Contractual governance in agro-industry institutions in Tanzania
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Chapter 1
Introduction

1.1 Introduction

Studying agro-industry institutions of Tanzania is timely and relevant, because Tanzania is currently implementing the “Agriculture First” (Kilimo Kwanza) Program (URT 2009) in order to increase economic efficiency. The program, which consolidates the Agricultural Sector Development Program (URT, 2007) aims at improving national food security. It also sets trade and marketing policies in order to stimulate agricultural production for domestic consumption and export. Therefore, institutional arrangement is essential in the process of organising and directing the resources under this program efficiently. Normatively, efficiency requires formal assignment of property rights prior to carrying out transactions. Otherwise, the costs of carrying out transactions may jeopardise the benefits to be obtained from the outcomes of the transactions. The findings obtained in this thesis from four case studies in the agro-industry of Tanzania reveal that economic agents partly adhere, circumvent, or obstruct formal rules in order to maximise (private) benefits. The study also shows that the institutions adapt to cope with such behaviour in order to increase efficiency, or lower transaction costs. In addition, the findings show that imported foreign rules combined with informal rules have been able to enhance private ordering. These rules increase efficiency and promote decentralisation processes in grassroots communities. Nevertheless, transaction costs among the four cases are still very considerable and a further lowering of these costs would increase efficiency.

The structure of this chapter is as follows. Section 1.2 explains the reasons for studying the efficiency of the agro-industry institutions of Tanzania. Section 1.3 gives a synopsis of the institutions of Tanzania. Section 1.4 sketches the theoretical approach. Section 1.5 contains the research questions. Sections 1.6 discuss the limitations of the study. Section 1.7 provides an overview of the book.
1.2 Studying efficiency in agriculture

In recent years, for example the years 2006 and 2007, agriculture contributed only approximately 26 percent to the Gross Domestic Product (GDP) of Tanzania. Agriculture in Tanzania is dominated by smallholder farmers (peasants) cultivating farms with a typical size between 0.9 hectares and 3.0 hectares (URT(a), 2008). About 70 percent of Tanzania’s crop area is cultivated by using hand hoes, 20 percent by ox plough and 10 percent by tractor (URT(a), 2008). It is a rain fed agriculture. Furthermore, the peasant farmers or smallholder farmers (SHFs) are engaged in agriculture mostly to produce food for their families (subsistence farming). Agriculture takes up 5.1 million hectares annually out of 44 million hectares suitable for crop production (URT, 2008). Eighty-five (85%) percent of 5.1 million hectares is for domestic food production. Agricultural activities contribute to the household food security in a country whose population is increasing at approximately 2% per year with a current population of 42 million people. It also contributes by supplying the biological inputs to the agro-industry factories. Apart from being a major employer of the majority of Tanzanians, URT (a) (2008) reports that labour productivity in agriculture is falling due to the application of poor technology, dependence on irregular and unreliable weather conditions.\footnote{Interestingly, however, agricultural GDP has grown at 3.3% per year since 1985, the main food crops at 8.5% and export at 5.4%. However, in order to halve abject poverty, the government estimates that it needs to boost overall economic growth from the current 5.8% (2007) to at least 6% - 7%. In 2009, the government of Tanzania announced a new phase of using agriculture as the pivotal sector to lead the economy when it published its “Agriculture First” policy. This policy hopes to start a new phase of green revolution in Tanzania.}

Meanwhile, a farmer in Turiani Ward finds his sugarcane field on fire just the day before he wanted to harvest and since he cannot sell fermented sugarcane, he needs to let it rot. He will not receive any income that season. A tobacco farmer has delivered tobacco leaves to the cooperative society and the farmer, therefore, is waiting to receive payment according to the contract signed between him and the buying company. He receives a notice that his tobacco is unsuitable for smoking and, therefore, it has been discarded. That farmer will have no tobacco income that season. Somewhere in the Kilombero valley, a farmer grows sugarcane. At the time that he is preparing to harvest, he

\footnote{See also www.tanzania.go.tz/agriculture.html.}
receives the notice from the harvesting committee that his field will not be harvested as the quota for selling sugarcane has already been reached that year. The farmer will receive no income and remains in debt for previously borrowed subsidised fertilisers.

The research in this thesis shows that these inefficiencies occur in Tanzania’s agro-industries. Although different stakeholders may promote agriculture, firstly it needs to address the underlying economic organisational problems that lead to the examples sketched above. Such inefficiencies are wake up calls to study contractual governance in order to increase efficiency in the agro-industry institutions. Studying these agro-industry institutions and their problems may offer a lesson to policy and lawmakers in order to find instruments and policies that increase agro-industry efficiency. With that, a focus on economic institutional design may indeed promote the agricultural sector to lead the economy and contribute to alleviate poverty among the majority of Tanzanians whose livelihood depends on agriculture.

1.3 Synopsis of the institutions of Tanzania

The government of Tanzania is administered in the traditional three tiers of government, which are the executive, judicial and the legislative branches. The executive branch includes the president and his cabinet who are elected every five years through the multiparty system that started in 1985. The judicial system is comprised of the Chief Justice and the court system. The legislature branch comprises the members of the parliament whose electoral areas (jimbo) vote for them. The electoral areas are different from the regions or districts, they depend on the number of the members of the constituents (electoral areas) (URT(b), 2002; URT(c), 1998).

The population of Tanzania includes 120 ethnic groups on the mainland. Religious institutions are Christianity (35%), Islam (35%) and traditional beliefs (around 30%). Zanzibar is roughly 98% Muslim.

Tanzania has been stable and peaceful since independence in 1961 under its first president Julius Kambarage Nyerere. President Nyerere implemented the Ujamaa-African socialism in 1967, upon which villagisation policies followed. The villagisation policies required people to live in collective villages (Hyden, 1980). This policy abolished private ownership as the means of production. In 1982, market liberalisation policies were necessary after the failure of Ujamaa policies to deliver the required social services and Nyerere
resigned. After Nyerere’s resignation in 1985, his successor, Ali Hassan Mwinyi, attempted to raise productivity and attract foreign investment and loans (Mwapachu, 2005). He dismantled government control of the economy and encouraged private ownership of resources, especially for business undertakings. This policy continued under Benjamin Mkapa (1995-2005). Currently, with President Jakaya Kikwete, the policies of liberalisation of markets and decentralisation by devolution are ongoing. The four case studies in chapter five, six, seven, and eight are used to explain the economic institutional set up of the agro-industry of Tanzania. The four cases’ findings reveal whether or not the private sector has been able to support the government efforts in implementing decentralisation and poverty alleviation policies, and whether the grassroots communities have been able to participate in the economy.

1.4 Theoretical approach

In this study, the agro-industry institutions of Tanzania are reviewed using three interdependent theories: property rights theory, transaction cost theory, and agency theory. Each of these three are necessary as the institutions reflect the way in which property rights are allocated and upheld, how contracts are used including the specific nature of the produce and the incentives inherent in these contacts that motivate inefficient self-interested behaviour. The above-mentioned examples exhibit the existence of the problems caused by lack of “well assigned” property rights. It also indicates specific organisational problems, and wrong incentives that generate adverse behaviour. Property rights theory shows why these rights are important to allocate and uphold to lower transaction costs. Transaction cost theory focuses on transactions (based upon allocated property rights) and the governance system surrounding those transactions. Agency theory focuses on incentives in contracts, the adverse behaviour that might result, and the instruments to counter that behaviour. In chapter 3, these theories are discussed more fully, within the setting of the research subject.

1.5 Research questions

In this study, the following research questions are formulated:

1. What are the contractual relationships between factory owners (FOs) and smallholder farmers (SHFs)?

2. What governance problems are encountered, affecting the contractual relationships?
3. Why do these governance problems arise?
4. What lessons can be drawn in order to improve the efficiency of the agro-industry institutions of Tanzania?

1.6 Limitations of the study

The study confines itself to studying smallholder farmers (SHFs) and factory owners (FOs) who grow and process sugarcane, tea, and tobacco. Therefore, it does not involve the whole agro-industry sector in Tanzania. As the study intends to investigate the role of the private companies operating in the grassroots communities, the study limits its scope to firms contracting the grassroots communities. Given the government policies of stimulating private sector involvement in agriculture, farmers and firms who contract on agricultural produce are of paramount importance for the future of Tanzanian agriculture. As this research started in 2007, only five companies were contracting the grassroots communities in Tanzania. Four of these five companies are taken up in the case studies in this thesis.

The private property rights issue is a new phenomenon in Tanzania, which contradicts with the collective ownership inherited from the Ujamaa African socialism. Only the companies that are exercising private property rights to carry out transactions through contractual agreements are involved in the study. This limits the research findings to these private contractual settings. However, with the promotion of private ownership (and most often at the same time foreign investment capital as well) the research findings are also of interest to sectors that are in transition or on the brink of such a transition.

Theoretically, this study builds upon the Coase Theorem to understand the reasons why SHFs and FOs choose different alternatives when they transact. This study attributes “well-assigned” property rights as facilitators of private negotiation. Failure to assign the property rights in a certain way to allow minimising transaction costs also creates agency problems. It does not study other types of institutions apart from those that affect the property rights assignment and the contracts in the agro-industry institutions.

Even though there are many informal contracts in Tanzania, the selected cases involve formal contracts between SHFs and FOs. The aim is to look for the contracts, which support grassroots communities to transact in the market. This case study limits its focus on the three agro-industries, which are sugarcane, tobacco, and tea. It investigates
four cases and the unit of analysis is the FOs and SHFs who contract with each other.

1.7 Structure of the book

There are ten chapters in this book. This chapter provides the introduction, the theoretical approach, the research questions, and the limitations of the study and the structure of this book. Chapter 2 gives the reader the background information on the agro-industry institutions of Tanzania. It sketches the historical development of the institutions and describes the status of the industries that are studied in the cases (i.e. sugarcane, tobacco, and tea). Chapter 3 provides the theoretical framework of this thesis and includes, property rights theory, transaction cost theory and agency theory. Building on these theories, the behavioural alternatives for farmers in a Tanzanian context are discussed. It also develops the Farmer Behavioural Model (FBM), which explains the choice among these alternatives. Chapter 4 discusses the methodology used in the research. Chapter 5 contains the case description of the Mtibwa Sugar Estate Limited (MSEL). Chapter 6 contains the case description of Kilombero Sugar Limited (KSCL). Chapter 7 describes the case of Alliance One Tanzania Limited (AOTL). Chapter 8 discusses the case of Tanzania Tea Packers Limited (TATEPA). Chapter 9 provides an analysis of the data obtained from the four case studies and gives a cross-case analysis. The last chapter (Chapter 10) concludes and summarises the findings and gives policy implications.