

# Legal and Regulatory Issues Challenging the Pakistani Construction Industry

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## Abstract

The Pakistani construction industry suffers many of the same pains as that of a developing country. Corrupt governmental involvement and lack of regulatory constraints allow ill-qualified consultants and contractors to structure the industry to suit their purposes. To continue leveraging on domestic opportunities and competing in the global marketplace, Pakistani construction industry players need to address these challenges. Improvements need to be implemented by all parties along the entire construction industry value chain for lasting transformation to occur. The absence of a strong regulatory environment and authority is a problem that requires priority attention. Structurally weak legal and regulatory framework acts as a deterrent for attracting qualified consultants and contractors. To present a construction opportunity that will appeal to ethical and competent companies of both national and foreign ownership the Pakistani construction industry must provide an improved business environment.

## Keywords

Business, ethics, legal, Pakistan, regulations.

## Introduction

This paper is founded upon the findings of a study performed by NED University of Engineering and Technology and Florida International University. The scope of the study was targeted toward identifying the key issues related to – and developing a strategic model for improvement of – construction project management framework in Pakistan, the findings of the study were more concentrated on identifying the gaps in construction project management education, research and practice in the industry. However, while diagnosing these specific issues, a number of macro-level industry issues in relation to the overall business and operational environment of the construction industry of Pakistan, in general, were also identified and noted.

Of the multitude of macro-level topics revealed those listed below will be discussed herein. Construction industry business environment

- Construction industry regulatory environment
- Construction industry legal environment
- Ethical behaviors in the construction industry

To continue leveraging on domestic opportunities and competing in the global marketplace, Pakistani construction industry players need to address these challenges. Improvements need to be implemented by all parties along the entire construction industry value chain for lasting transformation to occur. Therefore, in addition to contractors all of the other participants in a project such as public clients, approving authorities, consultants, and other stakeholders must be involved in this transformation.

### **Construction Industry Business Environment**

Political interference, corruption, transparency, and security issues are among the major impediments to the growth of the construction industry in Pakistan. Additionally, the lack of regulatory reforms, inadequate government planning, cumbersome policies and weak client agencies are responsible for many of the problems faced by Pakistani contractors. All of these factors contribute to the poor business environment and serve to multiply the transaction costs of doing business.

Disproportionately cumbersome business processes such as land acquisition; obtaining clearances; external agencies processes; funding and payments; cost escalations; changes and modifications; and, final certifications serve as enormous obstacles for companies trying to enter the industry. Even established businesses face difficulties in carrying out these project cycle activities.

There is no restriction on entry into construction by unqualified players, which further results in low quality and productivity; serving as a disincentive to the qualified professionals. Compound this with the nearly non-existent practice of black-listing and eradicating poor performing contractors/consultants from the available pool causes the problem to appear to outsiders as insurmountable.

A further detriment to the growth of the construction industry in Pakistan is that the industry is dominated by a few construction and consulting firms who subcontract an appreciable portion of their work to smaller contractors. Generally, the size of these subcontracts does not appeal to foreign contractors and consultants, hence, competition is scarce. Additionally, specialty contractors with adequate skills, manpower, equipment and tools in the fields of electrical, mechanical, HVAC, etc. are largely limited.

Pakistan is a high risk country in which the owners' practice to accept low bids by local (albeit poor performing or unqualified) consultants and contractors discourages foreign consultants and contractors from competing in the market.

### **Construction Industry Regulatory Environment**

Construction, engineering and consulting organizations in Pakistan are subjected to three types of registration which are:

- Registration for the legal entity of the business upon its formation, followed by the requirement to submit annual/periodic reports;

- Registration with the official engineering body: Pakistan Engineering Council (PEC), requiring periodic renewal of registration and
- Registration with client agencies

In the case of registration as a legal entity, the submission of annual/periodic returns applies only to incorporated business entities such as limited liability, public or private companies. Other registered entities, such as registered partnerships and sole proprietorships do not have a requirement for annual returns. In registration with PEC, the periodic renewal plays a limited role, in so far as regulation is concerned, and registration requirements with the client agencies vary from client to client. Apart from the above, other associations which exist for the construction and consulting organizations mainly provide a forum and voice for their members, but cannot be considered as part of the regulatory framework of the construction and engineering consulting industry.

The PEC is however a formally recognized legal body which plays the role of a regulator for the industry, ensuring that minimum criteria are met for initial registration of an organization (construction contractors and consultants) and those criteria are maintained to enable yearly renewal of registration. A participating construction or consulting organization is required to keep its registration with PEC up to date. Although PEC is the official body for the industry, its role as a regulator is not dynamic or effective. PEC is not capable of monitoring projects and activities, their performance, adherence to professional and ethical standards or quality of construction materials used or application of technical skills on a project. There exists no form of continuous reporting or verification mechanism which should be in place for enabling such continuous monitoring.

Regulation of the construction and engineering consulting organizations is hence weak if not altogether absent, and in the absence of an effective regulatory body the owner plays the role of a regulator to a great extent through flawed and one sided contract documents. At times, in addition to client, several other government agencies and “committees” (such as the Chief Ministers’ inspection team) also indulge in acting as regulators. The client can, in the short to medium term and until such time as an effective overall regulatory environment develops, play its de facto role of a regulator in a more positive manner, provided that the relationship between client, “The Engineer” (consultant), and the contractor is honored as laid down in the FIDIC and PEC standard contract documents in letter and spirit. Adding the role of Construction Manager as an entity for professionally managing the project in its entirety is a dire need. Strengthening of the PEC or establishing a separate regulatory body is an option, which should be explored.

### **Construction Industry Legal Environment**

With multiplicity of contract forms, varied dispute resolution mechanisms, lack of willingness of parties involved to honor the awards, and no effective implementation mechanism in practice, disputes, in most cases, end up in courts of law and remain unresolved for long durations.

The Pakistani construction industry has tried to implement an ad-hoc arbitration process. However, the process has some major shortcomings that include:

- No provision of specific rules and requirement for parties to sign an agreement regarding the rules to be followed
- No provision for a neutral body to administer and supervise Arbitration
- No quality control of Arbitrator's qualifications and expertise and an obvious lack of close supervision/monitoring of arbitrator's progress
- No assistance available in managing Arbitrator's fees, and any administrative support.

One of the major reasons attributed to the poor effectiveness of the Ad-hoc Arbitration process is that at the time of signing the arbitration agreement, the owner often insists on having arbitrators from among its own serving or retired corporate officers or a panel with which it has some direct or indirect association. While this works in a large number of cases where the real intent of both sides is generally to reach an agreement, this also provides grounds for resorting to judicial remedies after the award is given.

Even when a settlement is reached through the arbitration process there is an increasing tendency to appeal on the grounds of "misconduct" on the part of arbitrators. Claimants particularly take the view that the arbitrator's decisions are not being approved by any responsible organization. This has added to the delays in the arbitration process which are increasingly resulting in time and cost overruns of projects.

Another grey area pertains to non-availability of clearly defined eligibility criteria and code of ethics with the appointing authority. Eligibility criteria for arbitrators are not fully transparent and do not follow a defined code of conduct.

Legal council needs to become involved to transform the ad-hoc arbitration system to one with credibility. At the least, the process must be modified to establish uniform requirements for qualification of arbitrators as well as instituting a method of establishing an unbiased panel.

### **Ethical Behaviours in the Construction Industry**

Corruption and transparency issues are the major challenges the government has to address in order to develop the capacity to improve the country's image.

Implementation of FIDIC guidelines and contracts in letter and spirit is considered by industry participants to be essential for helping solve such problems.

Corrupt practices, which are a bane in the overall environment but over time have come to be accepted as 'necessary' and to be included if a project is to be won and then delivered with minimum hindrances. Offering bribes during the project lifecycle has become institutionalized. These practices cannot be called business processes but are an integral and unavoidable reality of the current business environment. These include unwritten procedures and fixed financial costs and charges for procedures such as; obtaining successful pre-qualification; having an audit objection cleared or expedited; obtaining timely approvals of work and release of payments; mobilizing the police to assist when needed; and for getting customs to give a favorable ruling of the duties and taxes on imports.

## **Conclusion**

Generally, the contractors and the business environment in developing countries also tend to be under developed. Given the opportunity, they can overcome their inadequacies, but they cannot easily change the environment. The challenges being faced by the industry in developing countries include lack of long-term vision and planning for the industry; fluctuations in work load; defective contract documents; corrupt contracting procedures; and, unfair competition from state-owned contractors and consultants.

The absence of a strong regulatory environment and authority is a problem that requires priority attention. Structurally weak legal and regulatory framework acts as a deterrent for attracting qualified consultants and contractors.

Finally, a dispute resolution process that has legitimate regulations as well as ethical and unbiased procedures will serve to encourage confidence in Pakistan's construction industry.

## **Reference**

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