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Transaction Costs in Tanzania's Rice Trade within the EAC and with the EU

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Key messages

- Comparatively high quality of Tanzania's rice and its low production costs provide price advantages in export markets which matter for competitiveness.
- Diverse information, bargaining, and enforcement costs lead to lack of coordination in the rice value chain, preventing Tanzania from tapping its export potential.
- Currently supplied quality and quantity of rice remains insufficient to meet demands of export buyers beyond the eastern Africa region, in European and Arabic countries.
- Investment into information technologies and directories, guaranteed and monitored rice purchases and flows in the value chain, as well as bilateral treaties to enforce contracts abroad are some ideas that deserve policymakers' attention.

Introduction

Tanzania has a comparative advantage in producing and exporting many crops, including cashew nuts, coffee, cotton, tea, tobacco, maize, and rice (World Bank 2015). In the context of the rice subsector, the country seeks to become an export lead and has recorded significant progress. It is the second-largest producer in eastern and southern Africa after Madagascar (IRRI 2018). While it used to be domestically oriented in the rice trade, this trend has shifted. In only five years (2016–20), the total exported quantity rose by 206 percent and the export value by 209 percent, substantiating this shift (ITC 2020c). In 2020, the amount exported stood at almost 350,000 tons worth $142 million. In 2020, Tanzania's rice export represented 0.5 percent of the world exports, ranking nineteenth (ITC 2020c). Still, significant transaction costs arise during coordination between value-chain actors that prevent the country from realizing its export potential in the East African region and the EU. This policy paper casts light on some of these most significant transaction costs in rice value chain. Insights are based on literature review and fieldwork conducted in Mbeya in October 2021 as part of the EU-ACP TradeCom II Program at REPOA.

Figure 1: Destinations of Rice Exported from Tanzania

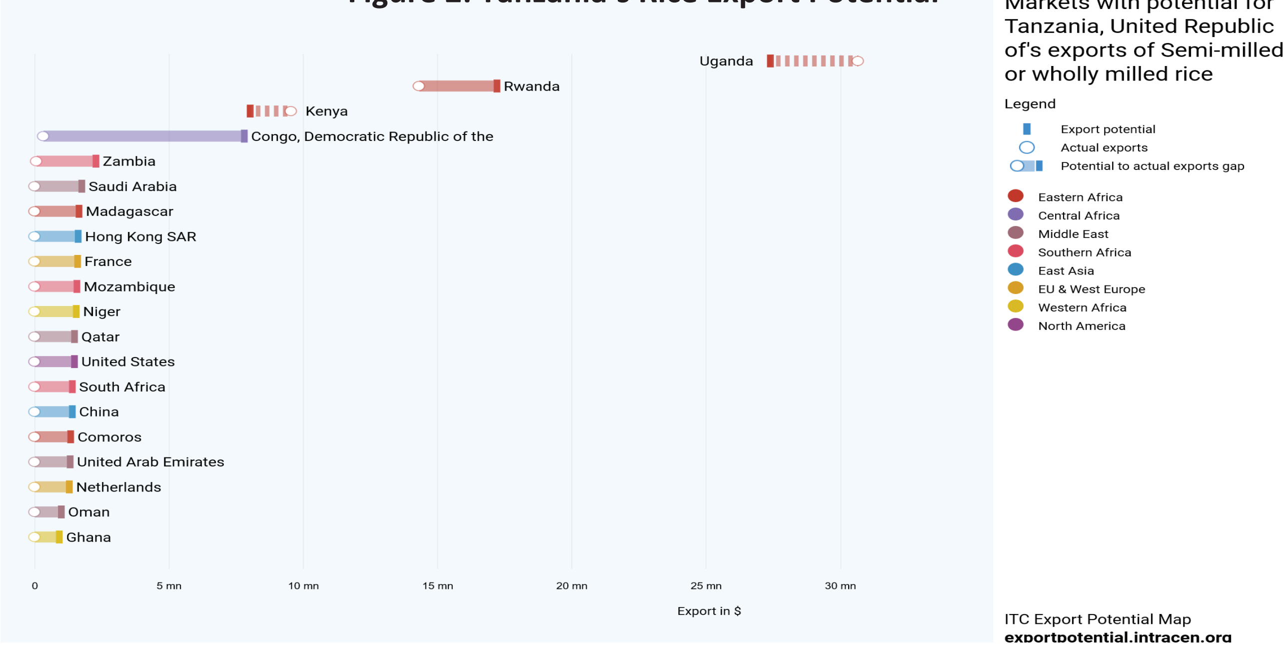
Source: International Trade Center (2020c)

Tanzania's Untapped Export Potential

Despite its ambitions to expand into distant markets, the highest demand for Tanzania's rice remains in the eastern Africa region. The largest regional importers are Uganda, Rwanda, Kenya, and the Democratic Republic of Congo, respectively (ITC 2020b). In 2020, the value of Tanzania's total exported rice (including whole paddy, husked and milled rice) only to Uganda ($77 million) totaled to almost half of its world exported rice value. Uganda was followed by Rwanda with nearly $35 millionand Kenya with $27 million. According to their rice imports, the Democratic Republic of Congo, Burundi, and Zambia followed, with significantly lower export quantity and value. The largest overseas markets were India, with $1.46 million in export value, and Belgium, the United States of America, and Oman, with substantially lower figures. Belgium taking the lead by importing only 25 tons of Tanzanian rice in unit value of $0.8 million showsthat Tanzania is currently not strong in the European market.

Regarding the export potential of the semi-milled or wholly milled rice from Tanzania, trends differ slightly. Based on the International Trade Center (ITC) data, Tanzania has realized only 57 percent of its total export potential. This potential is $85.2 billion, while the actual export is $55.4 billion, with $36.5 billion unfulfilled. In the region, the country tapped more than 100 percent of its export potential to Uganda and Kenya in 2020 (Figure 1) (ITC 2020a). Its actual export to Uganda was $31 million against the estimated potential of $26.7 million and to Kenya with $9.5 million above its $7.2 million potential. Unrealized potentials export to Rwanda and the Democratic Republic of Congo are $1.8 and $7.3 million, respectively. Other countries where Tanzania can export more rice include Saudi Arabia, Madagascar, and Hong Kong, with $1.4 million potential each, though these countries currently are not importers of Tanzanian rice. Outside Africa, Arabic countries, such as Saudi Arabia, Qatar, United Arab Emirates, and Oman, deserve attention.

Figure 2: Tanzania's Rice Export Potential



Source: International Trade Center (2020a)

The export potential to the EU market currently remains low, compared to the demand by African and Arabic countries. In the EU, while Belgium is the biggest rice importer at present (with very low import quantity and value) Tanzania can export larger amounts worth $1.3 million to France, which Tanzanian producers and traders should consider (ITC 2020a). Another market is the Netherlands, attracting almost $1 million in rice imports from Tanzania. Outside the EU, the United States ($1.2 million) and China ($1.1 million) are potent importers. Nevertheless, with its high quality and relatively low prices, Tanzania's rice has a comparative advantage in these distant markets if various transaction costs are addressed.

Transaction Costs in Rice Trade

Based on the underlying theoretical propositions in economics (Williamson 1971, 1985, 2002; Peterson, Wysocki, and Harsh 2001), three significant transaction costs erode the ability of actors to make cost-effective decisions while coordinating along the value chain, namely: searching and information, bargaining, and enforcement costs. Based on interviews conducted in October 2021 in the Mbeya Region (Ires 2022), one of the main rice producer regions in Tanzania, diverse such costs undermined the potential of the major rice producers and traders to export rice to the EU, especially France.

Regarding searching and information costs, one challenge that rice traders encounter is the lack of information about the quality standards, such as (aroma, color, brokenness, nutrition value, contamination percentage) expected by export buyers. The interviewed rice processor-traders argued that they did not know which buyers in regional and international export markets would be interested in their crops and what standards they expected (Ires 2022). Traders and trader associations pointed to lacking extensive information about economic policies that Kenyan traders are provided with by their government, which was allegedly behind their confidence in importing mass quantities of rice from Tanzania. Information gaps discouraged Tanzanian traders from expanding into new markets in a similar way. Furthermore, the lack of information about the required quality standards impacted coordination between processor-traders and producers down the value chain in spreading the use of specific farming inputs and cultivation knowledge to accomplish such standards.

The lack of statistics regarding where to procure specific types of rice in mass quantities incur another information cost. Mbeya rice producers and traders pointed that reliable data on production levels in different rice-producer areas was missing (Ires 2022). Many different types of rice varieties are cultivated in Tanzania, and export buyers have different demands. For example, the semi-aromatic and high-yielding TXD306 (SARO5) hybrid rice variety has demand in the region. But European buyers mainly look for high-aromatic and low-yielding traditional varieties, such as Kamsamba (from Sumbawanga), which are more challenging of supply in high quantities. Mbeya-based traders and trader associations found it challenging to spot supply points for such limited types of rice. Moreover, most of the exported rice has to fulfill different grading requirements. Regional buyers sometimes want traditional varieties, sometimes SARO5, and sometimes both mixed. European buyers demand the traditional rice only in first-grade quality with advanced color sorting, which requires processor-traders to install additional machines. Meeting such specific requirements is not only frequently costly but also uneasy to follow up. Without reliable data regarding stocks in different areas, businesspeople cannot close export deals requiring them to trade in specific qualities and large quantities. The prevalence of illegal export to Zambia, Malawi, and Arabic countries through the permeable bush and marine borders only adds to this uncertainty (USDA 2017; Ires 2021).

A significant bargaining cost that arises during regional export is that while Mbeya traders prefer cash-and-carry transactions for a rapid turnover, regional buyers often look for installment credit. For example, to the Raphael Group Limited, one of the biggest rice processor-traders in Mbeya, regional buyers often paid a percentage in advance and the rest after rice containers are delivered (Ires 2022). Often it took a long time to agree on these percentages, though the parties usually settled for 40 percent paid in advance and 60 percent later. Since Tanzanian companies rely on rapid cash flows to buy and mill new paddy, ensure new stocks, and remain operational, they look to finalize payments upon shipment delivery. Transactions involving installments extended over long periods are unfeasible.

The time needed to negotiate payment conditions and the lack of mediators are bargaining costs that cause unrealized export agreements between Tanzanian traders and the EU buyers. For example, in Mbeya, a French buyer showed interest in importing first-grade rice from several small- and medium-scale enterprises in Mbeya (e.g., Raphael Group Limited and Hu Feng) (Ires 2022). In the case of Hu Feng (owned by a Chinese investor), the sample container sent to this buyer met its quality requirements. But friction arose at the time of closing the export deal: the buyer agreed to pay for only 25 percent of the exported rice in advance and 75 percent after selling it in France. This offer was unworkable for Hu Feng because in order to stock and export its full capacity of 800 tons per year (though this buyer had initially demanded more: 100 tons per month equivalent to 1,200 tons per year), it needed a higher percentage paid in advance. Reportedly, in 2020, Hu Feng bargained with this buyer to increase the advance payment to 50 percent, which the French buyer did not accept, leading Hu Feng to turn down the export request despite protracted negotiations. A high enforcement cost in rice export is about ensuring timely payments. Based on the interviews, regional buyers frequently didnot pay for the delivered shipment on time, sought to postpone payments, and showed tendencies to default (Ires 2022). Traders often tackled this issue by visiting buyers in their country, which incurred travel costs and was not always successful in speeding up payments (the potential of the trade partner showing up in person is likely also a sanction deterring defaults). As a result, finalizing the transaction sometimes took up to 3–4 months, interrupting cash flows, nonetheless.

In the case of rice export to the EU, enforcement costs are higher than in regional export. On the one hand, Mbeya processor-traders did not desire to wait 20–30 days for the shipment to arrive and administrations to be completed in Europe (Ires 2022). On the other hand, in the case of payment delays, as it happened in the region, trader-processors would not be able to send their agents abroad to negotiate and settle the debt: visa requirements are difficult to fulfill, travel fares are expensive, while negotiation dynamics and sanctioning mechanisms differ in Europe. To avoid such hassle, some Tanzanian traders preferred to bear financial risk and ogistical costs only until the Port of Dar es Salaam where they concluded transactions. After that, buyers were responsible for covering export fees, clearing import permits with the EU, and complying with its non-tariff barriers.

Conclusion and Recommendation

Tanzania can leap toward realizing its potential in rice export to the eastern Africa region and with the EU if various transaction costs are addressed. Some of these costs include the lack of access to information on national rice stocks (both in terms of quantity and quality) and foreign import standards, uncertainties in timely trade flows and compliance of trade partners with contracts, and the widespread reliance on the cash-and-carry outlets for rapid cash flows. To address information costs, establishing a reliable market information system and investing in relevant technologies is imperative. Regularly updated directories of export buyers and non-tariff barriers imposed by foreign countries could be feasible ideas to address this gap. In addition, training on the quality demands of specific processor-traders and export buyers should be incorporated into the extension curriculum for farmers to make informed cultivation decisions. Furthermore, to alleviate bargaining and enforcement costs, the government should consider establishing an effective system of trade monitoring and signing bilateral agreements to position diplomatic staff for this purpose on the other side of the borders. This may encourage traders to better plan their business and sign export deals with confidence. Lastly, the government should consider options to improve traders' access to loans for the acquisition of costly processing machines (to keep up with the high-quality standards of the EU markets) and secure cashflows for continued interfirm operations and growth.

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