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ISSN: 2616-8413

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How to cite this article: **Mutegi, L. M., Okiro, O., K. & Kisimbii, J., M. (2025). Relationship Trade Liberalization, Public Governance and Tax Revenue of The East African Community Member Countries.** ***Journal of Public Policy & Governance*****, 9(1), 77-85. https://doi.org/10.53819/81018102t3133**

Abstract

Although tax revenue remains critical in meeting developmental challenges for all nations, tax mobilization in most developing countries like EAC affiliated countries has remained below potential due to numerous challenges among them wanting state of governance in tax administration. In light of the foregoing, developing countries like East African Community (EAC) member countries have prioritized numerous reforms such as trade liberalization with aim of enhancing tax revenue performance. However, due to varying state of public governance across these countries, the nature of the relationship between trade liberalization and tax revenue has largely remained unclear necessitating the need for an empirical study. In response to this development, this study sought to determine the effect of trade liberalization and public governance on tax revenue of east Africa community member countries. The study applied descriptive research design and collected secondary data from period 2000 to 2023. The collected data was analyzed using multiple linear regression. The findings revealed that public governance significantly influence relationship between trade openness and tax revenue of east Africa community member countries. This finding underscores the importance of creating a favorable investment climate devoid of extreme corruption levels for purpose of attracting foreign direct investment (FDI) as a strategic approach to enhance tax revenue performance across the EAC region. Also, this implies that governments must integrate governance reforms particularly anti-corruption plans into their trade policy frameworks to ensure that the benefits of liberalized trade are realized through increased tax revenue collection.

Keywords: *Trade Liberalization, Public Governance, Tax Revenue, East Africa Community Member Countries*

1.0 Introduction

In the wake of the 21st century, trade liberalization has emerged as a developmental strategy for most if not all developing countries. As a consequence, many developing countries have fused trade liberalization with their national development agendas as a response to the global pressure in order to align with not only global economic trends but also multilateral trade agreements which characterize world trade systems. While trade liberalization can lead to economic growth and potentially increased tax revenue through increased trade and efficiency in tax administration, in absence of effective public governance and robust implementation of domestic tax reforms to compensate for potential tariff revenue losses, trade openness can lead to wanton loss of tax revenue from tariffs. Moreover, it is notable that although trade reforms come with a promise of dismantling long-standing barriers such as import restrictions to stimulate economic growth and integrate nations into the global economic system, in absence of effective system of public governance, developing nations are left trapped in a state of under development due to their inability to collect ample tax revenue for development (Dramane, 2022). This unfortunate position has also pushed developing countries to extreme dependency on foreign aid and external debt from developed nations. Watson (2023) argues that trade liberalization helps to enhance resource allocation, promote competition, attracts foreign direct investment (FDI) and provides access to larger markets for domestic producers.

In a similar vein, trade liberalization also comes with a promise of stimulating innovation, transferring technology and improving productivity by accelerating development and reducing poverty. However, some scholars such as Ho, Tran and Nguyen (2023) view trade liberalization as a tool for economic destruction arguing that it comes with a cost to domestic industries by exposing them to intense global competition before they mature enough to compete effectively leading to the collapse of local firms, job losses and deindustrialization, particularly in countries lacking robust industrial policies or protective mechanisms. Moreover, trade liberalization is feared for its possibility of entrenching structural inequalities where developing countries become overly dependent on the export of low-value primary commodities while importing high-value manufactured goods from developed nations. This imbalance widens trade deficit perpetuating unfavorable terms of trade leading to tax revenue loss to the host government. On similar fashion, notwithstanding the immense benefits that abounds with trade liberalization, Zaki (2020) argue that in absence of effective public governance, trade liberalization may turn out to be a channel for entrenching corrupt practices and promoting transfer pricing by multinational corporations at the expense of generating ample tax revenue to improve the already wanting state of development in emerging economies.

Relatedly, corruption as one of the thorny public governance issues most common in developing countries is largely to blame for low tax revenue collections, limited provision of public goods and huge reliance on external debt for defraying fiscal expenses. Moreover, the infiltration of corrupt practices in tax administration has left these countries unable to generate sufficient amount of tax revenue from taxation. Needless to say, corruption in tax administration in these countries has increased due to wanting state of governance as characterized by blatant disregard of the rule of law and limited if any accountability from public officials. Also, frequent political instabilities in developing countries are also to blame for significant reduction in tax revenue, sluggish economic growth and low development. In this context, the quality of public governance as a whole act as a critical factor for development process of any country. Undeniably, lack of institutional capacity and corruption are main culprit for this low tax effort and this is directly attributable to massive corruption levels, weak public governance institutions and weak tax administration. Without the ability to raise tax revenues effectively, governments in low-income countries risk experiencing financial

Stratford Peer Reviewed Journals and Book Publishing
Journal of Public Policy & Governance
Volume 9||Issue 1 ||Page 77-85||July|2025|
Email: info@stratfordjournals.org ISSN: 2616-8413

bottlenecks not only in providing public goods and services but also in implementing crucial economic programs for accelerating economic development for their citizens. According to World Bank Governance Indicators (2021), many low-income countries such as Somalia, Equatorial Guinea, Libya, Afghanistan, South Sudan, Sudan, Angola and Zimbabwe are regarded as highly corrupt countries in comparison to the rest of the world. Inextricably, lower taxation levels in these low-income countries are highly linked to the inefficient tax system due to corruption.

1.1 Trade Liberalization

Trade liberalization refers to the act of removing trade barriers to promote international trade amongst countries. Some of the non-tax trade barriers to international trade includes: restrictive quotas on imports, restrictive trade regulations and trade embargo. Trade liberalization also includes removal of trade-distorting policies so as to promote free access to market information as well as promote free movement of capital and labor amongst countries. Trade liberalization as a multi-dimensional concept manifests in various forms of such as free trade area, free trade blocs and free trade agreements. Further, nations may permit trade liberalization through bilateral, regional or multilateral trade agreements (Dragusha, Hasaj, Kruja and Lulaj, 2023). In the context of East African Community, trade liberalization scope has largely been actualized through formalization of regional agreements such as the EAC Customs Union Protocol which endeavor to achieve regional integration by promoting free trade, harmonizing custom procedures and establishing common external tariff for products imported outside the bounds of EAC and trade policies.

1.2 Public Governance

Public governance refers to the exercise of public power and the utilization of public resources in managing the affairs of society while observing principles of good /governance (Farazmand, 2023). Public governance calls for prudent use of public power for the good of the society as a whole. This public power is broadly organized into; administrative, legislative, judicial and executive. Moreover, public governance refers to the traditions and institutions by which authority in a country is exercised, including mechanisms for assessing accountability, transparency, effectiveness and rule of law. According to Mahran (2023), public governance is the process through which public decisions are made and executed, guided by fundamental principles such as transparency, accountability, the rule of law and fairness. Effective public governance dictates that these principles must be upheld consistently, especially during times of crisis, in alignment with constitutionally enshrined values. Similarly, the OECD (2021) defines public governance as the manner in which decisions are formulated and carried out for the common good. In this study, corruption perception index was used as a measure of public governance

Public governance also refers to the structures, processes and traditions through which public institutions conduct public affairs, manage public resources and ensure realization of public interests. Public governance is also a mechanism through which governments are held accountable, policies are formulated and implemented and services delivered to citizens. Effective public governance is characterized by adherence to public values such as transparency, accountability, efficiency, public participation, responsiveness and the rule of law. It reflects how power and authority are exercised in managing a country's economic and social resources, and how public governance institutions interact with citizens and other stakeholders in shaping and delivering public policies (Dramane, 2023).

The discussions on public governance and related governance reforms have been a topical issue amongst east Africa community member countries particularly due to wanting state of

https://doi.org/10.53819/81018102t3133

governance in some countries like Somalia, democratic republic of Congo and South Sudan which continue to experience civil wars, extreme corruption levels and political instability. Although bad governance in these countries continue to threaten their economic take off, other countries like Rwanda have made headlines for championing for public sector reforms, such as digitization of public services, creation of anti-corruption agencies and enactment of legal frameworks to promote accountability and mitigate against the dangers of runaway corruption. Particularly, Rwanda has stands out with low corruption levels, efficient public service delivery and political stability (Dramane, 2023).

1.3 Tax Revenue

Tax refers to the compulsory payment made by the citizens to government for purposes of funding public goods and projects like construction of roads, bridges, security, social welfare, etc. The compulsory aspect of tax as evident in its definition make tax to be a quid pro quo payment where the taxpayer does not sometimes get direct benefit in exchange for the tax paid. In this regard, taxes are meant to satisfy common good and every citizen is entitled to enjoy benefits from public goods and services without discrimination. Taxes are categorized as either direct taxes or indirect taxes. While direct taxes are characteristically charged on corporate profits and income, borne by the taxpayer personally and cannot be shifted to another taxpayer, indirect taxes are taxes charged on goods and services and can be shifted or transferred to other taxpayers at ease. Typical example of indirect tax is value added tax (VAT) which is transferrable to the ultimate purchaser of goods and services by the registered VAT vendor. It is however important to note that the ultimate responsibility to remix tax collected to the tax authority rest with the registered seller (Dramane, 2023).

Collection of taxes is one of the responsibilities of all governments regardless whether a country is classified as developed or least developed. All governments are tasked with an overwhelming role of mobilizing revenues to finance supply of public good and services. The tax revenue collected also plays an important role in shaping the distribution of benefits by providing the basis for redistribution from those with the highest incomes to those most in need. Tax also acts as a means of social control and this allows government to encourage certain activities and discourage others by altering their relative prices through adjustment of taxation rates. Taxation therefore remains one of the best instruments for funding public sector performance, social control, financing social insurance program and meeting operational expenses like repayment of public debt. However, it is notable that the capacity and ability of a country to collect ample tax resources wholly depends upon the capacity of its tax administration in both economic and administrative terms (Oyinlola, Adedeji, Bolarinwa & Olabisi, 2020). Tax Revenue in this paper was measured in terms of tax-to-GDP ratio and expressed as a percentage of GDP.

2.0 Theoretical Framework

The study was anchored on Heckscher-Ohlin (H-O) and supported by dependency theory and agency theory. The Heckscher-Ohlin (H-O) model considers trade liberalization as a mechanism for enhancing economic growth through positive spillovers from developed nations, hence suggesting a positive relationship between trade liberalization and tax revenue. The theory also considers trade liberalization as a strategy for countries to attract foreign direct investment (FDI). However, according to the dependency theory, trade liberalization has a negative impact on tax revenue due to loss of tariff and elasticity of tax revenue to tax reforms. Moreover, as argued under dependency theory, the implementation of trade liberalization and by extension international trade systems create unequal trading system where developing nations are left exporting unprocessed production inputs like raw materials at lower prices

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Journal of Public Policy & Governance
Volume 9||Issue 1 ||Page 77-85||July|2025|
Email: info@stratfordjournals.org ISSN: 2616-8413

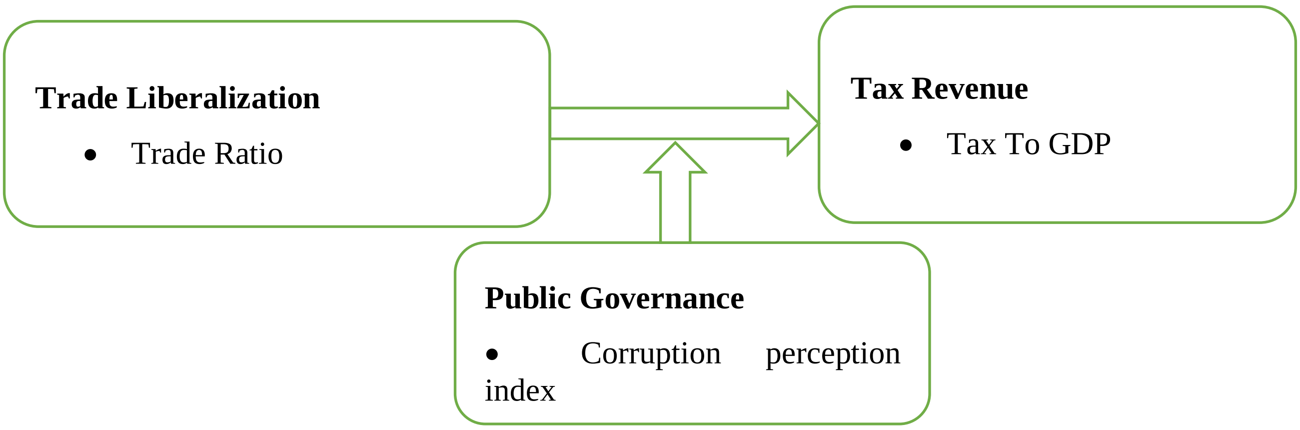
while at the same time buying finished consumable and production goods from developed nations at premium prices. Similarly, as argued by Jensen and Meckling (1976) in agency theory, the implementation of trade openness in absence of strong public governance may lead to reduced tax revenue due to the unethical practices such as profit shifting and transfer pricing by multinational corporations (MNCs). Also, absence of effective public governance may tempt multinational corporations to exploit institutional weaknesses as a strategy to minimize their tax obligations at the cost of tax revenue growth to the host country.

Moreover, weak governance may allow MNCs to engage in rampant unethical trade practices such as transfer pricing where they shift profits artificially across borders through internal transactions to areas that they regard as tax haven. Additionally, multinational corporations may engage in aggressive tax planning and complex legal arrangements to avoid taxation. These strategies significantly reduce the taxable income reported in the host country and as a result, rather than boosting public revenue, multinational corporations could erode the tax base, especially when tax authorities lack the capacity or legal framework to detect and counter such behaviors. Therefore, trade liberalization must be accompanied by sound institutional reforms to ensure that the benefits of increased FDI do not come at the expense of domestic tax revenue.

2.1 Conceptual Framework

The conceptual depicts the relationship between the independent and dependent variables. In this study, tax revenue was the dependent variable, public governance was the moderator while trade liberalization was the independent variable.

Independent Variable **Dependent Variable**



Moderating variable

Figure 1: Conceptual Framework

2.3 Empirical Review

Kurusic et al. (2023) examined the role of trade liberalization in Enhancing Tax Revenue and Economic Efficiency in Balkan Countries. This study adopted a quantitative research design, specifically employing a panel data analysis approach using secondary data covering the period 2000 to 2023. The data was sourced from reputable international databases such as the World Bank, IMF and national revenue authorities. Key variables included trade liberalization indicators measured through trade openness ratio and total tax revenue. The study utilized panel regression models, including fixed effects and random effects, to estimate the effect of trade liberalization on tax revenue. The findings revealed that trade liberalization has a significant effect on the composition and performance of tax revenue in East African countries. Specifically, the study found that as international trade taxes declined due to liberalization, there was a positive and significant increase in domestic tax revenue, suggesting that EAC governments have been actively reforming their tax systems to compensate for lost trade-related income. Additionally, the study established that trade liberalization promotes regional economic integration, enhances technological spillovers, and drives economic efficiency by exposing domestic firms to global competition. These factors collectively contribute to a broader and more productive tax base, thereby increasing total tax revenue in the long-term underscoring the importance of undertaking complementary tax reforms alongside improved public governance to fully harness the fiscal benefits of liberalized trade policies.

Dramane (2022) did a study on the effect of corruption and governance on tax revenues in WAEMU Countries investigating how institutional quality, particularly corruption and governance, influences tax revenue performance across WAEMU member states. The study employed a quantitative research approach using panel data analysis. Data was collected covering the period from 2000 to 2020. The main dependent variable was tax revenue, expressed as a percentage of gross domestic product (GDP). The key explanatory variables included indicators of corruption control and government effectiveness, both drawn from the Worldwide Governance Indicators (WGI) of the World Bank. To analyze the data, the study employed panel regression techniques and the findings revealed that corruption has a significant and negative effect on tax revenue mobilization in WAEMU affiliated countries. Higher levels of corruption were associated with weaker tax collection systems, reduced taxpayer compliance, and greater leakage of public funds. Based on these findings, the study recommended that WAEMU countries prioritize governance reforms, especially in the areas of corruption control and institutional efficiency in order to upscale their total tax collection.

Ho, Tran and Nguyen (2023) did a study on the effect of trade Openness and Government Tax Revenue. The study adopted a quantitative research design, utilizing panel data covering a sample of 70 developing and emerging countries over the period from 1995 to 2021. The study used secondary data sourced from the World Bank's World Development Indicators (WDI), the IMF and the World Governance Indicators (WGI). The dependent variable in the study was government tax revenue as a percentage of GDP while the key independent variable was trade openness, measured by trade openness ratio and expressed as a percentage of GDP. The findings revealed that in the early stages of implementing trade liberalization policy, tax revenue tended to decline due to reductions in trade tariffs, which traditionally forms a significant portion of tax revenue in developing countries. However, as countries advanced in trade integration and implemented domestic tax reforms, the effect of trade openness turned positive, highlighting the importance of undertaking tax reforms when implementing trade liberalization. Moreover, the study found that institutional governance quality played a crucial moderating role in this relationship noting that in countries with strong governance structures, trade openness recorded more positive and sustained impact on tax revenue than countries with weak institutions where trade liberalization often led to loss of tax revenue unless compensated from other sources such as domestic taxes.

3.0 Methodology

The study used descriptive research design and collected secondary data from a population comprising of 6 east Africa community member countries for the period between 2000 and 2023. This time period was chosen because of various reasons. First, the year 2000 marked the year when east Africa community regained their operations after collapse in 1977 due to among others issues such as governance and political ideology differences. Secondly, this period reflected a time when nearly all EAC member countries experienced declining tax revenue amid the clarion call to fully adopt trade liberalization for purposes of fostering regional integration. To empirically examine the relationship between trade liberalization, public governance and tax revenue of east Africa community member countries, a panel simple linear regression analysis was conducted using data for six countries. To test the null hypothesis, p-value was used and the null hypothesis was rejected if the P value calculated was less than 5%. The following model was used in estimation:

TR_{It}=ạ +ß$_1$X$_{1It}$+ß$_2$X$_{2It}$ + ἕ,

where:

ß= Regression coefficients

X_2=Trade Liberalization

X_2=Public Governance measured by Corruption perception index

TR= Tax revenue

ἕ= Error terms.

4.0 Analysis and Findings

4.1 Regression Analysis

Regression analysis is a statistical tool that is used in determining the nature and the extent of the relationship between two or more variables.

Table 1: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.419[a]	.176	.158	3.5955653

a. Predictors: (Constant), Trade Liberalization, Public Governance, Interaction Term

The findings revealed that the study model could explain about 17.6% of the total variations in the value of the tax revenue. Moreover, the correlation between Trade liberalization, public governance and tax revenue was weak but positive implying that increasing public governance would result to an increase in tax revenue.

Table 2: ANOVA

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	386.001	3	128.667	9.953	.000[b]
	Residual	1809.933	140	12.928		
	Total	2195.933	143			

a. Dependent Variable: Tax Revenue

b. Predictors: (Constant), Trade Liberalization, Public Governance, Trade liberalization*Public Governance

The findings revealed that model was statistically significant implying that public governance has an effect on the relationship between trade liberalization and tax revenue of east Africa member countries.

Table 3: Regression Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	18.123	3.146		5.761	.000
	Trade Liberalization	.210	.063	.838	3.355	.001
	Public Governance	.196	.124	.487	1.582	.116
	Trade*Public governance	.007	.003	1.008	2.620	.010

The findings revealed that public governance has a significant and positive effect on the relationship between trade liberalization and tax revenue of east Africa member countries suggesting that an improvement in public governance would impact positively the relationship between trade liberalization and tax revenue.

5.0 Conclusions

The study concludes that public governance plays a critical moderating role in enhancing the positive impact of trade liberalization on tax revenue of East African Community (EAC) member countries. Specifically, an improvement in public governance through control of corruption strengthens the capacity of governments to harness the benefits of trade liberalization, thereby increasing tax revenue mobilization. This implies that without strong public governance structures, the potential fiscal benefits of trade liberalization may not be fully realized. Therefore, policy efforts aimed at improving tax revenue should not only focus on liberalizing trade but also on reinforcing governance frameworks across the region.

Moreover, the paper concludes that although trade liberalization helps to enhance tax revenue of East African Community (EAC) member countries by enhancing trade flows and economic efficiency, without effective control of corruption, the anticipated benefits from trade liberalization may not fully translate into increased tax revenue. Corruption practices negatively undermine customs and tax administration by allowing illicit trade practices, underreporting of imports and exports and tax evasion, thereby shrinking the tax base. When corruption is effectively controlled, trade transactions become more transparent and compliant with tax laws, improving revenue collection from expanded trade activities. Thus, control of corruption helps to strengthen institutional capacity, enhances public trust and ensures that the gains from trade liberalization are equitably captured through the tax system, ultimately boosting tax revenue performance of EAC countries.

6.0 Recommendations

First, EAC member countries should invest in strengthening institutional capacity by providing adequate training, modernizing tax systems through digital technologies and enhancing administrative procedures to ensure transparency and accountability in tax collection. Second, regional governments should prioritize anti-corruption measures and enforce strict compliance standards across public institutions. By minimizing leakages and reducing opportunities for tax evasion and misappropriation of public funds, such measures will ensure that the benefits of trade liberalization translate into tangible revenue gains. Third, East African community member countries should harmonize their trade and tax policies to promote coherence, reduce loopholes and encourage fair competition. Regional cooperation in taxation and customs enforcement should also be encouraged to help track cross-border transactions more effectively and ensure that tax obligations are met uniformly across member states. Lastly, governments should foster public participation and build trust through transparent governance. By engaging citizens and stakeholders in the formulation and monitoring of tax policies and public spending, governments can enhance voluntary tax compliance, strengthen the social contract, and reinforce the legitimacy of tax revenue collection efforts within liberalized trade environments.

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