TRADE INCENTIVES AND CURRENT ACCOUNT ADJUSTMENTS IN KENYA: A BILATERAL ANALYSIS

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ABSTRACT

The study set out to analyse measures to correct recurrent and worsening balance of payments position of Kenya. A resource switching approach to correcting balance of payments problems,through Current account was adopted, with real effective exchange rate computed at a bilateral level and import duty levy for commodities, as major policy instruments.Other determinants of trade including impact of foreign debt owed to trading partner and income of trading partners were also estimated.

The study used an export supply and an import demand equation model framework to analyse effectiveness of exchange rate in current account adjustment programmes in Kenya. A disaggregate analysis by commodity estimated at a bilateral level for selected trade partners with Kenya was the approach adopted.
Annual data covering the period 1966-1987 was used in the study.

The empirical results of the study indicated that disaggregation by commodity estimated at a bilateral level greatly improved performance of exchange rate policy notably in influencing export supply of commodities. Commodities ultimately responded in varying degrees to exchange rate variation depending on the trading partner state. Import demand for commodities by Kenya proved only mildly responsive to import duty levy or exchange rate variation. Non-traditional export commodities like fruits and vegetables indicated higher potential of penetrating markets of these major trading partners than traditional exports like Coffee or Tea, as indicated by their income demand elasticity estimates,consistency

of signs and statistical significance of income coefficients.

Based on the empirical results of the econometric model adopted, the study suggests certain policy options. Diversification of the export base is an urgent requirement. A policy of reducing bias of incentive system towards traditional exports only should be encouraged by diversification of the export base.

For the export expansion strategy to achieve its stipulated objectives and avert adverse effect on export supply due to strong domestic demand pressure for the commodities,policies should be geared towards increased efficiency in production of the commodites to satisfy domestic demand without reducing goods available for export. The government should provide an institutional framework for increased efficiency in commodity production and more dynamic marketing policies.

Exchange rate policy should be supplemented by other export promotional measures to ascertain efficient adjustment process in a bid to facilitate reduction in the worsening Current Account balances.

The limitations of the research and areas for further study are also highlighted.