



The Impact of Regulatory and Institutional Arrangements on Agricultural Markets and Poverty

A case study of Tanzania's Coffee Market

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CONTENTS

	PAGE
Summary and Main Conclusions	4
1 Introduction	4
2 How coffee regulations increase transaction costs and weaken incentive	9
3 The political economy of the markets is an underlying cause of the existing institutional and regulatory framework	15
4 How do we address these issues?	16
5 Summary	19
References	21

SUMMARY AND MAIN CONCLUSIONS

Despite some early gains in the post liberalisation period, the performance of Tanzania's coffee sector has failed to meet expectations. Both quality and production show a declining trend. But most concerning from a poverty perspective is that the producer price share for Tanzanian coffee growers is lower than in most other coffee producing countries.

Several programmes are currently in place in Tanzania that aim to stimulate agricultural growth and reduce rural poverty, but the impact of these interventions on poverty reduction has been limited. Numerous initiatives to increase access to inputs, improve research and processing infrastructure in the coffee sector have not been able to reverse negative trend. The reason is that the markets that they aim to improve are subject to institutional and regulatory weaknesses that when unresolved, will reduce the impact of the significant resource flows.

A complex and multilayered regulatory environment is one of the key underlying causes of the coffee sector's weak performance. The existing marketing regulations dampen competition in the market and as a consequence limit the growth for small growers' incomes.

Superfluous licensing requirements prohibit the entry of small operators to the market, reducing employment opportunities for small entrepreneurs and grinding down the prices offered to small growers. Village buying and contracting restrictions against private coffee buyers also weaken competition and create monopsonistic buying conditions. Regulatory restructuring that dismantles these restrictions will be an important way of stimulating the coffee market's performance. Licensing requirements for village buying need to be removed. The coffee regulations need to be amended to allow private buyers to engage in contracts that allow the remittance of a quality premium to coffee growers throughout the buying season. Currently, cooperatives have a regulatory monopoly on this type of contract, which contributes to the under provision of quality in the market. But reforming laws and acts is unlikely to be sufficient. Competition between the two main players – cooperatives and private buyers – to influence regulatory reform is dynamic and strong. Therefore, innovations that improve the regulatory environment whilst also reducing the distributional conflict between the groups (by offering incentives to the losers for instance) will be critical for the sustainability of the reform.

Although small coffee growers suffer the most from the inadequacies of the regulatory environment, they lack effective and organised representation that is independent from the agendas of the cooperative movement or the local authorities, making them the group with the lowest levels of information, access to regulators and influence. Supporting the emergence of a strong coffee growers association, which is independent of the agenda of either the coffee cooperatives, villages or the large coffee businesses, would contribute to redressing the balance of power in the market.

Overall, a road map is needed for building competitive agricultural markets before a sustainable impact on poverty reduction will be seen. Group dynamics and the underlying political economy of the market are key variables for the success of any such initiative, and in many cases, solutions that take the vested interests within the market into account may have to be sought. In particular, solutions that consider the political

economy of the market as a dynamic factor are likely to be the most sustainable interventions.

1 INTRODUCTION

This note uses Tanzania's coffee sector as a case study of how institutional and regulatory arrangements can depress market outcomes, particularly for the smallest and the poorest stakeholders. Whilst the characteristics of the coffee market are in many ways unique to its own circumstances, most of the insights, such as those relating to group dynamics, quality incentives and price determination are broader than the peculiarities of the coffee sector. In addition, policy dialogue and interventions in Tanzania's agricultural sector have tended to centre more on variables such as attracting foreign investment, input subsidies and research and extensions service than on the institutional foundations and the regulatory arrangements of markets, with few results to show for it. This note argues that it is time to take a broader view of how agricultural market institutions maybe critical to setting Tanzania on the path to poverty reduction that has proven to be elusive despite significant GDP growth and large inflows of aid.

The arguments in this note are not reductionist in approach. It is recognised that many of the regulations that are currently in place are critical and beneficial to the functioning of markets. In fact, several of the market constraints discussed in the analysis arise because of the lack of a regulatory framework. Nevertheless, there are also frameworks in place that need to be amended in order to improve the livelihoods of the rural poor.

1.1 Market Performance: declining production, quality and producer price shares

Despite extensive reforms, Tanzania's coffee sector has not performed well. The Tanzania Coffee Board's records show that coffee production in Tanzania has declined steadily over the last twenty years. The decline in coffee production has been accompanied by a marked decline in coffee quality, particularly for Arabica coffee (Baffes, 2004). Moreover, the producer price share of coffee growers¹ (an important factor for grower incomes) initially went up after the reforms but subsequently continued to decline (figure 1), unlike in Kenya and Uganda, where their shares rose sharply subsequent to their reform periods (Krivonos, 2003).

¹ Arabica coffee

Figure 1²

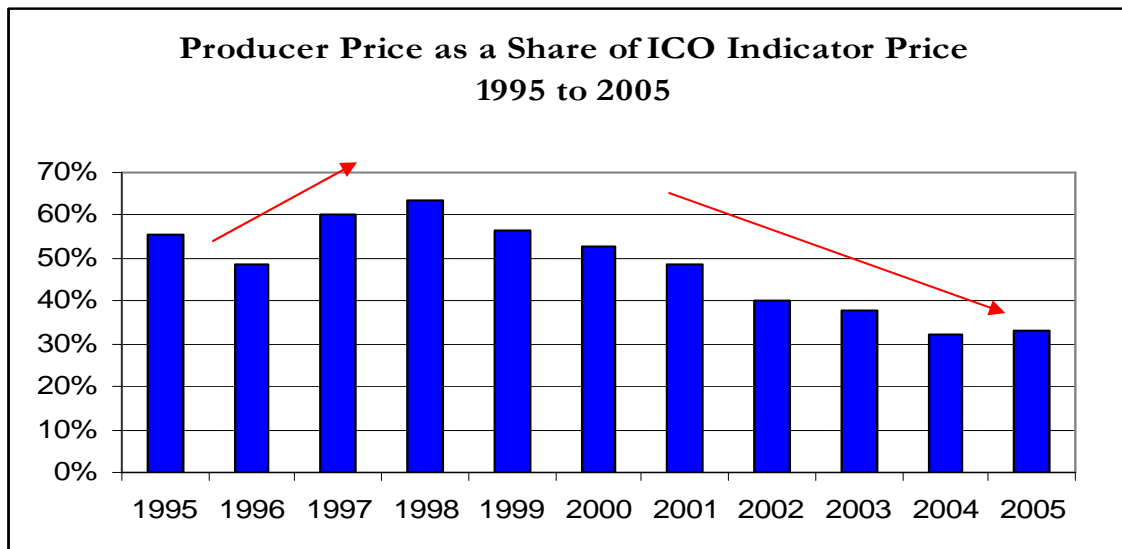
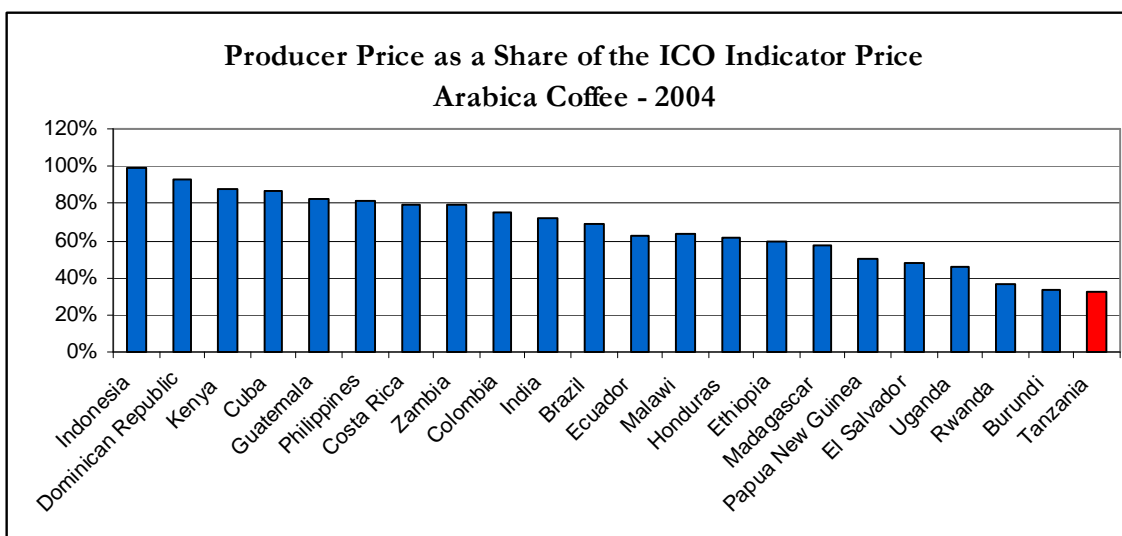


Figure 2³



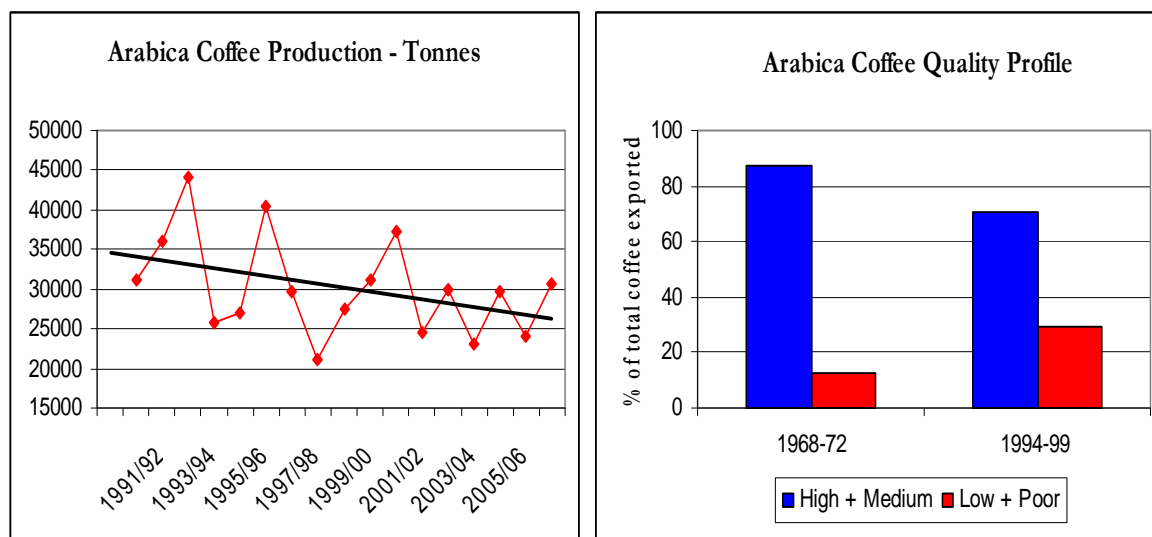
Overall, the coffee market reforms of the 1990s have had a mixed outcome at best (Nelson & Temu, 2002). On an aggregate level, the market has become more diversified with the entry of the private sector. However, price transmission patterns do not reflect those of a robustly competitive market. The decline in the quality of coffee has persisted through some fundamental changes to the structure of the market, including the

² Source: International Coffee Organisation data

³ Source: International Coffee Organisation data

liberalisation reforms of the 1990s, which do not seem to have succeeded in creating incentive mechanisms for improving the quality profile of the Tanzanian coffee sector. Overall, the result is a market that underwent macro level reforms that have not had the desired micro level impact. The reforms have not lead to the expected improvement in the productivity, incomes and overall livelihoods of the Tanzanian coffee growers.

Figures 3 and 4: Arabica coffee market trends⁴



1.2 Market Structure: many smallholder growers and a few concentrated buyers

The largest group in the coffee market in terms of production are the small growers⁵, composed of approximately 450,000 households. This group accounts for 95 percent of total coffee production⁶. The remainder of Tanzania’s coffee is produced by a handful of large privately owned coffee estates that are fully vertically integrated and that enjoy strong international market linkages⁷. Coffee marketing on the other hand is dominated by a handful of vertically integrated firms that collect, process and export coffee, referred to in this note as the coffee buyers. This segment of the coffee industry is highly capitalised, and similarly to the large estates, it is well connected to the international market. Small independent traders that buy coffee in villages do not play a role in the marketing chain of Tanzania’s coffee. The other key player in the coffee market, which straddles both production and marketing, is the network of the coffee cooperatives that acts as the marketing arm for its member coffee growers. The coffee cooperative unions are large organisations with apex bodies that coordinate the operations of smaller sub-

⁴ Sources: Figure 3 - Tanzania Coffee Board and figure 4 - Baffes - 2004

⁵ With an average farm size of 1 - 2 acres

⁶ Tanzania Coffee Board

⁷ This note does not include estates in the analytical framework, since they do not generally transact with other players in the market.

units known as cooperative societies. Even though the cooperative is in principle a union of individual farmers, the history of Tanzania’s cooperatives movement has shown that these large bodies inevitably develop their own set of incentives that are independent of those of the growers, and that may lead to the extraction of rents by the administrative cadres. This segment is only partially integrated as the operations of the cooperatives are mostly concentrated on collecting and processing coffee for sale at the Moshi auction.

Another important element for the coffee market is group representation. Group representation is strong for the large coffee businesses under the Tanzania Coffee Association. This association is composed of approximately 20 - 30 members and primarily represents coffee estates, buyers, processors and exporters⁸. The cooperative movement is another group that has a strong level of influence, albeit in the context of declining membership particularly in the southern coffee producing regions. Their influence is historically rooted in a national ideology of socialism that found its expression through the cooperative movements. The group in the market that has the weakest level of representation are the thousands of small coffee producing households that are not members of the cooperative movement and that sell directly to private buyers. This group has no effective direct channel for representation that is independent of the village authorities and the cooperative unions.

Table 1: summary description of the main groups in the coffee market:

	Buyer Market Share 2005/06 *	Level of Vertical Integration	Capital Base	International Market Linkages	Regulatory Access at the Central Level	Regulatory Access at the Village Level
Coffee Industry – buyers, processors & exporters	45%	High	High	High	High	Low
Cooperatives	55%	Low	Low	Low	High	High
Other Small Producers	n/a	Low	Low	Low	Low	Low

* Source: Tanzania Coffee Board.

⁸ Participation of one or two farmer representatives is accommodated by the association.

2 HOW COFFEE REGULATIONS INCREASE TRANSACTION COSTS AND WEAKEN INCENTIVES

The regulatory framework of the coffee market is complex and multilayered⁹. Some of the regulations in place are critical for the effective functioning of the market. Others however can prove to be significant obstacles for small growers' incomes and the profitability of business enterprises. We turn our attention specifically to marketing regulations. For a small coffee producer in a village, the main marketing channels that are available are either selling to a private trader or selling to the cooperative society¹⁰. In both cases, coffee marketing and procurement are strictly regulated. Both private buyers and cooperatives are forbidden from collecting coffee at the farm gate. Instead, they are required to set up buying posts at the villages. At each buying post, prices are to be displayed publicly. In the case of private buyers, an additional set of rules and licensing requirements are in place that are not applicable to the other groups. We will focus on three of these regulatory requirements and discuss their impact on market outcomes:

1. Coffee buyer licensing regulations
2. The village veto
3. The contingent contract restriction

2.1 Licensing requirements increase transaction costs, especially for small businesses

Prior to commencing their operations, private coffee buyers are required to obtain a multiple set of licences and permits to buy coffee on an annual basis. The licences extend to the separate operations of the coffee business, with a distinct authorisation being required for coffee curing, coffee warehousing and coffee exporting (GoT, 2006). Village coffee buying in particular has attracted heavy licensing requirements with multiple buying requirements:

1. Obtain a buying licence from the Tanzania Coffee Board
2. Obtain a buying licence from the District Council
3. Obtain a permission to buy coffee from each Village Authority where the buyer proposes to operate

Business licences are an important feature of many markets. They facilitate several important functions such as the coordination of market operations and the enforcement of standards and contracts. The licensing of private buyers by the Tanzania Coffee Board

⁹ As is the case with most of the other traditional export commodities

¹⁰ Although small farmer business groups also play a role in coffee marketing, we will not consider them independently of cooperatives in this note because of the similarities in their marketing structures and the small market share of the business groups.

is also an important factor for the management of the Moshi coffee auction. Although business licences may be useful in some instances, they need to strike a balance where they do not also pose a significant constraint to the efficient functioning of the market. For instance, heavy requirements for village buying are likely to dampen the competitive environment and encourage monopsonistic market conditions. Until recently, a fee of \$2000 was charged by the Tanzania Coffee Board for a coffee buying licence and \$2000 for a coffee exporting licence¹¹. These multiple requirements for licenses and permits arguably contribute more to the cost of doing business than to the quality of the regulatory environment. Moreover, a one license rule exists that is designed to prevent businesses from running vertically integrated operations. It prohibits the issuance of licences for both buying coffee from growers and exporting it to the same enterprise, making it another regulatory restriction that increases the cost of doing business for business that would otherwise be able to reduce their transaction costs by integrating their operations, particularly in a difficult contracting environment.

Despite the above described obstacles, large vertically integrated coffee businesses have continued to operate, invest and compete in Tanzania, and to dominate the private operations of the market (Baffes, 2004). They have shown the capacity to absorb some of the transaction costs that smaller businesses might not be able to support. For instance, the way that most of the large coffee businesses overcome the one license rule is by establishing new companies that operate independently on paper but that are owned and that transact solely within their business group. This may be a feasible solution for big businesses; smaller businesses however may find the costs of such manoeuvres too costly to be justified within the scope of their operations. It follows that the above factors have contributed to a market structure that has not supported the emergence of small or medium sized businesses where small coffee buyers or processors are virtually absent.

This set up contrasts with some of the other coffee producing countries. The Ugandan coffee industry has evolved in manner that is dissimilar to Tanzania's concentrated industry structure due to the differences in the respective reform processes and the resulting regulatory environment. Uganda's coffee market had many similarities with Tanzania's coffee market prior to the liberalisation reforms of the mid nineties. In both cases, marketing was dominated by coffee cooperatives and the state marketing bodies. Both markets underwent liberalisation reforms linked to structural adjustment programmes. Uganda's reforms in particular were fairly comprehensive. The monopoly of the Ugandan state marketing board was disbanded, export taxes were removed, price setting mechanisms were abandoned and public assets were privatised (Akiyama, 2001).

¹¹ This requirement was removed in 2007.

These reforms have created a market driven sector where transactions between buyers and sellers are subject to few restrictions. The marketing segment of the Ugandan coffee market evolved into a fairly competitive and efficient chain with a high level of participation of the private buyers and exporters throughout the supply chain as reflected by the low level of market concentration for coffee exports (Baffes, 2006). Village coffee buying is mostly handled by a large number of small coffee buyers known as *debe boys* that aggregate coffee from small farmers and deliver it to larger traders and exporters (Fafchamps & Vargas-Hill, 2008). These individuals purchase coffee at the farm gate and sell it on to larger buyers or coffee processors. The key characteristic of this regulatory and marketing structure however is that it maintains increased competition in buying and exporting coffee whilst keeping producer price share for Arabica coffee high and stimulating a considerable supply response¹².

In Tanzania, the transaction costs of buying coffee, including the licensing process and the costs of renting a buying post, may prohibit the entry of small operators to the market, reducing employment opportunities for small entrepreneurs and grinding down the prices offered to growers. Large businesses however operate with a considerably higher capital base that reduces those costs in relation to the volume of business transactions they make.

2.2 The village veto weakens competition and incentives at the village level

The regulatory arrangements for coffee buying also require private buyers to obtain the permission to buy from the village authorities. The approval to buy is to be granted by the village committee, under the overall leadership of the village chairperson, giving the village the power to veto private buyer entry. This single regulatory requirement delivers a fundamental conflict of interest in many villages, where the village committee is also active in the local cooperative society. In some cases, the village chairperson is also the chairperson of the local cooperative society.

These coffee buying regulations empower the village in managing the coffee business in their zone. However, at the same time, they also create a set of rent seeking opportunities for village authorities. The most concerning practice in this regard is the banning of private buyer operations in several villages, establishing a monopsony for the local cooperative. Other rent seeking opportunities also exist for the villages, including allocating village owned properties for buyers to rent as buying posts and levying village taxes on private buyer coffee purchases.

¹² Uganda also produces Robusta coffee, which is a variety of coffee that is not as refined as Arabica in terms of quality differentiation.

To demonstrate this, we take the example of coffee marketing in the Moshi Rural district of the Kilimanjaro region¹³. This is one of the Tanzania's prime coffee producing areas. As previously mentioned, unlike Uganda, small independent buyers that purchase coffee at the farm gate are not a feature of Tanzania's coffee marketing system. There are three licensed private coffee buyers active in this district in the 2008/09 buying season. Of the 127 coffee producing villages in the district, the private buyers are active in only 45 of the villages in the 2008/09 season¹⁴. In effect, 35 percent of the villages have access to only one private buyer, and only 9 percent have access to two or more.

One of the main expected outcomes of the liberalisation reforms was a more competitive market for the procurement and the processing of coffee. The entry of private operators to the market was expected translate to a wider range of marketing options *per grower*. However; the distributional conflict between two of the main players in the market is effectively eroding this goal. The regulatory arrangement in effect backs one group against the other, creating an asymmetry of power that is reflected in the overall level of competition, and in the market shares of the various buyers¹⁵. Prior to the reforms, coffee marketing was controlled solely by the coffee cooperatives and the State. However, for the small coffee growers, the current situation has not clearly led to an increase in the number of marketing options, and has weakened the incentives for buyers to offer optimal prices. The weak competition at the village level is particularly problematic because most villagers are unaware of the prices offered for coffee in the neighbouring villages, where the competitive environment or prices might be more favourable. Even if they have that information, the transaction costs of transporting coffee for sale outside of the village are prohibitively high for most small growers to benefit from selling their small volumes of coffee in neighbouring areas.

2.3 Contracting restrictions weaken the incentives to increase farmer prices and returns

Coffee transactions between growers and the private buyer are based on a *spot contract*, where the payment made at the point of sale is the final one. The transaction that takes place between the grower and the cooperative is based on a *contingent contract*, whereby a first payment is made at the point of sale, and a second payment is made several weeks or months later that is contingent on quality achieved and prices received after the goods are sold at the coffee auction.

¹³ Data referenced is from the Moshi Rural district authorities

¹⁴ The village and the ward levels is the most appropriate level of analysis in this context, as the operations of rural producers, including coffee growers, are mostly limited to the village or the ward.

¹⁵ This is the case in the coffee producing areas where the cooperative unions are still active, mostly in the Northern Highlands.

The main difference between these two types of contracting arrangements from the coffee grower's perspective is that unlike the spot contract, the contingent contract allows for quality premiums received at the auction to be passed back to the grower. This is because coffee grading is based on a dual system that is split along the supply chain. Under this system, the quality of coffee is defined differently by the different people involved in each of the two stages. At the first stage when coffee is sold by the grower at the village, all coffee is sold for one price, irrespective of quality characteristics. The coffee grower would consider that he or she has obtained a good quality crop when the normal production levels are reached and when the crop has not been affected by the climate and/or traditional coffee diseases. Buyers however will not give a verdict on the quality of the crop until the second stage when the coffee has been processed and then graded to determine the size, colour and flavour profile before it is sold at the auction. It is a system that maintains an underlying asymmetry of information between coffee growers that sell at the village and coffee buyers that process and export the coffee beans. In other words, the quality of the coffee is determined only after the transaction between the buyer and the grower has taken place.

In an efficient equilibrium, the price premium paid for high quality goods in comparison to lower quality goods will be equal to the marginal utility derived from the quality characteristics. This efficient equilibrium requires that complete information about the product's attributes is conveyed when transactions take place, or that there are no transaction costs incurred in verifying quality and information. However, when an asymmetry of information exists, so that the full characteristics of a good cannot be determined at the point of sale, but can be determined later, buyers will hedge against risk and pay the price of the lowest quality grade for all goods¹⁶. Moreover, in a competitive market with asymmetric information, buyers will not have the incentive to invest in long term mechanisms for improving the quality of coffee by offering a price premium to growers because they would still have to compete with other buyers in the following season. An *information rent* is generated through the above described grading process that gives an incentive to the buyer to pay only the minimum price for coffee and that causes the under-provision of quality in the market, since any two growers, one

¹⁶ If the attributes of the product are not observable by the buyer but are observable by the seller, the seller will have an incentive to report a higher quality and therefore ask a higher price. Since this claim cannot be verified, the buyer will have the incentive to offer only the lowest price. If there is asymmetry of information, in that the attributes of the product are observable by the buyer but not observable by the producer, the buyer will, again, have an incentive to offer only the lowest price.

with high quality coffee and the other with low quality coffee, would receive the same price for the goods¹⁷.

The transaction costs of grading each coffee consignment at the village are high, causing coffee buyers to grade samples from pooled consignment of the coffee they have bought in villages. This is why the contingent contract is an important tool for transferring quality premiums back to producers once the coffee grades have been identified and sold. But it requires that the right market incentives and regulations (such as licences) are in place to ensure that the terms of the second payment of the contingent contract are respected. Once again, competition is an important factor for contract efficiency.

Currently, cooperatives (and farmer groups) have the exclusive rights to offer this type of contract to growers. Private coffee buyers are prohibited by the coffee regulations to enter into such an arrangement with growers. In this way, contractual competition¹⁸ is eliminated, and the incentives for cooperatives to transfer the full quality premium to producers may be reduced. Coffee growers tend to change their coffee marketing channel depending on the price offered – a proxy of efficiency. In a competitive contracting environment the suppliers of contingent contracts would have an incentive to give the highest possible premium to growers to maintain their market shares and to attract buyers in the following season. The large coffee buyers in particular have long term investments in buying networks and productive capital, so rent seeking behaviour that would alienate coffee sellers would cause them to lose market share and run below capacity, potentially at a loss. When there is no competition, the sole supplier (cooperatives in this case) only has the incentive to only marginally exceed the prices offered under the spot contracts of the private buyers, as opposed to offering the full quality premium. And as already highlighted, the spot contracts offered by private buyers do not set a high benchmark in terms of pricing because of the structure of coffee grading.

2.4 The compulsory coffee auction and other constraints

The institutional and regulatory constraints described in the previous sections do not represent a comprehensive list. Other challenges also exist that merit further analysis to determine their impact on market efficiency and the livelihoods of small coffee growers. For instance, until recently, the Moshi coffee auction was the only channel for marketing coffee prior to export in Tanzania. In 2003, a direct marketing channel was opened for

¹⁷ A similar type of pricing behaviour has also been identified by Fafchamps, Vargas-Hill & Minten (2006) in their analysis of quality premiums in Indian agricultural markets.

¹⁸ Contractual competition refers to a situation where several buyers are operating under each contract type, so that once a seller has selected a contract type (spot or contingent), he or she has a choice between different buyers in completing the transaction.

speciality coffee producers. Direct exports of the highest grades of coffee were permitted by the Tanzania Coffee Board, allowing high quality producers to have a direct links and negotiations with buyers. This was a good regulatory change adopted by the Government of Tanzania that created the right incentives for increasing the quality of Tanzanian coffee and for rewarding producers. It maybe that requiring the remainder of Tanzania's coffee to be sold exclusively through the auction causes other inefficiencies. This can be determined through a deeper (and comparative) analysis and consultations with the stakeholders of the market.

3 THE POLITICAL ECONOMY OF THE MARKETS IS AN UNDERLYING CAUSE OF THE EXISTING INSTITUTIONAL AND REGULATORY FRAMEWORK

Most of the regulatory requirements as described above apply solely to the private buyers. Examining this from the perspective of two major actors that are competing in the marketing of coffee, a sense of regulatory capture begins to emerge. The regulatory environment seems to be heavily skewed against private buyers, in favour of the cooperative societies and unions. This may be an outcome of their level of influence, which has traditionally been high, both at the national level and the local level. For the most part of the period since Tanzania's independence, the cooperative societies and unions were the most powerful agents in the coffee market. At the height of their power, they operated as a monopsonistic buyer. Their power base was socially and politically embedded within the socialist ideology that is associated with Tanzanian politics of the time. They represented the interests of the masses of small producers, who traditionally voiced their concerns and interests through the cooperative movement. The cooperative movement eventually collapsed as a result of a combination of factors, including the lack of competition leading to operational inefficiency, financial mismanagement and a declining capital base.

When the coffee market was liberalised in 1994, the new private sector entrants to the market began competing with the failing cooperatives, and had to establish their market position. As the incumbents, the cooperatives maintained an advantage over the private buyers, and in this way, they may have influenced the path of institutional reforms during the liberalisation period. Therefore, the disadvantage that private buyers face may reflect the relatively low level of influence they had over the regulatory environment during the reform period, and the difficulty of accumulating socially embedded political capital, such as that of the cooperatives.

Nevertheless, the private buyers succeeded in entering the coffee market in this context. They came with a large capital base and a high volume of operations that allows them to mitigate the high transaction cost environment. But in addition to this, they have invested in establishing a strong industry association, the Tanzania Coffee Association, which now has a high level of access to regulators. Their association provides them with a direct channel for advocacy and influence to facilitate their business operations. For instance, it meets with the main regulatory body (the Tanzania Coffee Board) on a monthly basis to lobby and to discuss industry issues.

The main power deficit remains to be that of the small, often poor, coffee growers, whose voice is not being heard. They lack effective and organised representation that is independent from the agendas of the cooperative movement or the village authorities, making them the group with the lowest levels of information, access to regulators and influence.

4 HOW DO WE ADDRESS THESE ISSUES?

4.1 Coffee specific recommendations

Rationalising licensing requirements

All unnecessary coffee licensing requirements should be removed. All businesses are required to obtain a general business licence in Tanzania. Any additional licences beyond this one should serve a specific purpose that is not served by the general licence. For the coffee sector, removing the requirements for village buying for registered coffee businesses may remove some of the bottlenecks for more effective competition at the village level.

Licensing and veto powers should be restricted exclusively to the Tanzania Coffee Board because of their legal mandate to manage the coffee industry and their oversight over the industry at the national level. Coffee buyers that comply with industry regulations should be able to enter and exit the market unhindered by village and district authorities. Furthermore, an arbitration mechanism should be developed by the Tanzania coffee board to mediate between coffee buyers and village authorities if a conflict should arise, with the aim of ensuring that buyer concentration is maximised at the village level.

Allowing private buyers to make contingent contracts Contingent contracts are an important tool for providing quality premiums to coffee growers and stimulating the overall supply of high quality coffee in the market. Revising coffee regulations to allow private buyers to enter into contingent contracts will create a mechanism for the transfer

of quality information and price premiums to the large proportion of coffee growers that sell through this channel. It would also stimulate competition between private buyers and cooperatives on the basis of quality determination and pricing. This reform would potentially create a mechanism for fostering high quality coffee in a competitive market environment.

Allowing private buyers to engage in contingent contracts with coffee growers may cause a loss of market share to the cooperatives. It is likely therefore that they will pose some level of resistance to this reform at the point of change, and in the subsequent periods. Gaining their buy-in to the reform may require additional measures such as fiscal incentives. For instance, exempting the cooperatives from some of the industry taxes and levies would reduce their operating costs give them some space to retain a level of competitiveness in the post reform period. The reform itself would increase competition in the market and erode buyer rents. Consequently, it would create an environment where fiscal incentives (or reductions in transactions costs) would be more readily translated in to higher producer prices as opposed to buyer margins.

This type of solution acknowledges that market players are in constant state of distributional conflict over market shares and institutional arrangements. Elite capture of market institutions are a reality in many contexts, and often the best solutions to market inefficiencies are those that consider the political economy of the market as a dynamic factor. Such an approach requires that innovations that essentially arbitrate between the various groups are sought.

A coffee growers association

1. Supporting the emergence of a strong coffee growers association, which is independent of the agenda of either the coffee cooperatives, villages or the large coffee businesses, would contribute to redressing the balance of power in the market. This is the group that has the largest interest in developing a competitive market with regulations and institutions that reduce transaction costs. The group would need to have regular platforms for dialogue with the industry regulator and the other groups or associations such as the cooperatives and the Tanzania coffee association.

As indicated in the previous sections, other challenges exist in the coffee market, and other solutions also exist for the challenges we began to explore in this note. A more detailed analysis of the constraints and the context of Tanzania's coffee market would be critical to identifying a fuller set of effective interventions. One of the key questions to be

addressed would be which village marketing mechanism would maximise grower returns and incentives for quality.

4.2 The bigger picture

As is in the case of the coffee sector, many of Tanzania's agricultural markets (particularly the export commodities) suffer from similar regulatory and institutional impediments that in some cases are more severe in their impact, particularly on the poor. The cashew market for instance suffers from extremely poor marketing incentives for buyers and sellers (Cooksey & Shao, 2008). This does not mean that solutions should be sought for the agricultural sector as a whole single unit. Each agricultural market has a specific set of issues and potential solutions to problems that might not be directly transferable to others. A framework is needed that addresses the institutional and regulatory challenges of the agricultural sector because of its importance for poverty reduction, which treats each separate market as a sole and distinctive unit. It is a challenging task that could be moderated by initially targeting a small number of key markets for poverty reduction. Some approaches to structuring such a framework are explored below:

Institutional and Regulatory Assessments of Agricultural Markets: the major business environment surveys and assessments (e.g. ease of doing business, investment climate assessment) tend to investigate the institutional and regulatory structures that relate most directly to large urban businesses. For instance, the unit of assessment for the adequacy of infrastructure for businesses is more likely to be the national marine or air ports rather than the rural feeder roads. Their direct relevance is limited in relation to the majority of small agricultural producers that do not register their businesses or transact outside of their own village. Regular assessments of agricultural market institutions and regulations are needed to form the basis for designing interventions and reforms in this area. This is particularly relevant in the context of rapidly changing market conditions relating to international prices, regional integration, trade agreements and the food security situation.

A Vehicle for Institutional & Policy Reform for Agricultural Markets: Since the major business environment reform initiatives in Tanzania draw on the above mentioned surveys and assessments, they also fail to identify small agricultural producers as the business units that would benefit from these interventions directly. This is also reflected by the tendency to treat agricultural reforms in Tanzania as one off events that took place in the liberalisation frenzy of the mid nineties. Whereas in fact, the agricultural environment is has been changing over the past fifteen years, and some markets even

indicate the emergence of rules and practices that have reversed the outcomes of previous reforms (GoT, 2006).

A specific vehicle for addressing the costs of doing business for agricultural markets could be a way of easing the bottlenecks that inhibit the growth of small and medium sizes businesses in this sector, and that depress the incomes of the 4.5 million families that are engaged in small scale farming. The emphasis should be on regulatory impact at the producer end of the supply chain. Some of the areas that would be addressed under such a framework are price determination, contracting mechanisms, property and land rights, border trading policies, marketing regulations and regional/ international trade.

Strengthening Growers' Associations: lobbying, influence and voice are major drivers of regulatory frameworks and the associated market outcomes (Acemoglu, 2006; Knight, 1992; Bates, 1989). Our coffee example demonstrated the value placed on regulatory access by large businesses, and the how regulations affect the balance of power in the market. The distributional conflict in the coffee echoes in many of the other agricultural markets, that have large business dominated associations that are significantly better resourced than the grower associations (if they exist at all) e.g. tea & dairy. The voice of the small agricultural producers and pastoralists is very much lost amidst the cacophony of the large business associations and interests of the markets.

There is an urgent need to strengthen growers' associations and to reduce the influence costs of the poor. The challenge is a well recognised and Olsenian in nature: it is much more difficult for large dispersed groups (farmers, pastoralists, etc) to coordinate themselves than it is for small mutually identifiable groups (dairy processors, coffee exports, etc). In this context, external assistance may contribute towards reducing the costs of large groups to organise themselves, to gain access to information, to share it amongst themselves and to use it to lobby for a better institutional and regulatory environment. Without a core of informed and well organised stakeholders, reform initiatives or programmes such as those suggested in this note are not sustainable endeavours.

5 SUMMARY

Several programmes are currently in place in Tanzania that aim to stimulate agricultural growth and reduce rural poverty. They range from large national initiatives such as the Agricultural Sector Development Programme to smaller projects in various parts of the country. Many of these interventions are important, and address key constraints such as

the weak national research and extension systems, capacity building and market access for niche agricultural produce. The impact of these interventions however has been limited. The reason is that the markets that they aim to improve are subject to institutional and regulatory weaknesses that when unresolved, will dampen the impact of the significant resource flows.

A road map is needed for restructuring Tanzania's key agricultural markets before a sustainable impact on poverty reduction will be seen. Group dynamics and the underlying political economy of the market are key variables for the success of any such initiative, and in many cases, solutions that take the vested interests within the market into account may have to be sought.

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