THE EFFECT OF INDIRECT TAXATION ON THE MANUFACTURING SECTOR OF PAKISTAN: A Case Study of Shoes Industry.

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INTRODUCTION: Economic development is reflected into the up-shoot of GDP. The pre-requisite for economic growth is the positive performance of the sectors' to such extent conducive to raise the GDP of the country. It is quite common that performance of each sector in the economy can be encouraged by providing certain incentives like tax holidays, subsidies etc. Many the like studies conducted by Bond (1981), and Azhar and Khan (1974) proved that tax incentive/ holidays had positive impact on the output of the firms. But there is a drawback in it. That is, industries did not respond positively after the expiry of the lax holidays period. It means that it is effective only in the short run. Therefore such fiscal measure is not effective in the long run. So we have to look for other alternatives fulfilling the goal of economic growth even in the long run. So the liberal taxation policy is the suitable for the various sectors of the economy. Or, in other words, liberal fiscal device is suitable to encourage the output of various sectors. Since our interest is in the manufacturing sector, therefore we will concentrate on the on this Sector.

In the manufacturing sector almost all the firms aim at the objective of profit maximization. There are two alternatives to maximize the profit. Either to maximize the output level or to minimize the cost.. As in either case, the gap between the output and cost will be the maximum resulting into the sole objective of profit maximization. Moreover the firm is said to be efficient, if it minimizes the production cost at any level of output. But the decisions of the firms are influenced by the governmental policies, especially the taxation policy. So it can be said that tax rate has an impact on the efficiency and output of the firms. Or, in other words, we can say that indirect taxes like excise duty, sales tax etc. affect the producers' decision about the output level and resources allocation.

Therefore, it is strongly felt that there should be a clear-cut indicators/guidelines for the producers to decide about the output level and resources allocation. On the basis of given quantitative relationship between output and tax rate, the producers will be certain in their actions. It will avoid the business fluctuations in the economy. Thus result will be the stabilized economy. That is why, intend to analyze the effect of tax rate on the output level of the firms. This paper deals with determining the quantitative relationship between the lax rate and output level of the firms. In this way, by knowing the tax rate we would be able to foresee its impact on the output level of the particular firm. It will be helpful to estimate the total output of all the firms in the said industry needed to fulfill the total demand in the economy. Total demand is .assumed to be known keeping in view the state of inertia (constant previous trend).

REVIEW OF LITERATURE: The previous studies showed that the share of indirect taxes in Pakistan has been substantially higher in the total tax revenue, as concluded by Lewis and Qureshi (1964). Raymond (1989) explained the same in slightly different manner for the economy of United States. Moreover, the efficient working of the manufacturing sector is conducive for the economic development. Cheema (1978), Kemal (1981) and Wizarat (1989) showed the performance of large-scale manufacturing sector of Pakistan. Moreover tax holidays also encourage investment in the industrial sector. For example, Azhar and Sharif (1974) and Bond (1981) empirically proved the positive correlation between tax holidays and industrial output. But it is also worth to note that tax rate and output of manufacturing sector are inversely related Robert and Uriel (1987) empirically .proved the above notation. The authors used the data of West Virginia State of United States. However, Radhu (1965) showed the positive