxford Economics (2016) estimates that between 2016 and 2040, Pakistan will require US\$480 billion in infrastructure investment across all sectors, but at current trends will only mobilise US\$355 billion, leaving an investment gap of US\$124 billion. The gap is especially acute in the road, port, telecommunications and water sectors.

Typically high-value, complex in scope and overseen by government, infrastructure projects are vulnerable to corruption. The integrity issues associated with public tendering processes present the principal form of risk in infrastructure projects. However, the execution of works, which typically requires approvals from government ministries and agencies, the need for importation and transportation of equipment and materials and subcontracting of work to local firms also can entail

integrity risks. These risks vary according to a company's role in the project.

Pakistan has a poor record of managing infrastructure projects in a transparent manner; estimates from a decade ago put the cost of kickbacks in public works at about 25% of the total project budget (The Daily Journalist 2013). However, when it comes to high-profile infrastructure projects where there is a clear desire to attract foreign investors, experts consulted for this Helpdesk answer noted that collusive contracting is on the decline and procurement processes are being increasingly well managed and transparently awarded.

The previous government's initiative to build liquefied natural gas terminals is an interesting case study. The NAB launched an inquiry into the project less than a week after the PML-N party finished its five-year term in July 2018, amid allegations that Nawaz Sharif and his successor Shahid Khaqan Abbasi had granted a contract "to a company of their liking, in violation of rules and by misuse of their powers" (Shahzad 2018). In fact, other reports indicate that the government issued an open and competitive tender in 2013 that involved a single step, two envelope bidding process (Kiani 2018). An independent international consultant, QED, was hired by USAID to evaluate the bids and the bidder with the lowest re-gasification cost was selected, reportedly in accordance with Pakistan's Public Procurement Regulatory Authority rules (Bhutta 2018a). Inter State Gas Systems, the company set up by the government to handle gas import projects, has insisted that the decision was taken in an auditable and transparent fashion (Bhutta 2018b).

However, infrastructure projects in the framework of the China-Pakistan Economic Corridor buck this positive trend, as they tend to be much less

transparent, and there is widespread suspicion of corruption, bribery and other collusive practices in bidding processes (Dunya 2017; The Times of India 2017; Gul 2017).

Telecommunications

The telecommunications sector in Pakistan is often seen as a success story (Global Village Space 2018), and revenues reached 464 billion Pakistani rupees (US\$3.33 billion) in 2017 (Pakistan Telecommunication Authority 2018a). Investment in the sector is nonetheless on a downward trajectory, from US\$3.97 billion in 2008 to US\$1.82 billion in 2014 and to US\$0.65 billion in 2017 (Pakistan Telecommunication Authority 2018b). Oxford Economics (2016) estimates that there is an investment gap of US\$37 billion in the sector to 2040.

In response, the government has introduced a number of initiatives to stimulate further investment in the sector, including levelling zero income tax on information technology (IT) exports until June 2019, permitting 100% of equity ownership for foreign investors, allowing 100% repatriation of capital and dividends, and tax holidays for venture capital funds and IT start ups (Farooq 2018).

Experts consulted for this Helpdesk answer noted that the sector is relatively transparent due to the technologically driven nature of the business, good documentation of mobile payments and the fact that tax is taken at source. Industry tendering processes and the awarding of 3G and 4G licences is also seen to be done in a transparent manner (Attaa 2018). This is partly attributed to the influence of foreign telecommunications companies, such as Telenor and Veon, whose Pakistani subsidiaries between them have a 65% market share (Pakistan Telecommunication Authority 2018c). After previous corruption

scandals in Uzbekistan, which resulted in Telenor and Veon being stung by fines of US\$835 million under the FCPA (The Guardian 2016), these companies are believed to have cleaned up their act and made it clear in other markets that they will not engage in corrupt practices (Fildes 2017).

Despite the generally positive picture, certain integrity risks remain, particularly when it comes to bidding for mobile network and spectrum licences, which tend to be highly competitive processes. For instance, the NAB recently opened an investigation into alleged kickbacks to officials at the Pakistan Telecommunication Authority in the auction of mobile licences in 2004 (Attaa 2018).

Energy and mining

The Pakistani oil and gas industry is notoriously corrupt, and kickbacks in public contracting are widespread. Oil and gas is a sector that is widely known to be prone to corruption. The principal risks confronting companies active in the sector include corruption in licensing processes, permit applications and the subcontracting of parts of a company's operations. Pakistan is not a member of the Extractives Industry Transparency Initiative (EITI 2018).

In 2017, it emerged that national and multinational oil and gas companies had embezzled 134 billion Pakistani rupees between 2012 and 2015. Companies that had been awarded oil and gas exploration licences in 2002 had not invested any money in exploration or constructed any oil wells, while other companies in collusion with officials at the petroleum ministry had sold oil illicitly drawn from 34 "test production" wells (Khan 2017).

The NAB has stated it is currently investigating 19 cases of alleged corruption, abuse of authority and misappropriation in the sector (Malik 2018). These

cases illustrate the range of integrity risks, and include:

- collusive contracting by officials at Pakistan State Oil
- manipulated evaluation reports in which assets acquired by the state-owned enterprise Paksitan Petroleum Limited were enormously overvalued in exchange for kickbacks
- the misuse of public money to pay exorbitant salaries to favoured officials
- illegal appointments and promotions in regulating agencies

Pakistan's mining sector is also very corrupt, especially in the award of licences at provincial government level. One major case is the Reko Diq mine in Baluchistan. In 2006, a foreign consortium of Canadian and Chilean mining interests acquired the rights to an exploration permit to look into the viability of mining gold and copper in the region. The consortium's feasibility study alone was reportedly the single largest foreign direct investment in Pakistan's history at that point (Allbritton 2012). In 2012, the Baluchistan government refused to grant a mining licence to the consortium, and instead granted further exploration permits to newly formed Pakistani and Chinese companies with no mining experience (Allbritton 2012).

The case went to the supreme court, the International Centre for the Settlement of Investment Disputes (ICSID), and the International Criminal Court (ICC) amid mutual recriminations and allegations of corruption (Bhutta 2017; Rana 2018c). While the supreme court ruled in 2013 that the original joint venture agreement was null and void from the beginning (Malik 2017), the ICSID and ICC rejected the Pakistani government's application to dismiss the

case on the grounds of corruption and malpractice by the international consortium (Bhutta 2017). Pakistan currently faces a bill of over US\$11 billion dollars in damages (Rana 2018d).

Textiles

Pakistan's textile industry accounts for over 50% of the country's total export earnings, and, with 15 million workers, it is the second largest employer (Hussain 2017). Experts believe that Pakistan's textile sector is not reaching its full potential as major buyers are not sourcing from the country due to fear of contravening foreign bribery laws and partnering with firms who are not compliant on child labour, environmental and integrity issues (Brown 2015).

The sector is characterised by widespread informality and subcontracting used to avoid labour regulations. The process of certification of compliance with labour, safety and environment standards is riddled with corruption (Hussain 2017). In 2012 a fire in a Karachi textile factory killed over 250 people, though the factory had been awarded a SA8000 labour standards certificate only weeks before. SA8000 certificates are issued by the US based Social Accountability Accreditation and accepted in the European Union, but the certificates are invariably awarded by local firms who have purchased franchising rights (Hussain 2017). In Pakistan, the National Accreditation Council does not have the right to regulate or sanction certification bodies, meaning they are not monitored in practice. This system, along with rampant petty bribery in government inspection bodies, means that much of Pakistan's 47 labour laws are ignored (Hussain 2017).

Business anti-corruption initiatives in Pakistan

There are some private sector anti-corruption initiatives in Pakistan. Beginning in 2005 and operating until recently, the Washington DC-based Centre for International Private Enterprise (CIPE) worked on improving the business climate in emerging markets. In the past few years, it ran a number of training programmes for local businesses on anti-corruption compliance (Brown 2015). However, in late 2018 the CIPE was caught up in the new PTI administration's decision to shut down a number of foreign non-governmental organisations and has been forced to suspend its operations (Mukhtar 2018).

In 2017, the Securities and Exchange Commission of Pakistan overhauled its code of corporate governance, and changes included new measures related to internal audit, risk management and conflict of interest (KPMG 2018).

It is important to note that foreign investors and businesses are required to comply with anti-corruption laws in their home country while active in Pakistan. Some laws, such as the US Foreign Corrupt Practice Act (FCPA) and UK Bribery Act, (UKBA) have broad extraterritorial application regardless of whether a company is headquartered in the UK or US. Both the FCPA and the UKBA hold firms responsible for the behaviour of their suppliers, vendors and agents, and so are relevant throughout the value chain. There is growing anecdotal evidence that regardless of whether or not local firms believe anti-corruption law will be enforced domestically, multinational companies are increasingly looking for robust anti-corruption mechanisms in Pakistani partners.

Indeed, focus groups with large Pakistani firms show that anti-corruption compliance is a growing concern for them due to Pakistan's new GSP+

status and the need to comply with EU standards, as well as pressure from multinationals to comply with foreign bribery laws (Brown 2015). A CIPE survey of Karachi-based anti-corruption compliance officers found that, due to Pakistan's trading patterns and cultural factors, there is good awareness of the UKBA and its private-to-private component (Brown 2015). As such, the business case for anti-corruption is getting ever stronger among ambitious firms looking to join global value chains, especially those exporting to highly regulated markets such as Europe and North America.

Anti-corruption guidance for businesses

Companies looking for guidance on how to manage integrity risks in their operations can draw on ample existing reference material. The following section briefly points to some of the most useful tools and documents for companies implementing anti-corruption measures.

GAN Integrity's Business Anti-Corruption Portal (2018a) provides a good starting point for companies wishing to develop an internal compliance programme. The portal sets out eight elements to a successful compliance programme:

- the development of proportionate written policies and procedures, such as a code of conduct, and the implementation of internal controls
- top-level commitment from the company's senior management to show visible support for a company's compliance activities
- periodic and comprehensive risk assessment to identify the corruption risks affecting a company's operations
- oversight autonomy and resources, namely by investing an individual with

- responsibility for compliance and establishing a compliance oversight team
- due diligence on third parties, such as joint venture partners, agents, consultants and contractors
- communication and training on policies and procedures
- monitoring and review of the effectiveness of the compliance programme through reports to senior management
- establishing a whistleblowing channel to allow employees to report issues without fear of retaliation.

Alternative reference documents providing an overview of the core components of a compliance programme are Transparency International's Business Principles for Countering Bribery (2013a) and the United Nations Global Compact Framework for Action for Businesses Against Corruption (2011).

More detailed guidance on specific anti-corruption mechanisms can be found in other documents. For example, on risk assessment, valuable publications include Transparency International's Diagnosing Bribery Risk (2013b) and the United Nations Global Compact's (2013) Guide for Anti-Corruption Risk Assessment. Free e-learning training courses are available on GAN Integrity's Business Anti-Corruption Portal (2018b) and the Transparency International (2018) website Doing Business Without Bribery. The World Economic Forum has also released Good Practice Guidelines on Conducting Third-Party Due Diligence (2013).

Many of these publications speak primarily to managing integrity risks in larger multinational companies. There is nonetheless additional guidance available for SMEs on developing compliance procedures proportionate to their operations. The Centre for International Private

Enterprise's (2014) Anti-Corruption Compliance Guidance for Mid-Sized Companies in Emerging Markets is one such example. The International Chamber of Commerce (2015) has also released a guide for SMEs on conducting third-party due diligence.

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