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Sustainability of Trade Imbalances in East African Countries

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Abstract

This paper aims at examining the sustainability of trade imbalances in the long run for the development of EAC countries. Because sustainability of the trade imbalances refers to the existence of cointegration relationship between exports and imports which implies that countries do not violate their international budget constraint, thus cointegration regression under Fully Modified Least Square (FMOLS) applied for full confirmation of sustainability. This paper uses quarterly data for Burundi, Rwanda and Kenya cover periods from 1981:1 to 2015:4 (140 observations) while for Tanzania and Kenya available data cover periods from 1980:1 to 2015:4 (144) observations. Based on Johansen technique this paper provides new evidence in the long-run convergence between exports and imports for Burundi and Rwanda but cointegration is not evidenced in Tanzania, Kenya and Uganda. These main findings indicate that macroeconomic policies of Rwanda and Burundi have been effective in the long-run and suggest that these countries are not in violation of their international budget constraints. For Burundi, long-run results further confirmed that all slope coefficients for exports and imports are positive and less than unity which confirms the necessary condition for sustainability (weak form) for the economy to satisfy its intertemporal budget constraints. Slope coefficients for exports and imports of Rwanda are positive and very close to unity which confirms the necessary condition for sustainability (strong form). Since the trade imbalances for all East African countries continue to grow regardless of the fact that Rwanda and Burundi can sustain their budgets, governments and policy makers should try their level best to minimize levels of external borrowing at least down to 25 percent of their GDP. This approach might be difficult in the short run but also gradual reduction of unnecessary government expenditure will put these countries in a position of self-sufficiency to sustain their inter-temporal budget constraints. Furthermore, East African countries still have potentials for exports given their abundance of natural resources and therefore policy makers should continue to enhance environments to attract export led foreign direct investment (FDI) especially in promising manufacturing industries.

Key Words: EAC, Exports, Imports, Trade Imbalances Sustainability