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TRADE BALANCE DETERMINANTS IN EAST AFRICAN COUNTRIES

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ABSTRACT

East African Community (EAC) countries run huge trade imbalances and have maintained it as high as five percent for many years. Many countries including those from EAC borrow to sustain their budget deficits. This borrowing raised concerns about the sustainability of these imbalances and long-term consequences. Therefore, the main objective of this paper is to examine empirically the determinants of trade balance in East African countries and propose possible trade balance deterioration remedies. The proposed trade balance model was estimated using cointegration regression under the Full Modified Least Square (FMOLS) followed by the Vector Error Correction Model (VECM). Different mixed results were obtained across countries under study. However, among all other variables, this study found Foreign Direct Investment (FDI) as the main variable of interest and probable solution in improving the trade balance of EAC countries. EAC countries should, therefore, concentrate on export-oriented development policies which focus on export-oriented manufacturing industries because large amounts of FDI flow into those areas already.

Keywords: Trade balance, FDI, Real Exchange Rate, Investment/Saving, GDP per capita