THE DETERMINANTS OF LONG-RUN EXPORT DEMAND FOR KENYAN TEA: EVIDENCE FROM COINTEGRATION AND ERROR CORRECTION ANALYSES

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ABSTRACT

This study investigates both the long-run and short-run determinants of the export demand for Kenyan tea from 2002-Q1 to 2012-Q2. Using the Johansen-Juselius maximum likelihood methodology this paper concluded that there exists a stable long-run equilibrium relationship between the export demand for tea, the export tea price (own-export price), the beverage index price(coffee, cocoa, all varieties of tea) taken as proxy for the average price of related export products, the average real income of major importers of Kenyan tea (using the real income of the United Kingdom, one of the major importers of Kenyan tea, as proxy), and the dummy political variable used to capture the structural effects of the 2007 highly disputed presidential election which lead to violence. Results from the error correction model, while validating the existence of an equilibrium relationship, shows that any disequilibrium away from that long-run equilibrium condition between the export demand for Kenyan tea and its basic determinants is restored at the rate of adjustment of over 91% . Consistent with theory, the export demand for Kenyan tea is negatively related to own-export price; but, positively associated with beverage index price as well as to the average income of the country's major trading partners. Although the elasticity coefficient of own-export price is smaller in the short-run than it is in the long-run, both estimates are less than one; perhaps suggesting that the Mombasa Tea Auction has monopoly power over tea export pricing.

Keywords: *export demand for Kenyan tea, cointegration analysis, long-run equilibrium relationship, short-run error correction mechanism.*