



Case Study on Coffee in Tanzania

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Summary

Tanzania, a largely agrarian country, has not been able to fully take advantage of access to international markets in the past. Coffee production and innovations in the industry highlight the challenges faced by African countries, while providing examples of initiatives that can be replicated by Aid for Trade in order to ensure the greatest possible impact with respect to poverty reduction and market access. One such initiative is KILICAFE, a farmer owned association that has been able to dramatically improve the quality as well as the yield of coffee produced with assistance from TechnoServe, an international non-profit organization focused on development of businesses in rural areas. Higher quality coffee, supported by assisted marketing services, has commanded prices twice as high as the regional average with the consequence of substantially increased producer income.

Background

Tanzania is rich in natural resources, including timber, gemstones, fish and minerals. Tourism and gold exports are the top two foreign exchange earners for Tanzania which, together with traditional agricultural exports (including coffee, cashew and cotton), contributed over three-quarters of all foreign exchange earnings in 2004¹. But the major contributor to employment and GDP is agriculture, which employs 80 percent of the country's 36 million people.

Tanzania is held up as a model of donor coordination and donor-government cooperation, replacing past patterns of multiple donors supporting individually-run projects with improved efficiency and effectiveness. This change can be seen in the transition from an externally-driven Poverty Reduction Strategy process to a much more nationally-owned MKUKUTA (the Swahili acronym for the national poverty reduction plan), which emphasizes three pillars of 1) growth and reduction of income poverty, 2) improved quality of life and social well-being, and 3) good governance and accountability. This is complemented by the Joint Assistance Strategy (JAS) of donor countries that moves them toward the principles of aid effectiveness and harmonization outlined in the Paris Declaration on aid effectiveness.

Despite these advances, serious challenges remain. Unless the agriculture sector can take better advantage of domestic, regional and international markets, and extractive and tourism industries can create more forward and backward linkages into the local economy, Tanzania will be unable to foster broad-based sustainable economic growth. Given the importance of agriculture in the economy it is an important starting point for Aid for Trade or other donor-supported initiatives.

Coffee Production in Tanzania

Coffee is one of Tanzania's most significant agricultural export crops and is grown in three regions of the country. The Tanzanian Diagnostic Trade Integration Study (DTIS) prepared under the Integrated Framework for Trade Related Technical Assistance to

¹ Bank of Tanzania, 2005

Least Developed Countries (IF) estimates that 2,120,000 Tanzanian coffee farmers and their dependents derive their main source of income from coffee production.

When international market prices for coffee fell to an all time low in 2002, making many coffee farms unprofitable, Tanzania's rural communities were hit particularly hard. While prices began to recover the following year, a study of the global coffee market showed that for many farmers around the world, the prices remained low due to:

- Technical innovation in Brazil which led to a large increase in coffee production
- The emergence of Viet Nam as a low-cost coffee producer
- The increasing use of Robusta, a lower-cost type of bean, for specialty blends.²

However, these problems are not insurmountable given that Latin American nations are increasingly accessing markets for industrial and high-value agricultural products, thereby making room for East Africa's comparative advantage in coffee production.

Adolph Kumburu, the Executive Director of KILICAFE, a coffee growers association based near Mount Kilimanjaro, explained the extent to which the recent period of low prices had an effect in Tanzania. "As smallholders' coffee income evaporated, investment in coffee production stopped and a vicious cycle of low investment, resulting in lower production and ever lower incomes, starved coffee communities of their main source of income," he said.³ In addition to the recent period of low prices, Tanzanian coffee producers have faced a number of other challenges:

- Over 90% of Tanzania's smallholder growers lack access to modern processing technology and market information. As a result, despite the high quality of their coffee, farmers must sell their produce into the undifferentiated commodity markets.
- Despite liberalization of the coffee market in 1994, there has been minimal investment in the coffee sector.
- Specialty coffee buyers from the USA, Japan and Europe market Tanzanian coffee as a 'premium' brand. However, buyers including Starbucks Coffee Company report difficulties in sourcing a sufficient quantity of specialty coffee from Tanzania that is needed to meet growing demand.

The KILICAFE Farmer Association

To facilitate improvements in quality and marketing of the coffee produced, TechnoServe, a non-profit business development organization, has provided technical assistance to KILICAFE and its 9,000 smallholder farmers. KILICAFE is an association of 93 farmer business groups in the Arabica producing regions of the North and South of the country. The organization's goal is to promote the production and processing of high quality specialty coffee and to improve its access to international and local markets in order to boost the incomes of its members.

² TechnoServe Global Coffee Study. December, 2003

³ Kumburu, Adolph. Presentation for the Delegation of Realizing Rights. Nombeko Rural Cooperative Society. February 23, 2006

Recognizing the limitations of the farmer business groups to individually access credit and buyers, TechnoServe has worked closely with KILICAFE to develop a range of marketing and credit services for these groups with significant outcomes:

- Cooperative unions typically pay a uniform price, dividing proceeds equally among members regardless of the quality of their coffee. On the other hand, KILICAFE prefers to deliver revenues to each farmer business group in proportion to the price received at auction or through direct export for the individual group's coffee. As a result, farmers with prospects to produce high quality coffee maximize their income by associating with KILICAFE instead of allowing it to be bulked and sold with inferior quality coffee.
- The potential for higher prices paid by KILICAFE creates incentives for higher quality production and processing. The higher quality coffee, supported by assisted marketing services, has delivered prices 70% higher than the national average to member farmers.
- In 2005, KILICAFE provided over US\$700,000 in working capital to its members and linked 12 groups to finance in order to purchase quality-enhancing central pulperies (processing) equipment.
- KILICAFE sold more than US\$3million worth of coffee in 2005 and launched a partnership with the US-based Peet's Coffee & Tea to sell KILICAFE's coffee in the USA under the 'Tanzania Kilimanjaro' brand.

As demonstrated by KILICAFE, the value-adding activities of supporting the development of central pulperies processing, credit access, improved marketing and the development of new business models translate into higher revenues and more income for the rural poor. Smallholder farmers can sell specialty coffee, produced in central pulperies, for US\$2 per kilogram at the farm gate, compared to US\$1 per kilogram for commodity coffee produced using back-yard processing. Creating access to efficient central pulperies facilities for all coffee growers in Tanzania, and developing the Tanzanian Specialty coffee brand, could benefit 400,000 rural families and increase foreign currency earnings annually by US\$23 million. With a program of modest investment, the KILICAFE model can be replicated and substantially scaled up, significantly impacting the development of Tanzania.⁴

Aid for Trade and Tanzania

In order for Tanzania to take advantage of opportunities for growth presented by coffee production and other sectors, and to overcome supply side constraints, farmers and entrepreneurs must be supported through technical assistance and investment in infrastructure and institutions.

Direct Investment in Production and Marketing

Access to Capital and Credit: A lack of access to credit and capital is one of the biggest hurdles for entrepreneurs in Tanzania, including farmers looking to expand their production or create a higher quality product.

⁴ It is reported that a coffee production initiative of this type has also been proposed for Rwanda. See Nielsen, Aid for Trade, in Trade, Doha and Development: A Window Into The Issues.

- Credit-related problems were listed as the number one constraint perceived by Micro, Small and Medium firms doing business in Tanzania.⁵
- The banking system is structured to service large companies and more established businesses with longer term loans. Therefore, a common situation is that of a farmer with whom Realizing Rights delegates met, who was without the funds to send his daughter to school in the period between crop harvesting and crop sale, regardless of the visibility of his assets. This structure needs to be shifted in order to benefit farmers by creating more flexibility in the length and size of loans and the collateral needed to gain access to credit. The development of micro-finance products specifically for smallholder coffee growers would address the cash-flow problems associated with this annual crop.
- National studies have shown that only a tiny proportion of operators in the informal sector could acquire capital from the formal financial sector. The inability to utilize land as a form of collateral is the most significant barrier for smallholder farmers who wish to access credit.
- A lack of access disproportionately affects women: only half of the women who applied for bank credit were successful (ILO, 2003), and they cited the main obstacles as difficult procedures, high interest rates and the requirement of 125 per cent loan collateral.
- It is particularly hard for local businesses, especially early stage ones, to identify and access sources of good quality technical assistance and business advice to help them overcome these challenges. TechnoServe has found that banks and other providers of capital are far more willing to open their doors once a business has been provided with assistance of proven quality.

Indirect Investments Required to Facilitate Trade

The following areas offer a combination of public and private investment opportunities that need more support. Doing so requires a new focus and significant coordination from the Tanzanian government and willingness of others to co-invest.

Power: Developing Tanzania's capacity to trade, and growing the economy more generally, is stymied by insufficient power generation.

- Tanzania relies heavily on hydropower, but with frequent drought and the prospect of continuing low rainfall due to climate change, this brake on production and trade must be urgently addressed.
- Increased electricity demand – which inevitably comes with economic growth – must be satisfied in a country that already faces a power crisis.
- Tanzania needs support in finding alternative energy solutions – one suggestion was using the Highly-Indebted Poor Countries (HIPC) debt relief dividends to purchase turbines; another was adopting alternative fuel sources (coffee waste

⁵ Verspreet and Berlangue. Small scale enterprise development in Tanzania: Driving forces, 1998

products including coffee husk, pulp waste and central pulper waste-water are utilized to produce energy in rural areas of Latin America).

Transport: Expanding and improving road and port infrastructure is essential for Tanzania's producers.

- Without proper infrastructure to get agricultural goods out of the country, producers are not able to take advantage of export opportunities
- As a coastal country bordered by several landlocked states, infrastructure development could have a very positive benefit for several countries and millions of producers in East and Southern Africa as well. Tanzanian business people noted that President Kikwete is known for his amicable relations with countries in the region, and felt that this could be the basis for creative regionally-synchronized infrastructure development.

Developing Human Resources: The recent Tanzania demographic growth study revealed that secondary education achievement rates are low relative to other sub-Saharan countries. The human resource gaps for engaging successfully in markets exist at all levels.

- People recognized that basic education is as important as technical skills, but this would obviously be beyond the scope of Aid for Trade assistance.
- What should be incorporated in any Aid for Trade initiative is an effort to increase skills directly needed by local entrepreneurs: marketing, accessing finance, negotiations, packaging, customs facilitations, and so on.

Policy Changes to Support Growing Businesses

Technical assistance for streamlining of business registry and export processes: A vast majority of Tanzania's economic activity still takes place in the informal economy. In order to take advantage of trade opportunities, the country needs assistance to make it simpler and more beneficial for businesses to emerge into the formal economy.

- Almost sixty percent of Tanzania's GDP and 70 percent of employment are in the informal sector, but as in many developing countries, the procedures required to obtain license and permits are a real constraint on the growth of informal enterprises.
- As sanitary and phytosanitary standards in global trade are revised, the ability to export will be even more dependent on capacity to follow regulations - and coping with domestic regulations is already a challenge. The World Bank has estimated that it takes 26 steps and 313 working days a year at a cost of 4110% of per-capita income to keep a company compliant with domestic rules.⁶ This

⁶ The Guardian (Tanzania), February 24, 2006, p. i.

discourages businesses from ‘formalizing’ and will decrease their chances of benefiting from export markets.

- A recent World Bank study ranked Tanzania lowest in a study of 155 economies in keeping businesses compliant once they start operating. Therefore, streamlining the procedures, and then enforcing them, will be important in expanding markets.
- And once the regulatory path is clear, it is still very difficult and challenging for local would-be entrepreneurs to access the knowledge and advice required to launch and grow their businesses.

Strengthening of Institutions: In Tanzania, people were interested in the idea of strengthening the ‘social compact’ between government, the private sector, trade unions and other civil society organizations.

- This means forging a sustained collaboration in order to promote economic growth and sustainable development. For example, continuing to build the capacity of public officials to understand the value drivers of the coffee sector, and their ability to take action to simplify taxes and other aspects of running a business, can produce an environment that is more conducive to new investments and increased value flowing to the rural poor.
- Additionally, institutional strengthening can mean building people’s economic organizations such as production or marketing networks that strengthen the bargaining power of producers and workers.

As indicated by Tanzania’s coffee industry, market access does not guarantee market entry. The Aid for Trade initiative is a unique opportunity to move the process of market entry forward as well as bolster broad based growth that is employment intensive, illustrated by the coffee sector. Through measures like those mentioned above, trade has the potential to benefit hundreds of thousands of families in countries like Tanzania, improving livelihoods and living conditions and promoting human development and human rights.