Findings

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT — WORLD BANK

Environmentally and Socially Sustainable Development

31056 **245**

December 2004

Findings reports on ongoing operational, economic, and sector work carried out by the World Bank and its member governments in the Africa Region. It is published periodically by the Knowledge and Learning Center on behalf of the Region. The views expressed in Findings are those of the author/s and should not be attributed to the World Bank Group.

IMPORTANT NOTICE: Effective November 2004, *Findings* and *InfoBriefs* will only be available electronically. Register your e-mail address at www.worldbank.org/afr/findings to continue receiving the electronic version.

Tanzania's Tea Sector: Constraints and Challenges'

Tea was first planted in Tanzania in 1902, when German settlers introduced the crop to the Agricultural Research Station in Amani and Rungwe. Commercial production began in 1926 and increased considerably after World War II, when the British took over the tea plantations. By 1960 Tanzania's tea production reached 3,700 tons of made tea (a little less than 0.5% of world's total of 800,000 tons).

Before independence, tea was produced on estates, a common practice in Africa and South Asia. All tea-related matters were handled by the Tanganyika Tea Board. Smallholder tea farming begun during the 1960s. In 1968, the government initiated a full-fledged smallholder tea development program, and all aspects of smallholder tea marketing and trade were turned over to the Tanzania Tea Authority which assumed a wide array of responsibilities.

The Authority promoted smallholder tea production, typically on plots of about a third of a hectare. Tea expansion was assisted by the donor community, including two World Bank lending operations. Smallholders accounted for about a quarter of Tanzania's tea production during the early 1980s. Most of the smallholder tea leaf went to the eight Tea Authority-owned factories for processing, and the rest to factories owned by the estates.

Despite its apparent success, there were numerous signs of distress in the smallholder sector which were vividly summarized in a World Bank report in 1983. Interestingly, the report was written when the smallholder sector was at its peak, implying that while the sector appeared healthy, the fundamentals were poor. By the mid-1990s, smallholders' share dropped below 10 percent and by 1998 it fell to 5 percent, the lowest level since tea was introduced as a smallholder crop. Contributing to the decline were low prices and late payments by the Tea Authority, old and inefficient processing factories, inadequate use of inputs, rundown transport equipment, poorly maintained feeder roads (i.e., roads connecting farms to tea factories), and low yields due to failure to adopt new varieties.

The problems of the industry were reflected in the estate sector only in a limited way. When Tanzania nationalized most large companies during the 1960s and early 1970s, tea estates were exempted—with two exceptions in the East Usambaras. The Kwamkoro estate (630 hectares) was nationalized in 1967 and the Bulwa estate (680 hectares) was "bought" by the government in 1971. Before nationalization the two estates together produced more than 1,800 tons of made tea. Production dropped to 300 tons in the mid-1980s as almost two thirds of the original 1,300 hectares were abandoned. The factors behind the deterioration were similar to those in the smallholder sector.

Public research on tea also ran into major problems. Before independence, research for the East Africa tea producing region was conducted by the Tea Research Institute of East Africa. Following the collapse of the East African Community in 1977, the research program was transferred to the Department of Research and Development of the Ministry of Agriculture and Cooperatives, but the program was inadequately funded. The tea estates contracted with a UK university to operate a tea research unit, housed in one of the estates in the Southern Highlands. The research focused primarily on production systems with high input intensity, as practiced in estate tea production.

The Road to Recovery

Deterioration of the two nationalized estates, the poor performance of the smallholder sector, and the collapse of the research system clearly signaled that broad-based reforms were needed to revive the sector. The first step toward reform was privatization of the two nationalized estates, a process that extended from 1988 to 1993. Initially, the government considered three options: do nothing and let the estates and their factories close; let the estates continue producing at a loss with minimal renovation over the next 10 years, by which time their residual value would be zero; or fully rehabilitate the estates with external assistance. The third option was selected, mainly for political reasons.

The Commonwealth Development Corporation, a statutory corporation of the British Government was invited to purchase a 60 percent equity share in the estates, with the rest to be retained by the Tea Authority. They would form a joint venture to rehabilitate the estates. The incremental funding was estimated at £5.9 million. In 1995, the Commonwealth Development Corporation and Karimi Agriculture signed a memorandum of understanding to merge the two tea estates—Karimi was a company owning an 882-hectare tea estate in the East Usambaras—and finally the two companies merged. In 2001, it was understood that that the role of the Commonwealth Development Corporation had been fulfilled and the new company, the East Usambaras Tea Company, was sold to Global Tea and Commodities, a United Kingdom-based tea packing company. The East Usambaras Tea Company currently operates three tea factories, is the third largest tea producer in Tanzania, provides employment to some 3,500 workers, and produces more than 3,600 tons of made tea.

Next came the separation of regulatory and development functions of the Tea Authority. The Tea Act of 1997 established the Tea Board of Tanzania and the Tanzania Smallholder Tea Development Agency. Their functions were set out in the Tea Regulations of 1999. The Tea Board is responsible for regulating tea cultivation and processing, licensing tea blenders and packers, licensing and controlling tea exports and imports, collecting statistics on the tea industry, and representing the government in international tea forums. The Tanzania Smallholder Tea Development Agency is responsible for promoting and developing the smallholder tea sector, advising the Ministry of Agriculture and Food Security on tea industry matters, offering extension services to smallholders, and monitoring the privatization of Tea Authority factories.

Another important step in tea sector reform was the decision to privatize the tea factories. Of the six Tea Authority-owned tea factories put up for sale in 2000, four were in private hands as of November 2001 and three of them have begun renovating the facilities and paying farmers more promptly.

The research program faced several problems and by the mid-1980s was in a state of collapse. The Tea Research Steering Committee formed in 1988 to arrest the decline in research recommended creation of an independent research organization funded primarily through industry levies. The Tea Research Institute of Tanzania was finally established in 1996 as a nonprofit organization. In 1997, the Ngwanzi Tea Research station, a privately funded organization in the Southern Highlands was officially incorporated into the Institute. In 1998, a similar transfer to the Institute from the government-owned and managed Marikitanda Tea Research Station in the East Usambaras took place. Currently, the Institute is managed by a 10-member board, with broad representation, including estates, smallholders, and the government. As a non-statutory body, the Institute can use merit and performance criteria rather than seniority to determine the career paths of its researchers. The Institute is funded by the industry, receiving 1.5 percentage points of a 2.5 percent levy on the net sale value of made tea and the other 1 percentage point covering the operational expenses of the Tea Board. Although smallholders contribute just one-tenth of the tea levy (because of their small share in total output), one third of the Institute's budget is earmarked for activities to benefit them. Dissemination of research findings to estates and small tea growers is managed by the institute's Technology Transfer Unit.

Recent Performance and Constraints

The reforms have had a positive effect on the tea sector. Production of made tea rose from about 20,000 tons in 1990, to about 26,000 tons during the 2001 and 2002 seasons. Reports by government officials and traders at the Mombasa auction indicate that the quality of smallholders' tea has improved considerably as well, claims that are supported by the numbers. In 2000, for example, Tanzanian tea f tched the same price as Ugandan tea, commanded a 35 percent premium over Malawian tea, and sold for 18 percent less than Burundian tea and 25 percent less than Kenyan tea, the highest quality among the teas sold at Mombasa. Data for 2001 and 2002 show even better performance.

Tea research is on a solid footing. Both research stations—Ngwanzi and Marikitanda—are working on several projects ranging from the development of new tea varieties to the optimal use of fertilizer and soil and water conservation while the technology transfer unit successfully disseminates research results to tea growers. The research institute is also engaging in contractual extension services with the newly privatized tea companies.

These are solid achievements, but several issues still require attention: the ban on made tea imports, taxation, the role of the Board and the ministries, and infrastructure. The ban on black and packed tea imports has been in place since the inception of the Tea Authority. The ban on packed tea was imposed in order to protect the domestic blending and packing industry. The motivation behind the ban on black tea imports is not clear. Despite the ban, a considerable part of the domestic market is supplied by "illegal" imports from neighboring countries. While there are no solid estimates on the amount of tea imports, industry representatives and government officials concur that it is between 30-35 percent of domestic consumption. Industry representatives report that the imported tea is of secondary quality, in high demand among low-income rural households. The imports continue because of this demand, the difficulty of monitoring trade in rural areas, and incentives on the supply side (importers' avoidance of VAT and some exporters' avoidance of high export taxes at home). Opinions about the "problem" and how to solve it are mixed. Some suggest that that the war on illegal tea imports and smuggling must be strengthened and should involve the Tea Board, Tanzania Revenue Authority and the police. Others have noted that what some see as a smuggling problem is really an excess taxation problem, since the illegal importers bring in their cargoes free of taxation, thus making their tea much cheaper than the locally produced tea. Naturally, any buyer would prefer buying cheaper tea than the more expensive local tea. An alternative to the failed import ban would be to levy an import duty on tea of, say, 5 percent. This policy would have several benefits. Tax revenues would be generated, the quality of imported tea could be monitored, accurate statistics could be collected to improve policymaking and investment decision making, legitimate jobs will be created for importers, traders, and shop owners, corruption will be reduced, and consumers could pay lower prices for tea. This policy action should be part of a comprehensive revision of the tax code, which would ideally include a move to a uniform import duty across the board.

Despite frequent amendments, the tax code remains unnecessarily complicated. There are too many taxes and the rates are too high. Tea producers are subject to as many as 44 taxes, levies, and licenses. High tax rates can lead to tax avoidance and corruption. And administering the taxes takes a substantial amount of staff time for producers as well as the government. A recent government report estimated that the nominal protection coefficient on the tea sector had increased from –55.2 in 1990-93 to –77.0 in 1994-99, with the negative sign indicating taxation. Thus, despite the frequent changes and amendments to the tax code, taxes are not being eliminated or reduced; they are just changing names. Streamlining the tax code and reducing the tax burden should be a priority.

Both the Tea Board and the Ministry of Agriculture and Food Security still have too much discretionary power. For example, Article 22 of the Tea Act of 1997 indicates that the Tea Board may refuse licenses on "any ground which may appear to it to be sufficient." Article 29 of the 1999 Tea Regulations states that "the Board shall, in issues relating to quality in respect of domestic and export market, be the final arbitrator." Wielding this excessive power, the Board has denied licenses for imports of made and packed tea, a questionable policy on economic grounds and one that entirely ignores issues of consumer welfare. Penalties for violating Tea Board regulations are high—often as high as $ 2,000, which is 10 times the per capita GDP (equivalent to a fine of $350,000 in the United States). Despite such stiff penalties a third of Tanzania's domestic tea demand is supplied by "prohibited" imports, implying that tea smugglers are not caught (the ban is ineffective) or are caught and not fined (the ban spawns corruption.)

In addition, violations of regulations are frequent. For example, the 1997 Tea Act stipulates that the Tea Association has the right to nominate two members to its Board: "The Board of Directors shall consist of ... two other members representing the interests of licenses nominated by the Tea Association of Tanzania amongst farmers or manufacturers." However, as the government review of the agriculture sector noted that: "The President did not respect this legal provision in a reshuffle of the [Tea and Sisal] Crop Board members in June 1999. Because of that reshuffle most of the members of the Coffee, Cotton, and Cashewnut Associations, who were 'a titre personnel' member of the crop Boards, lost their membership of the Board as well."

Inadequate infrastructure has been a major reason for the tea sector's poor performance and an impediment to the sector's development. Because green leaf must be processed within six hours of plucking, rehabilitation of feeder roads used for transporting green leaf from farms to factories must be given priority. But most of the infrastructure problems (such as poor quality of the national road system and frequent disruptions in electricity supply) are not specific to the tea sector and need to be dealt with at a broader level. While improvement of infrastructure of a public goods nature needs public sector involvement, some infrastructure problems need to be resolved by the private sector, such as rehabilitating tea factories, building new ones, replacing transport equipment, and the like. Here, the public sector should be involved only in monitoring, regulating, and disseminating information. Creation of a new tea auction, proposed by some, seems unnecessary since the Mombasa auction well serves the interests of the entire East African tea producing community.

This article was prepared by John Baffes, Senior Economist, Development Prospects Group. It is an extract of a full document, ***Tanzania's Tea Sector: Constraints and Challenges in a Global Environment,*** *Africa Region Working Paper.* *www.worldbank.org/afr/wps*.