Impact of Direct and Indirect Tax Incentives on Textile industry (Pakistan)

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There was huge problem regarding tax incentives in Pakistan. The current study aimed to explore the impact of these incentives on textile industry of Pakistan. In order to investigate the impact, secondary data were collected from financial reports (2005 to 2010) of companies regarding textile sector. Economic Survey of Pakistan (1996 to 2010) issued by FBR were also applied. Two different models were applied to make final analysis. The results revealed that excise duty has positive impact while custom duty has no impact on the growth of textile sectors. The direct tax has negative impact of profitable of textile sector.

Keywords: Textile Industry, Direct and Indirect tax incentives

INTRODUCTION

The Pakistani economy ranks 47th in nominal terms and 27th in terms of purchasing power parity (PPP) in global context. As Pakistan is semi-industrialized, it mainly encompasses textile, chemical, agriculture and other industries. The World Bank and International Finance Corporation’s reports rank Pakistan 85 among 181 countries around the globe in perspective ease of doing business Index 2012. Pakistan stands highest in South Asia and also ranks higher than China, Russia and India (Pakistan economic survey 2009-10).

Textile is vital important for Asian economy as it is considered the back bone of the economy of many countries like India and Pakistan etc. In Pakistan the export contribution in GDP is 25 billion rupees in which the textile sector of contributed 60 percent in the total amount of export contribution (Dawn, Feb, 23, 2012). Pakistan export in the region-US$ 19 billion while export of Malaysia is 210, India 201, Thailand 152 Philippines 55, Bangladesh 16 and Sri Lanka 9 (The world bank indicators 2009-10). Pakistan textile sector is going down day by day due to energy crises, high burden of taxes and other hurdles as well. These hurdles are creating serious consequences and complicated problems in the country like electricity shortage, gas shortage, and inflation, high prices of petroleum, unemployment, and vicious circle of poverty, external debt, domestic debt and high rate of taxes. Among them the most serious problem is the high rate of taxes of direct 40% and indirect 17% (Pakistan Economic survey 2010-11).

There are different types of taxes are being imposed in Pakistan in shape of special excise duty, regulatory tax , corporate tax, undivided tax, sale tax(value added tax), goods and services tax (GST tax), property tax , pay roll tax, income tax, capital gain tax, corporate tax, social security...
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contribution, inheritance tax, expatriation tax, transfer tax, tariff, lenience fees, poll tax, advalorem, consumption tax, environment tax, etc. All these taxes become the cause of increasing the cost things which affect the purchasing power of people.

In Pakistan, the textile sector has obsolete equipment & machinery. The lack of availability of modernized machinery and equipment leads to decline of textile sector competitiveness. The cost of production has been increased due to the obsolete technology as compared to other countries like India, Bangladesh, and China. In Pakistan people tend to export raw material to the global textile buyer and the same raw material come back to Pakistan in form of finished value added textile products and fashion accessories on higher prices. These all taxes is like a mountain for a company to pay. Textile sector is falling down day by day, the people has been set their mind that they will not pay the taxes because they have not enough money to bear this burden of taxation. Experts claim that more and more people in Pakistan are slipping under the poverty line. In the last five month, more than 1500 people have committed suicide because of poverty. (The international news, feb-28-2012) Pakistan per capita income is 2288 $ that is the lowest GDP per capita of in the region-US$ (purchasing power parity base) while in Malaysia 12149$, Thiland 7364$, Sri Lanka 3651, Philippines 3055$, Vietnam 2290, India 2393$ (The World Bank indicators 2009-10) It is expected that textile sector may fall from 14 billion dollar to 10 billion dollars. 50 percent of textile sector have been closed (Pakistan textile exporters association). Pakistan considered the unattractive for investments; the total investment has been decline 22.5 percent of GDP in 2006-07 to 13.4 percent of GDP in 2010-2011 (Pakistan Economic survey 2010-11).

Taxation revenue is necessary for the progress of any country economy. But due to the wrong policies and mismanagement the taxation has become the burden on the nation. According to IMF report one percent of total population of Pakistan is paying the tax, due to this tax to GDP has become 9 percent which is very low with compare to other neighbor countries and other world countries. Taxes should be imposed through proper consultation method; preferable through administrative discretion. There should be no taxation without representation. In this scenario the government of Pakistan should give some special incentive to textile sector. Government should do something to reduce the tax collection gap (69 percent) which is necessary to increase tax to GDP. Taxation incentive plays a Vital role in the growth of industry. Incentive can be define that the any incentive which can reduce the burden of taxation of enterprises and individual. Taxation incentive is compulsory for any industry growth as it is blood for a human body.

Pakistan textile sector is seeking taxation incentives in shape of cross cutting issue, textile investment support fund (TISE), technology upgrading fund (TUF), infrastructure development, skill development, standardizing, zero rating export, rationalization of tariff structure, removing regulatory frame work, Market access, export housing scheme, Marketing insurance scheme, information and communication technology, low prices of fibers or cotton, ginning filament yarn, spinning, weaving and knitting, decrees in local taxes. Therefore, taxation incentive plays a vital role in the development of the textile industry. Government can make the performance of textile sector better if the existing policies and practices get reviewed and critically reviewed. The textile industry over all contribution of taxes in 2012-2013 is expected to reach Rs. 20.5 billion. Textile export stood at $ 12.5 billion from July 2012. Tax department of Pakistan collected Rs. 10.5 billion as 0.1 % withholding tax. Hence, this study will attempt to analyze with more details about the taxation policies and incentive that Pakistan has been practicing. As well as the shift of policies and how it affects the country’s textile sector as a whole and the impact of indirect taxation incentive on textile industry in Pakistan. As researcher we are focusing on textile industry’s improvement and impact levels of taxation on textile sector.

In this research we want to improve some new taxation types and more incentive to promote Pakistan textile industry. The research paper also explain that the tax incentive play an important role in the growth of industry. What type of
incentive the investors want in the Pakistan? The research also gives some model and suggestion to increase the growth of industry and improve the balance of trade.

There are many problems which the textiles industries facing in developing countries like Pakistan. Textile sector growth is decreasing day by day due to the energy crises, political instability, high rates of interest, lack of capital, inflation, poor government policies, agricultural and industry backwardness, technical backwardness, trade deficit, vicious circle of poverty, inadequate infrastructure, tight monetary policies, lack of new investment, shortage of raw material, high burden of debt, global recession, and the huge burden of taxes in shape of direct and indirect taxes. The high rates of taxes affecting the textile sector very badly as the general public are not in position to bear the burden of taxes. Therefore, cost of goods is going high and purchasing power of the consumer going down. The current study does investigate the quantitative impact of taxation on consumers of textile sector of Pakistan, and will propose it solutions of the problem.

Keeping in view the research problem, the current study achieves the following objectives:

1. To identify the impact of direct taxes on textile sector in Pakistan.
2. To quantify the impact of indirect taxes on textile sector.
3. Recommendation policy for government of Pakistan.

LITERATURE

Rana (2012) analyzed in his study that number of tax dodgers grossly overstated FBR in the Pakistan. He tried to dig up year resource of these numbers and get some insight into the future of the campaign, through background interviews conducted with various taxation officials. Naqvi (2012) examined the response of people regarding high rates of prices with title of "Is it the only way out". She claimed that more and more people in Pakistan are slipping under the poverty line. Lack of measures taken to decrease poverty coupled with constant rise in prices is leading many to take the extreme step of subside. He said in his article that the people are not able to bear the high prices of things due to the high taxes.

Sheikh (2011) explained that under develop countries like Pakistan has very complex and inefficient tax system. He also told that fiscal deficit increased due to the narrowing down of the gap between the public revenue and the public expenditure. The objective of this research is reducing the reliance on indirect taxes and increases the share of direct taxes. He said that share of indirect in total tax revenue is 80 % in 1990 and it became now is 60 % on the other side the direct tax share was 18 % in 1990 and 40 % now. The other objective of this research is improving the tax administration system in Pakistan. Hamid (2011) investigated impact of taxes on dividend policy in banking sector Pakistan. He concluded significance co-relation between tax dividends by using the secondary data in sampling technique model of correlation and regression; He also suggested that there is a strong relationship between depended variable (dividend) and in depended variable (taxes). He also suggested that the tax rate was important element of dividend policy of banking sectors.

Pasha (2010) identified the reason of low tax to GDP trap in the Pakistan. She also point out the effect of IMF loan effect on the tax to GDP in the Pakistan. She described the greater emphasis placed on budget deficit reduction in order to contain the rate of inflation and restore a measure of fiscal policy. She also explores how Pakistan can get out of the low tax to GDP trap and come close to achieving its revenue. She calculated that rate effect negative while the base affect positive. Selin (2009) disclosed the relationship between the rise in female employment and the role of tax incentive. Selin used a time series model to know the average growth of women employment in different era due to the fluctuation in tax incentive. In his research he tried to point out that female employment is so much affecting due to the lack of tax incentives.

Sarker (2006) explained in his study about the problems of individual due to the high burden of taxation in under developing countries like Bangladesh. To measure the progressive of taxes
and hence to calculate marginal and average tax rates in different income year. He used a time series data on both personal and corporation income tax. In this article he organized into five sessions. He also explained how an individual and organization had been affecting due the high rates of taxation in the Bangladesh.

Albama (2006) investigated in his research that tax incentive is necessary to create the attractiveness of new investors. He also explained that stability of the tax environment is increase the growth of industry. He tried to point out the fault of the procedure of tax administrative. He briefly explained the various types of taxes and this impact on the economy. Chaudhary (2001) he analyzed in his theory of optimal taxation and current tax policy in Pakistan’s agriculture that the application on the theory and development of appreciate model in agriculture are more limited in view of complexity of production system and limited availability of tax instrument. He explained that the tax system of Pakistan is very in bad condition it badly needs to review its all policies regarding agriculture tax system in Pakistan.

HYPOTHESES

Main hypothesis
• There is a relationship between Direct tax and textile units.

Subsidiary hypothesis
• There is association between Sale tax and textile units
• There is a relation between Excise Duty and textile units
• There is a linkage between Custom Duty and textile units

METHODOLOGY

In order to fulfill the objectives of study, secondary data pertaining to the period 1996-2012 were collected form Federal board of revenue (FBR) and Economic Survey of Pakistan. Ordinary least square (OLS) model approach was applied to test the hypotheses. In multiple-regression model, unit of textile industry (UTI) was taken a dependent variable while direct tax (DT), excise duty (ED), custom duty (CUD) and sales tax (ST) were used independent variables.

\[ UT_{it} = \alpha + \beta_1 DT_{it} + \beta_2 ED_{it} + \beta_3 CUD_{it} + \beta_4 ST_{it} + \epsilon_{it} \]  

Where

\[ UT_{it} = \text{Unit of textile industries (dependent variable)} \]

\[ DT_{it} = \text{Direct tax (independent variable)} \]

\[ ED_{it} = \text{Excise duty (independent variable)} \]

\[ CUD_{it} = \text{Custom duty (independent variable)} \]

\[ ST_{it} = \text{Sales tax collection (independent variable)} \]

\[ \epsilon_{it} = \text{Error Term} \]

FINDINGS

Table-1 shows the Direct tax (DT) mean is 220997.85 and standard deviation 142574.47, Excise Duty (EXD) means is 66438.5 and Standard Deviation 25297.98, Custom duty mean is 100485.28 and standard deviation 39168.41215, Total tax Collection (TTC) mean is 618072.7143, Sale tax (ST) mean is 230151.0714 and standard deviation 145304.27129 and the mean of Units of textile industries is 460.9231 and Standard Deviation 27.6811.

From the empirical results as shown in above Table-3, it is concluded that Direct tax (DT), Excise duty (ED) and Sales tax have significantly negative impact on units of textile industry (UTI) of Pakistan. The study reveals that the custom duty (CUD) also has negative impact but coefficient not statistically significant.

DISCUSSION AND RESULTS

Since the textile sector is considered to be the most important sector of Pakistan so, there should be adequate changes in the tax incentives policies needed. Indirect taxes which are charged should be charged according to the necessity of goods and services. Careful thought and consideration should be given in order for the indirect and direct taxation to have its desired effect on the growth of textile sector. A proper and adequate tax system is required that implement reasonable and carefully
planned direct and indirect tax policies that will improve Pakistan’s economic condition. The standard of living can also be improved in such a way. Therefore, it is necessary for careful planning and procedures to be carried out in dealing with such policies. Awareness has to be spread in order to inform all consumers about the direction and objectives the authorities wish to achieve by administering the indirect and direct taxation policy.

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APPENDIX

Table-1 Descriptive statistics

<table>
<thead>
<tr>
<th></th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>DT</td>
<td>85060.00</td>
<td>528649.0</td>
<td>220997.8</td>
<td>142574.4662</td>
</tr>
<tr>
<td>EXD</td>
<td>44754.00</td>
<td>121182.0</td>
<td>66438.50</td>
<td>25297.98697</td>
</tr>
<tr>
<td>CUD</td>
<td>47818.00</td>
<td>161489.0</td>
<td>100485.2</td>
<td>39168.41215</td>
</tr>
<tr>
<td>TTC</td>
<td>282087.0</td>
<td>132862.0</td>
<td>618072.7</td>
<td>342786.5596</td>
</tr>
<tr>
<td>ST</td>
<td>53942.00</td>
<td>517302.0</td>
<td>230151.0</td>
<td>145304.2712</td>
</tr>
<tr>
<td>UTI</td>
<td>440.00</td>
<td>521.00</td>
<td>460.9231</td>
<td>27.68111</td>
</tr>
</tbody>
</table>

Table-2 Correlation Coefficients

<table>
<thead>
<tr>
<th></th>
<th>DT</th>
<th>EXD</th>
<th>CUD</th>
<th>TTC</th>
<th>ST</th>
<th>UTI</th>
</tr>
</thead>
<tbody>
<tr>
<td>DT</td>
<td>1</td>
<td>.911(**)</td>
<td>.884(**)</td>
<td>.993(**)</td>
<td>.965(**)</td>
<td>.901(**)</td>
</tr>
<tr>
<td>EXD</td>
<td></td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
</tr>
<tr>
<td>CUD</td>
<td>.911(**)</td>
<td>1</td>
<td>.773(**)</td>
<td>.882(**)</td>
<td>.805(**)</td>
<td>.900(**)</td>
</tr>
<tr>
<td>ST</td>
<td></td>
<td>.000</td>
<td>.001</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
</tr>
<tr>
<td>UTI</td>
<td></td>
<td>.000</td>
<td>.001</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
</tr>
</tbody>
</table>

*** Significant at 1% level. ** Significant at 5% level. *Significant at 10% level.
Table-3 Coefficients of regression Model

<table>
<thead>
<tr>
<th>Mode 1</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig. Std. Error</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td>B</td>
</tr>
<tr>
<td>(Constan t)</td>
<td>388.996</td>
<td>13.188</td>
<td>29.496</td>
<td>.000</td>
</tr>
<tr>
<td>DT</td>
<td>.000</td>
<td>.000</td>
<td>-1.359</td>
<td>-2.029</td>
</tr>
<tr>
<td>EXD</td>
<td>-.001</td>
<td>.000</td>
<td>-1.068</td>
<td>3.543</td>
</tr>
<tr>
<td>CUD</td>
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<td>.000</td>
<td>-0.244</td>
<td>-1.160</td>
</tr>
<tr>
<td>ST</td>
<td>.000</td>
<td>.000</td>
<td>-1.552</td>
<td>3.385</td>
</tr>
</tbody>
</table>

Dependent Variable UTI

*** Significant at 1% level. ** Significant at 5% level. *Significant at 10% level.

R² is 93% and F-statistic 29 proves the fitness of model.