

The Impact of Tax Collection and Domestic Entrepreneurial Business Ventures on Services Sector in Pakistan: An ARDL Bound Test Approach

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ABSTRACT

The services sector is the leading sector of Pakistan's economy. It creates employment, foreign exchange earnings, research, and innovation, and significantly contributes to Pakistan's economy. A significant amount of tax revenue is collected from the services sector. Therefore, it is imperative to analyze how taxation influences the services sector in Pakistan. The objective of the present study is to analyze the impact of tax revenue, entrepreneurial ventures, trade openness, inflation, and GDP per capita on the service sector of Pakistan. For this, data from 1980 to 2020 is used. The long-run ARDL estimates show that taxation adversely impacts Pakistan's services sector. The results show that the variables domestic entrepreneur venture, gross national expenditures, and trade openness were significant and positively related to the service sector growth of Pakistan, while the variables tax revenue, poverty, and inflation rate were negatively related to Pakistan's service sector growth rate. By considering the study results, it is concluded that the tax system significantly impacts Pakistan's services sector. Due to high taxes, businesses in the services industry find it challenging to expand and compete. The policy recommendations are that the government must balance raising tax income with promoting the expansion of the services sector. Further, the government should endeavor to streamline the tax system so that companies can easily comprehend and adhere to the law. However, future research can be used the panel data form for developing countries. Further, the impact of taxation on other segments of the economy, such as agriculture and large-scale manufacturing, can be analyzed.

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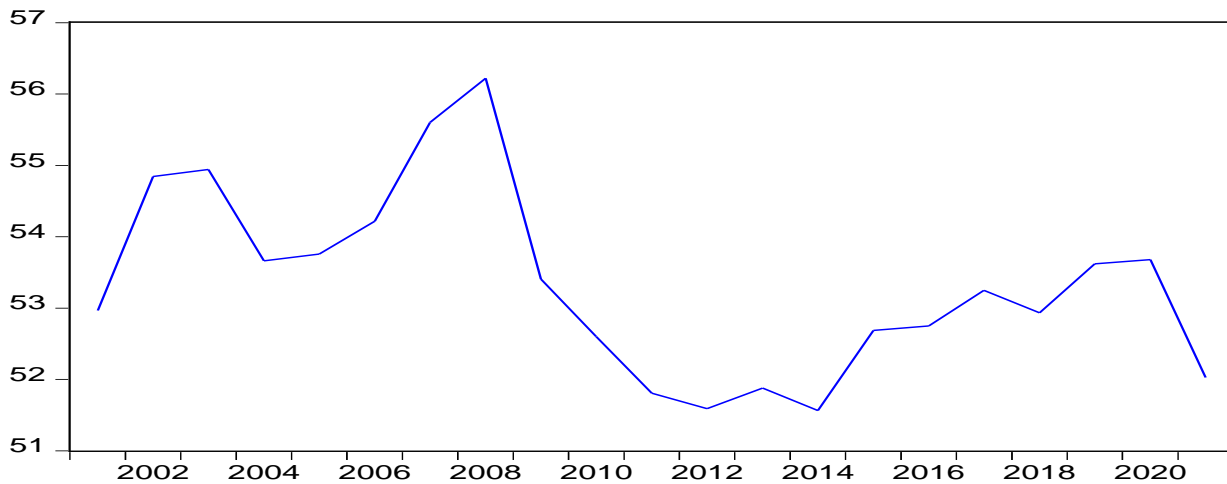
INTRODUCTION

The development of an economy is significantly dependent on the service sector (Ambreen et al., 2017). A key characteristic of a developed country is that the services sector increasingly dominates the economy (Jalil et al., 2016). This sector is the fastest-rising industry, with the highest employment rates and levels of productivity (Ahmed & Ahsan, 2011). The heterogeneous service sector includes both capital- and labor-intensive activities. The industry provides intermediate and final needs generated and utilized by the public and private markets. Developed and developing economies immensely depend on the service sector (Singh & Kaur, 2014). The World Bank has demonstrated distinct concerns about escalating the service sector to combat poverty. The expansion of economic activity depends on the services rendered by trade, commercial operations, insurance, banking, and other subsectors of the services sector (Soni & Parashar, 2013). The economy regularly

uses services from the sectors like education, health, food to finance investments, travelling to entertainment, researching activities, and for marketing as well. Economic liberalization is a key factor in the fast-paced expansion of the service sector, which has increased its importance to the world's economies (Singh & Kaur, 2014).

The direct and indirect ways that the service sector can influence the country's economy are the creation of both forward and backward linkages and an increase in overall output, trade, and employment. Nonetheless, emerging economies' primarily agrarian character conceals the potential contribution of the service sector to economic reform. Numerous reasons, including trade liberalization, investment, consumption, and technological advancements like digital service delivery, are responsible for the service sector's rapid expansion (Nayyar et al., 2021). Additionally, because the industry is used to operationalize sophisticated and complex industrial economies like finance, information, and logistics, it has become an essential component of global trade. As a result, the industry is now an essential component of both the agricultural and industrial sectors (James et al., 2023). Additionally, the service industry offers a variety of jobs, ranging from low-skilled to highly trained laborers (Johnston & Huggins, 2018).

According to Sundrum (1990), the transformation of a developing economy into a service-oriented economy is natural. An economy's service sector's effectiveness affects its trade and economic success. A country's overall economic performance and the welfare of its people depend on a healthy service sector. The services sector reforms offer a vital opportunity for policymakers to boost productivity, employment, and innovation. The ability to strengthen developing economies like Pakistan to adjust to trade globalization in the services sector and increasing significance services for future expansion of the economy in poverty elimination and economic development will also be strengthened (Ajmair & Ahmed, 2011, Amin.S, 2022). In Pakistan, the services sector contribution towards economy is rising. Actually, the service sector growth rate is greater than that of the industrial and agriculture sectors. The services sector contributes 58 percent to the GDP of Pakistan. This sector is also closely linked to the other economic sectors and supplies vital inputs to the industrial and agricultural sectors (PES, 2021-22). In Pakistan, the service industry has emerged as the key elements supporting the country's development expansion. Figure 1 illustrates how quickly the service industry has grown since 2008. Pakistan's economy saw a significant transformation due to this sector, just like many economies across the globe. From 2008 to 2014, the service sector contribution role to Pakistan's GDP was decreasing. From 2015, the share of the services sector to GDP increased till 2019, but after the COVID-19 shocks, its trend declined.

Figure I: Trend of Service Sector (Percent of GDP) in Pakistan

Source: World Development Indicators

On the contrary, taxes are imperative to raise government revenue, although high taxation rates can adversely influence the services sector of the economy. Taxation's positive and negative impacts on the economy's growth are given. The negative view may be given as taxation is the main determinant of investment, which may harm the economy's growth. The taxation system prevents businesses and individuals from being creative and prevents them from investing more. Thus, supporters of this idea suggested lowering the tax to encourage people to be more creative (Chamley, 1986; King & Rebelo, 1990). Moreover, Engen & Skinner (1996), for example, stated that taxation could only have negative effects on the economy's growth in different ways, such as investment, affected supply of labor, decreased growth productivity, declining marginal efficiency share of the capital, and efficiently usage of human capital is falling. In contrast, the positive view states that tax revenue finances public goods and services, like health care, education, infrastructure, and so on, which businesses and innovators benefit from and depend on. So, the tax increase is desirable if it supports public goods, raising entrepreneurs' revenues. These economists suggest that greater tax and redistribution can increase the economy's investment opportunity (Aghion & Bolton, 1997; Benabou, 1996).

In addition to raising revenue for government expenditure (Edame & Okoi, 2014, Kumar et al., 2023), taxes significantly affect the performance of the consumption and production sectors, which account for the majority of tax income raised by the government (Olufemi et al., 2018). The claims made by Agell et al. (1997) and Castles & Dowrick (1990) that those distinct applications of overall government spending have varying effects on growth also hold for tax policy. As a result, there has never been a consensus on the effect of taxes on the functioning of the economy, either in theory or in practice. First, the neoclassical growth model of Blinder & Solow (1976) suggests that tax policy has little bearing on steady-state growth. It implies that taxation policy has no longer effectiveness on the growth of the economy. Romer (1986) growth model proposes that long-term or sustainable

growth may be impacted by tax and spending policies. Furthermore, Romer & Romer (2010) described that taxation sustains economic growth and creates more substantial competitiveness in the world, gives predictable and stable fiscal circumstances; subsequently, helps to collect funds for financing the physical and social infrastructure needs, decreases long-run dependency on aid, and guaranteed for good governance by strengthening accountability of the government. In Pakistan, the government mostly depends on tax revenue to cover planned spending and satisfy growth targets. A country's ability to finance the many social and physical infrastructures required to achieve more equitable and sustainable economic growth depends on having an effective tax system.

The study aims to find the core answers of the following research questions that how tax revenue and domestic entrepreneurial business ventures with other control variables influences Pakistan's service sector. Policymakers will find this study useful in creating policies to set the appropriate level of taxes without adversely influencing the services sector of the economy.

The study is structured as follows: the literature review is shown in Section 2, data and methodology are illustrated in Section 3, the results and discussions demonstrated in Section 4, and the conclusions and policy implementations are presented in Section 5.

LITERATURE REVIEW

In the theoretical literature, exogenous growth theory, sometimes called neoclassical theory, assesses the association between growth and taxation. This idea is the antithesis of the new or endogenous growth theory, which will be covered in a moment. One type of exogenous theory is the Solow model, which was developed by Robert Solow in 1956. This theory states that government actions related to fiscal policy will not influence growth but rather that changes in economic growth will be attributed to factors that are determined outer side in the model, such as labor, capital, and technological advancement (Solow, 1956). In the neoclassical model, government taxes can influence growth throughout the shift to a new steady state if they influence saving and, in turn, the investment ratio level in the economy (Maganya, 2020).

According to the idea of optimal taxation, under certain economic circumstances, creating and implementing a tax will reduce inefficiency in the market equilibrium. The idea of optimum taxation is to choose a tax that, given a set of limitations, will maximize the welfare function of society. Furthermore, if the first best outcome is not achievable and the second best must be sought, knowing how to use socially optimal strategies to enhance the number of outputs from a varied population is necessary for the design and execution of the optimal tax (Mankiw et al., 2009).

At the empirical level, different studies explored the nexus between taxation and the services sector. James et al. (2023) used an ARDL model and data from 1980 to 2020 to investigate the factors causing Uganda's service industry to grow rapidly. The findings demonstrated that the sector's current performance was based on its historical level of service delivery. Additionally, FDI, GNE, and human capital significantly boost the service industry's expansion over the long and short terms. Nguyen & Darsono (2022) used the data from 2000 to 2020, to find the link among tax collection,

investment, and the growth of the economy in ASEAN countries. According to this analysis, tax revenue at large has a harmful influence on economic progress. Nevertheless, it became clear that greater tax income might lessen the negative effects of tax impacts and promote economic progress when the asymmetric impacts of tax collection were taken into account. Taxes have a negative impact that is evident in growth theories; however, it varies with tax revenue. While lower tax revenue may promote investment and saving, it also increases the government deficit and slows down economic development due to debt, spending, and investment. Using data from 1993 to 2020, Korbi & Zani (2021) examined the influence of taxes on the GDP in Albania. The outcomes of the research demonstrated a substantial link to direct tax collections and the lag in economic expansion. Indirect tax receipts typically don't significantly influence economic expansion. Maganya (2020) used data from 1996 to 2019 to estimate the influence of taxation on Tanzania's economic growth. The findings demonstrated an optimistic relationship between domestically goods and services taxes and GDP growth. GDP growth was found to be adversely correlated with income taxation.

Rathore et al., (2019) explored the key factors influencing the service sector in Pakistan by employing data from 1990 to 2017. Their study disclosed that FDI and service trade have a considerable and positive impact on the service industry. The results discovered a sizable impact of FDI and imports on GDP. The services sector had a considerable influence on GDP. Another study in the case of Pakistan was conducted by Saqib et al., (2014), which investigated the effect of taxes on Pakistan's gross domestic product using data from 1973 to 2010. The outcomes exhibited that the tax-to-GDP ratio negatively influenced Pakistan's economic growth. The income tax also negatively affected investment, and the sales tax negatively influenced government consumption expenditures. Stoilova & Patonov (2013) found the influence of the tax collection on the GDP of the European Union member nations using data from 1995 to 2010. The outcomes of the tax system, which depends on the direct tax base system, were efficient and positively influenced economic growth. Direct taxes significantly influenced the economic progress of the EU countries. The reason may be the gains from revenue accumulation through wealth taxation. Azeem et al. (2013) observed the link between taxes rate and economic progress in Pakistan, utilizing data from 1975 to 2009. The outcomes showed that the tax rate negatively influenced economic growth. Health expenditures, exports, and capital stock positively affected economic growth. The researchers concluded that Pakistan's tax policy needs to be changed to increase the country's tax base.

In the case of Nigeria, Okafor (2012) interrogated the association between revenue from income tax and economic progress by considering data from 1981 to 2007. His research showed a positive with statistically substantial association between income taxes and economic progress. Similarly, Dahlby & Ferde (2012) observed the influence of tax rates on Canada's progress in the economy using data from 1977 to 2006. The outcomes found that corporate taxes negatively influenced private investment, and in turn, they also negatively affected Canada's economic progress. The outcomes also indicated that value-added taxes enhanced provincial investment and economic progress. Atif et al., (2012) explored the role of taxation and inflation in affecting economic growth and investment using data from 1981 to 2010 in Pakistan. This analysis displayed that taxes do not significantly

influence Pakistan's economic growth but affect economic growth through investment channels. Inflation harmfully exaggerated the economic growth of the country. Bank loans optimistically affected private investment. The findings also showed that income tax negatively influenced investment and the growth of the economy. It was suggested that the lower government taxes on capital stock and ease the process of providing bank loans to boost investment and economic growth. Ogbonna & Ebimobowei (2012) explored the influence of oil tax revenue on the economic expansion of Nigeria using data from 1970 to 2010. The findings of this analysis exhibited a long-run link between the oil tax revenue and the growth of the Nigerian economy. The causality analysis revealed that the petroleum profit tax causes economic growth.

Ajmair & Ahmed (2011) investigated the causes of Pakistan's service sector growth rate using data from 1990 to 2005. The study indicated that as long as the services sector continues to be deregulated, there will also be a significant opportunity for future rapid growth in the Pakistani services economy. Employment development in Pakistan's services sector was relatively slow, highlighting the significance of the country's industry and agriculture, both of which are expanding quickly. Lastly, Ahmed & Ahsan (2011) advocated that Pakistan's growth process gains greater stability due to the expansion of the higher service sector. According to the analysis, the employment growth rate in other sectors that produce commodities is either flat or decreasing, whereas there are more employment prospects in the services sector. This raises the quality of life and lessens the effects of poverty. Trade and investment growth in the services sector fuels economic expansion and competition. For the services sector to become a significant driver of growth, employment, and eradicating poverty, the report recommended measures and strategies for reducing bottlenecks in the sector's expansion and a comprehensive package of policy reforms.

In the literature, it has been analyzed the different studies of taxes on economic growth, especially in the case of Pakistan; however, no study in literature explored the impact of taxes revenue and entrepreneurial business ventures on services in Pakistan. So this study will be significant contribution to the academic literature by providing important outcomes of how taxes influence the service sector of Pakistan. From the outcomes of the study, some policy recommendations will also be made to improve the performance of the service sector in Pakistan.

DATA AND METHODOLOGY

This study uses yearly data for Pakistan from 1980 to 2020. Data collection sources utilized in the present study was the World Development Indicators. To evaluate the impact of tax revenue and business ventures on the service sector in Pakistan, the outcome variable exercised in the model is the service sector growth, while independent variables are the gross fixed capital formation proxy used for domestic entrepreneurial business ventures, tax revenue proxy used for government revenue or the taxes, gross national expenditures, inflation rate, trade openness, and GDG per capita. The model's econometric form is shown below:

$$SSGR_i = \beta_0 + \beta_1 GFCF_i + \beta_2 TAX_i + \beta_3 GNE_i + \beta_4 INF_i + \beta_5 TRD_i + \beta_6 POV_i + u_i \quad (1)$$

Where SSGR represents service sector growth (annually percent), GFCF is gross fixed capital formation (percent of GDP), TAX indicates tax revenue (percent of GDP), INF represents inflation rate (consumer price index), TRD indicates trade openness (percent of GDP), POV indicates poverty (poverty headcount ratio), u_i is error term, and β 's are coefficient parameters of considering variables.

For data analysis, different data estimation techniques are applied. Firstly, the augmented Dickey-Fuller test is applied to check the degree of stationarity of variables. This analysis supports the researchers in determining the estimation technique for long-run parameters (Engle & Granger, 1987). Secondly, the bound cointegration test is used for the long-run cointegration of variables. The above-mentioned hypothesis is tested to estimate the long-run cointegration of variables:

H_0 : No Cointegration between variables

H_1 : Cointegration between variables

Fourthly, an autoregressive distributed lag model (ARDL) is applied for the long-run parameter estimation. This technique is suitable when the variables have a mixed order of integration (Pesaran & Shin, 1995). The error correction form of the ARDL model is given as follows:

$$\begin{aligned} \Delta SSGR = & \beta_0 + \sum_{l=1}^n \beta_1 \Delta GFCF_{t-j} + \sum_{l=0}^n \beta_2 \Delta TAX_{t-j} + \sum_{l=0}^n \beta_3 \Delta GNE_{t-j} + \sum_{l=0}^n \beta_4 \Delta INF_{t-j} + \sum_{l=0}^n \beta_5 \Delta TRD_{t-j} \\ & + \sum_{l=0}^n \beta_6 \Delta POV_{t-j} + \gamma_1 ECM_{t-1} + u_{1t} \end{aligned} \quad (3)$$

Where β_1 to β_6 are short-run coefficients while γ_1 is the parameter of the error correction term.

Lastly, model diagnostic tests such as autocorrelation, heteroskedasticity, residual normality, and model stability tests are applied.

RESULT AND DISCUSSION

Table 1 shows descriptive statistic of variables. The mean of service sector growth rate is 5.205, maximum SSGR is 9.242, minimum SSGR is -0.550, the SD is 1.936, skewness value is -0.446, kurtosis value is 3.888. Mean of GFCF is 15.916, maximum GFCF is 19.112, minimum GFCF is 12.521, standard deviation is 1.642, skewness value is -0.283, and the kurtosis value is 2.088. The mean TAX is 12.066, the maximum TAX is 15.178, minimum TAX is 9.264, standard deviation is 2.030, skewness value is -0.033, and kurtosis is 1.445. The mean GNE is 105.911, maximum GNE is 106.278, minimum GNE is 99.060, standard deviation is 3.567, the skewness

value is -0.167, and kurtosis value is 2.095. Description of other variables can also be observed similarly from Table.

Table I: Descriptive Statistics

Variables	SSGR	GFCF	TAX	GNE	INF	TRD	POV
Mean	5.205	15.916	12.066	105.911	8.163	32.463	32.131
Median	5.090	16.343	12.390	106.278	7.844	32.940	26.954
Maximum	9.242	19.112	15.178	112.038	20.286	38.499	64.300
Minimum	-0.550	12.521	9.264	99.060	2.529	25.306	17.320
Std. Dev.	1.936	1.642	2.030	3.567	3.763	3.531	12.019
Skewness	-0.449	-0.283	-0.033	-0.167	0.675	-0.435	1.141
Kurtosis	3.888	2.088	1.445	2.095	3.770	2.397	3.267

It is essential to do correlation analysis to determine the extent of the correlation that exists between two variables. Table 2 exhibits the correlation matrix. The study results show that the service sector growth is positively correlated with gross fixed capital formation (0.366), tax revenue (0.164), gross national expenditures (0.286), trade openness (0.138), and negative correlation with the inflation rate (-0.247) and poverty (-0.030). It can be observed that there is no strongly correlated pair of variables; hence, we can assert that there is no problem of multicollinearity being present among the variables.

Table II: Correlation Matrix (Model-I)

Correlation	SSGR	GFCF	TAX	GNE	INF	TRD	POV
SSGR	1.000						
GFCF	0.366	1.000					
TAX	0.164	0.524	1.000				
GNE	0.286	0.084	0.113	1.000			
INF	-0.247	0.248	0.062	0.188	1.000		
TRD	0.138	0.619	0.520	0.122	0.590	1.000	
POV	-0.030	-0.219	-0.663	-0.466	-0.122	-0.393	1.000

In this analysis, the ADF test is utilized to determine the degree of stationary of variables. Table 3 shows that the variable INF is integrated at a level while the variables service sector growth rate, GFCF, TAX, gross national expenditures, TRD, and poverty are stationary at 1st difference. These outcomes depict the mixed integration order and suggest that the ARDL model is better for estimating the parameters in the long run.

Table III: Unit Root Analysis

Variables	Level		1st Difference		Outcomes
	t-stat.	Prob.	t-stat.	Prob.	
SSGR	--	--	-5.8433	0.0000	I(1)
GFCF	--	--	-5.8882	0.0000	I(1)
TAX	--	--	-7.1326	0.0000	I(1)
GNE	--	--	-6.2787	0.0000	I(1)
INF	-3.0255	0.0410	--	--	I(0)
TRD	--	--	-6.7281	0.0000	I(1)
POV	--	--	-3.1570	0.0305	I(1)

The ARDL bound test examines the long-run cointegration of variables in a model. Table 4 demonstrates that the F-statistic value (5.8264) is higher than the upper bound values at a significance level of 1 percent. This leads us to the conclusion that long-run cointegration between variables in a model is present.

Table IV: ARDL Bound Test

Test Statistic	Value	K
F-statistic	5.8264	6
Critical Value Bounds		
Significance	I0 Bound	I1 Bound
10%	2.12	3.23
5%	2.45	3.61
2.5%	2.75	3.99
1%	3.15	4.43

About the ARDL long-run results are presented in Table 5. Looking first at the relationship between GFCF and SSGR, it is evident that GFCF is optimistically and significantly associated with Pakistan's service sector growth rate. The GFCF's coefficient value increases by one unit, the service sector growth rate is also enhanced by 0.3470 units. Positive association infers that an upsurge in the GFCF increases employment opportunities in the service sector so that people's income increases, leading to an upsurge in the SSGR. The study tax's core variable is negatively related to Pakistan's service sector growth rate. The TAX coefficient demonstrates that TAX increases by one unit, the service sector rate of growth declines by -0.9630 units. A rise in the rate of tax declines the net income of the people and discourages the investment level in a country. It adversely impacts the service industry in a country. The variable of gross national expenditures is positively and significantly related to Pakistan's service sector growth rate. The GNE's coefficient demonstrates that as the GNE increases by one unit, the service sector growth rate also increases by 0.2142 units. The increase in gross national expenditures enhances a country's investment and employment level, increasing the service sector growth rate. These results are also confirmed by studies such as those by Ambreen et al. (2017). The variable rate of inflation originated to be adversely connected to the service sector growth rate in Pakistan.

The INF’s coefficient demonstrates that as the INF upsurges by one unit, the service sector growth rate declines by -0.3233 units. A rise in inflation declines the people’s real income and discourages the investment level in a country, adversely impacting the service industry in a country. The variable of poverty is harmfully and considerably connected to Pakistan’s service sector growth rate. The POV’s coefficient demonstrates that as POV increases by one unit, the service sector growth rate leads to a reduction of -0.0695 units.

Table V: ARDL Long-Run Estimates of the Impact of Tax on the Service Sector

Dependent Variable: SSGR				
Selected Model: ARDL (2, 0, 0, 0, 1, 2, 2)				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
GFCF	0.3470	0.1653	2.0993	0.0460
TAX	-0.9630	0.4204	-2.2906	0.0366
GNE	0.2142	0.0653	3.2797	0.0031
INF	-0.3233	0.0805	-4.0154	0.0005
TRD	0.1711	0.1123	1.5235	0.1402
POV	-0.0695	0.0314	2.2153	0.0361
C	-30.2775	8.6312	-3.5078	0.0017

Table 6 exhibits the short-run ECM estimates. In the short-run ECM, it is essential to analyze the ECM term. It has been discovered that the ECM term is not only statistically significant but also contains a negative value (-0.6830). Specifically, it highlights the fact that, as we move from the short run to the long run, 68.30 percent of errors are discovered and remedied.

Table VI: ARDL Short-Run Estimates of the Impact of Tax on Service Sector

Dependent Variable: SSGR				
Selected Model: ARDL (2, 0, 0, 0, 1, 2, 2)				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(GFCF)	0.3758	0.2408	1.5604	0.1312
D(TAX)	0.1910	0.1895	1.0075	0.3233
D(GNE)	0.2320	0.1056	2.1971	0.0375
D(INF)	-0.1391	0.0774	-1.7971	0.0844
D(TRD)	0.2256	0.1057	2.1336	0.0429
D(POV)	0.0429	0.0634	0.6771	0.5045
ECM(-1)	-0.6830	0.2979	-2.2922	0.0313

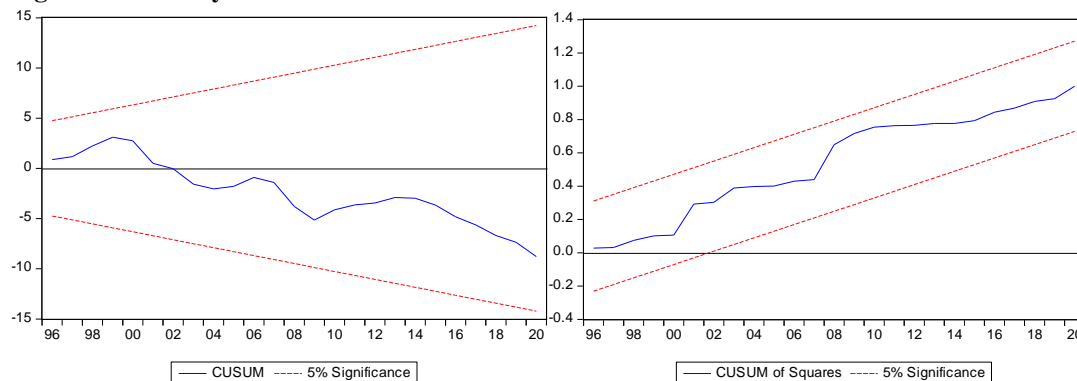
In addition, a variety of model diagnostic techniques are utilized to examine autocorrelation, heteroskedasticity, and residual normality. The Breusch-Godfrey, Breusch-Pagan-Godfrey, and Jarque-Bera tests are utilized to accomplish this desired outcome. The results presented in Table 7 demonstrate that there is no problem of autocorrelation or heteroskedasticity in the model, and the residuals are distributed normally.

Table VII: Model Diagnostic Tests

Problem	Test	Statistic	Prob.	Outcomes
Autocorrelation	Breusch-Godfrey	1.7303	0.1863	Not Found
Heteroskedasticity	Breusch-Pagan-Godfrey	0.9917	0.4863	Not Found
Residual Normality	Jarque-Bera	1.8904	0.3886	Normally Distributed

Lastly, the recursive model is utilized to evaluate the dynamic stability of the current model. To determine the stability of the model, the CUSUM and CUSUM of the square are utilized. Therefore, based on Figure 4, we can conclude that the model is dynamically stable because it has been discovered that the estimated lines are located inside the regions of crucial lines at a level of significance of five percent.

Figure II: Stability Test



CONCLUSION AND POLICY IMPLEMENTAION

This analysis examines the impact of taxes on the services of Pakistan. To accomplish this goal, an annually time series data set utilized for Pakistan, spanning the years 1980 through 2020. The bound test confirmed long-run cointegration between variables in models. The results display that the variables GFCF, gross national expenditures, and trade openness were positively related to the SSGR while the tax revenue, poverty, and inflation rate were negatively related to Pakistan's service sector growth rate. It is seen by the short-run ECM model that 68.30 percent of errors are rectified by moving from the short to the long-run. The findings of the present study, conclusion is that the tax system significantly impacts Pakistan's services sector. Due to high taxes, businesses in the services industry find it challenging to expand and compete. Therefore, the government must balance raising tax income with promoting the expansion of the services sector. A few policy recommendations could help enhance the taxation of Pakistan's service industry. First, the government might think about reducing taxes for small and medium-sized service sector enterprises. This would facilitate expansion and job creation of these enterprises. Second, businesses that engage in employee education and training could be eligible for tax breaks from the government. This could raise worker skill levels and increase the competitiveness of the service industry. Lastly, the government should endeavor to streamline the tax system so that companies can easily comprehend and adhere to the law.

This study has some limitations. First, this paper examines how taxation influences Pakistan's services sector by using data from 1980 to 2020. However, future research could use the panel data of developing countries to explore the nexus between taxation and service sector growth. Examining the link between the services sector and taxation can be helpful for policymakers to set suitable levels of taxes to promote the service sector's growth. Secondly, other factors that could be influenced of the service sector can be analyzed, such as human capital, technological innovation, and digitalization. Lastly, the influence of tax reforms on more sectors of the economy, like agriculture and large-scale manufacturing, can be analyzed.

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