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Determinants of Leather and Leather products Exports in Tanzania

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Abstract
This study examines the determinants of Leather and Leather products Exports in Tanzania. We apply Ordinary Least Square (OLS) analysis on time series data from 1980 to 2015. The findings show that export of raw hides and skins, and high costs of production are among the deterring factors to leather and leather products export in Tanzania. Export of raw hides and skins and costs of production recorded negative and significant relationship with leather exports. On the other hand, hides and skins collection recorded insignificant relationship while leather price in the world market had negative and significant relationship with leather exports. This suggests that other factors such as low quality of leather and leather products exported, inadequate capital investment, stiff competition with foreign companies for hides and skins and inadequate market information explain the state of current Tanzania's leather exports. Thus, attracting local and Foreign Direct Investment (FDI) in the leather subsector by providing friendly investment climate and addressing the supply side constraints will enable increased high quality leather and leather products diversification and exports.

1. Introduction

Leather industry in Tanzania has many untapped opportunities which if sufficiently exploited can boost economic growth and development through raising productivity in the manufacturing sector and increased exports. Tanzania is the second country in Africa after Ethiopia with livestock worth with population reaching 22 million cattle, 15.2 million goats and 6.4 million sheep (Majaliwa and Nkwame, 2016). Large population of livestock represents a formidable supply of milk, meat and Hides and Skins which entails large impact in nation economy (Ndaro and China, 2016). However, according to Mbassa *et al.,* (2014), the rate of tanning hides and skins to leather in Tanzania is very low. In terms of Gross Domestic Product (GDP), Tanzania's leather sector contributes only 2% (REPOA, 2015) compared to Ethiopia's leather sector which contributes 80% of the GDP. The reason is less effort paid to the sector to harness the potential values of leather in economic growth (Kalagho, 2014). Nonetheless, according to Tanzania Investment Centre (2014), Tanzania leather sector has huge opportunity to expand and become a reliable supplier of leather and leather products in the region and world at large. This is due to the existence of favorable environment to support the sector such as labor availability, labor facilities, well planned economic development zones and current government willingness to revive leather sector.

The survival of leather sector is determined by availability of raw hides and skins. Raw hides and skins are substantial portion of the value of livestock by products which if utilized effectively can be an important source of foreign exchange earnings (Jabbar *et al.*, 2002). Table 1 shows the collection of hides and skins for a period of 2007-2012. The data shows the collection of Hides and skins has been relatively lower compared to the existing livestock potentials in Tanzania. URT (2014) states that, despite a number of policies and regulations to support the sector, low growth remains entrenched and the sector appears to be performing well below its potential. It has not managed to adapt successfully to produce new varieties of products, and continues to experience low growth and low levels of investment. However, the volume and value of exports are generally increasing, despite a sudden fall in 2009/10 presumably resulting from the global economic crisis of the time. The changes were particularly remarkable with goat skins than with both hides and sheep skins (Table 1).

In terms of leather and leather products, Tanzania's exports remain very small in comparison to its livestock population. According to URT (2015), as a whole, Tanzania ranks fourteenth in Africa for hides and skins, ahead of Botswana but behind Kenya. For articles of leather, Tanzania ranks seventeenth, and for footwear it ranks twelfth. On the contrary, Tanzania has been experiencing rapid increase in imports of processed leather (wet blue) while her share in export market has been growing at a slow pace (TRA, 2008). This low growth rate in export of leather (wet blue) is an indication of the presence of setbacks affecting marketability of domestically produced leather in foreign markets. Therefore, the objective of this study was to examine the determinants of leather and leather products export in Tanzania and identify major constraints to leather exportation.

Table 1. Collection and Exports of Hides and Skins 2007-2012

	Collection of Hides and Skins				Exports of Hides and Skins			
Year	Hides	Goat Skins	Sheep Skins	Value (Tshs.'000)	Hides	Goat Skins	Sheep Skins	Value (Tshs.'000)
2007	1,980,000	1,520,000	1,200,000	8,700,000	1,700,000	1,055,000	925,530	16,200,000
2008	2,500,000	1,900,000	1,500,000	13,500,000	2,300,000	1,600,000	1,100,000	21,500,000
2009	1,650,000	2,990,000	1,250,000	10,900,000	982,668	2,700,000	769,936	12,800,000
2010	1,500,000	2,400,000	650,000	8,500,000	739,315	1,912,182	176,400	8,191,803
2011	2,500,000	2,400,000	200,000	16,100,000	1,719,506	2,111,176	83,600	17,400,000
2012	2,800,000	3,400,000	650,000	32,988,000	2,000,000	2,900,000	578,000	17,500,000

Source: Ministry of Agriculture, Livestock Development and Fisheries

1.1. Study Hypothesis

1. *Volume of Tanzania leather export is affected negatively by the export of raw hides and skins;*

2. *Tanzania leather export is constrained by production cost;*

3. *Increase in hides and skins collection results in increase in leather exports;*

4. *Increase of leather price in the world market will have positive impact on Tanzania leather export.*

1.2. An overview of the Leather Industry in Tanzania

Tanzania leather industry provides huge opportunity for expansion and value addition. Tanzania has a livestock population reaching 22 million cattle, 15.2 million goats and 6.4 million sheep. According to URT (2015), the additional advantages that the sector enjoys are labor availability, port facilities and the commitment of the Government to improving the sector. However, the country's tanning industry only produces at around 46 % of installed capacity and mostly processes up to the stage of wet-blue. Exports from the leather sector have been fluctuating between US $ 7 million and US $ 21 million over the last decade.

The government has been trying to revive the sector by taking various initiatives; the most recent ones include formulating the United Republic of Tanzania Leather Sector Development Strategy (2015), launching of Tanzania Livestock Modernization Initiative (TLMI), introduction of demand driven hides and skin curriculum for Livestock Training Institutes and curriculum for leather processing and footwear manufacturing at technical institutions, and integrated hides, skins, and leather strategy in 2007 etc. The current market situation is dominated by export of both hides and skins and of semi-processed leather. Most of the Tanzania's hides and skins are mainly exported as mixed grades to the Asian markets particularly Pakistan, Hong Kong, China and India.

China *et al.* (2016) state that like in other developing countries, most leather products and footwear industry in Tanzania is controlled by small and medium scale enterprises. These SMEs are being provided with trainings to empower them for quality production together with loan as capital for production (UNIDO, 2015).

2. Literature review

2.1. Theoretical Postulations

2.1.1. Theory of Absolute Advantage

Theory of Absolute Advantage by Adam Smith (1776) is an important theory in this study. It suggests for a country to produce and export products in which it has absolute advantage (can produce more efficiently) and import those products which it has absolute disadvantage (Bidlingmaier, 2007). In this case, Tanzania has to export leather and other livestock products because is endowed with rich livestock resource base and import capital goods which can be used to produce other goods. Tanzania is yet to exploit leather market opportunities available abroad for example, in 2008 the leather demand in the world was worth 1053.7 million US$ (World statistical compendium, 2009) while Tanzania's leather exports stood at 3.8 million US$ (TRA, 2009).

2.1.2. Law of Comparative Advantage

The early classical theory pointed out possible gains from trade. These gains stem from specialization in production due to international trade. If countries specialize according to their comparative advantage, enhanced resource allocation can be

achieved (Salvatore, 1990). The theory advocates that, a country should produce and export goods in which it can do better, and import the goods in which it has comparative disadvantages (Leamer *et al.*, 1995). To a developing country like Tanzania which ranks third in terms of cattle population in Africa and majority of its people have low level of technological skills is advised to produce and export livestock products such as leather and import from developed countries intermediate and capital products such as machines. This would improve (allocation) efficiency because resources which have formerly been employed in the production of other goods are now shifted to the production of the goods of which a country can produce best. Consequently, the welfare of all trading nations is improved.

2.1.3. Heckscher-Ohlin Model

This model states that, a capital-abundant country will export the capital-intensive good, while the labor-abundant country will export the labor-intensive goods (Bowen and Sviekauskaus, 1992). According to Heckser-Ohlin model a country with a relatively plenty of labour and a shortage of capital, it would imply directing focus in exporting labour intensive goods such as leather and importing capital intensive goods. Furthermore, the theory puts emphasis on resource endowment in making decision the products to be exported. For example, Tanzania, despite ranking third in Africa for having large number of livestock, it earns little foreign exchange from leather exports than other countries like Botswana and South Africa which are known to have less number of livestock in relative terms (UNIDO 1997).

2.2. Empirical literature review

There are few studies that have explored the determinants of leather and leather products exports in developing countries. Available studies have found out that weak support policy, poor quality of leather and leather products, market access barriers, low pace of industrialization and poor marketing strategies are some of the reasons for the low exports leather and leather products from developing countries in global markets. Wakari (2009) states that there is wide range of issues that industry operators and policy makers identify as factors affecting the industry's competitiveness. These include product quality, scale of operation, marketing strategy and external trade taxes. They also include infrastructure, government incentives, raw material price instability, financial problems and lack of policy focus to the leather sector in general and the like. Schmel (1998) and Magretta (2000) observe that, marketing is the core of the modern leather trade. Having necessary trade information on both local and export market is something which is lacking in most African countries. Currently, Tanzania domestic marketing system is not well integrated due to infrastructure constraints and institutional weaknesses. Furthermore, marketing chain of the said product involves a number of middlemen from primary producers to the exporter who are not considering the quality of the product.

Likewise, King (2000), using Uganda as a case study found that constraints to leather exports include export of raw hides and skins, low price of the product, poor quality of hides and skins and lack of market information. Similarly, Schmitz (2004), found that the availability of raw hides and skins to the traditional leather manufacturing industries of the developed countries is influenced by the import restrictions imposed by the developed countries in processed leather from developing countries, these restrictions of processed leather affects many of developing countries, Tanzania is among them. On the other hand, Collier (2000) argues that transaction costs faced by African leather manufacturers are typically high, because manufacturing firms are intensive users of services that are particularly expensive in Africa, this results to the export of raw hides and skins instead of processed ones. UNIDO (2002, 2003) argues that, indirect costs have also been found to be working against the capacity utilization, efficiency and productivity, and some of these costs are induced by inappropriate government policies while some are inherent.

World Bank (2004) asserts that African leather export is not competitive enough in the world market due to market access barriers-by developed countries, low level of technology and poor infrastructure. The study recommends that public infrastructure, such as paved roads, has an important role to play in lowering production costs and thus increasing external competitiveness and market shares. Similarly, Parez and Wilson (2008), find that Africa could not benefit from livestock trade unless it reduces infrastructure costs. UNCTAD (2007) argues that, in Tanzania, transport costs account for 60 percent of the total marketing cost for agricultural products, and losses due to poor husbandry (i.e. improper branding and inadequate control of diseases), poor handling at the abattoirs (e.g. improper flaying), and poor preservation methods were estimated to be 30-40 percent of production in 2007.

Kiuluku (2008) argues that there is little value addition in leather industry and about 70 percent of exports from Africa are raw Hides and Skins. The industry has been neglected after liberalization and suffers from poor regulation and weak policy support. Other constraints facing the leather industry in Africa include poor quality of the Hides and Skins recovered, husbandry practices and low quality base of the hides and skins which has impact on each of the subsequent stages of processing of the leather, ultimately determining the quality and price of the intermediary or an end product. FAO (2005), point out four constraints that inhibit African agricultural and livestock products; these are production constraints, high unit

domestic processing and marketing costs, market access constraints, and lack of reliable and up to date market information. However, Gereffi *et al.* (2001) state that access to international market cannot be achieved merely through making and marketing of new products, it requires gaining entry into international markets, design of quality products and market network consisting of many different firms. Therefore, for Tanzania leather sector to improve they must create environment internal and external environment that will link the sector to the global markets.

3. Methodology of research

The study employs a regression analysis in which leather (wet blue) export is assumed to be determined by the price in the world market, export of raw hides and skins, hides and skins collection and costs of production. The data used is for a period covering between 1980 to 2015 and is specified as follows:

$$X = f(E,P,C,Y) \tag{1}$$

$$X = \beta_0 + \beta_1 E + \beta_2 P + \beta_3 C + \beta_4 Y + \mu, \beta > 0 \tag{2}$$

By taking natural log on both sides

$$\ln X = \beta_0 + \beta_1 \ln E + \beta_2 \ln P + \beta_3 \ln C + \beta_4 \ln Y + \mu, \beta > 0 \tag{3}$$

Where: lnX = Volume of exports;

lnE = Hides and skins production;

lnP = export of raw hides and skins;

lnC= Cost of production;

lnY = leather price in the world market;

μ = vector of other variables that influence the supply of exports.

Variables Definition

1. Leather Export

Leather export is refers to as sale of domestic leather (at wet blue stage) to other nations. An export of leather is expressed in terms of value (USD) of the leather exported.

2. Hides and skins collection

Tanzania is well known for its immense potential to supply raw hides and skins, which is a raw material for finished leather, but despite its strong raw material base, hides and skins recovery is very low. In this study, collection of hides and skins was measured in term of value (in US dollar) of pieces collected from either farmers or slaughter houses and reported to the Ministry of Agriculture, Livestock development and Fisheries. Therefore any effort to increase hides and skins collection considered having positive impact in export of leather.

3. Export of raw hides and skins

In this study, export of raw hides and skins is the selling of hides and skins outside the border without any processing after collecting from either farmers or slaughter house. It was measured in value of USD dollar. Leather export is negatively affected by export of raw hides and skins because it reduces the volume that can be processed and exported as processed leather or leather product.

4. Production cost

Leather production costs include all necessary costs involved in preparing leather (wet blue) for exports. It includes transportation costs to slaughters houses, communication costs, costs of chemicals and other raw materials, utilities costs (water and power), man power, rent costs etc. The costs of production was measured by an average cost for producing leather per dozen which is equivalent to 12 pieces. It is expected that high costs of production would reduce the volume of leather that could be exported.

5. Price of Leather

If the price of leather in international market is stable, then the quantity produced and exported will increase where as if the price of leather is unstable, then less amount of leather will be produced and exported due to uncertainty and possibility of incurring loses. In this study, leather price is measured by taking an average leather price per dozen (in US dollars) in the

world market for the specified period. It is expected that unstable/low price of leather in the world market will affect Tanzania leather exports.

3.1. Estimation Techniques

Unit root test

The standard procedure in econometric analysis is to first examine the time series properties of the variables in the model. In this case the unit root tests are undertaken using Augmented Dickey Fuller (ADF) test with the lag length based on Schwarz Information Criterion (SIC) and the Phillips-Perron (PP) test bandwidth selection and used to check for stationarity of variables. Consider the following equations;

$$\Delta \gamma_t = \beta_1 + \beta_2 t + \partial \gamma_{t-1} + \alpha_i \sum_{i=1}^{m} \Delta \gamma_{t-1} + \varepsilon_i \tag{4}$$

Where γ_t = leather exports, Δ is the differencing operator, t is the time trend and ε is the White noise residual while β_1, β_2, ∂ and $\alpha_1...m$ are parameters to be estimated. The null hypothesis implies unit root or non-stationary and alternative refers to stationarity. Specified as:

H0: = 0 γ_t is non-stationary)

H1: =0 (γ_t Is stationary)

Co-integration test

If the variables are stationary, the co-integration test using Johansen and Juselius (1990) is undertaken to establish whether there is a long-run relationship between the variables in the model. In this case two likelihood ratio tests are considered the trace and Maximum Eigenvalue tests. And two possibilities are assumed; null hypothesis assumes no co-integration; while the alternative implies co-integration. Considering the following equation,

$$Trace = -N \sum_{i=r+1}^{m} In\left[1-(r^*)^2\right] \tag{5}$$

Where N is the number of observations, M is the number of variables and r_i is the I correlation between ith pair of variables. τtrace has a chi-square distribution with M – r degrees of freedom. Large values of τtrace give evidence against the hypothesis of r or fewer co-integration vectors.

Maximum Eigen Value Test

This test evaluates the null hypothesis H0: r = r0 against H1: r = r0 + 1, and according to Johansen and Juselius (1990) the maximum eigenvalue test is more influential than the trace test. The null hypothesis of r cointegrating vectors is tested against the alternative of r+1 cointegrating vectors. It is presented as;

$$T_{max} = -T\ln(1-\lambda r + 1) \tag{6}$$

3.2. Data Sources

The study uses secondary data, and the data were obtained from the Ministry of Agriculture, Livestock Development and Fisheries; Tanzania Revenue Authority; Bank of Tanzania (BOT); National Bureau of Statistics; United Nations Conference on Trade and Development (UNCTAD); and International Trade Centre (ITC). Data for the costs of production of leather were collected from leather processing industries in Dar-es-salaam, Dodoma, Kilimanjaro, Singida and Arusha regions, others were sourced from WTO Trade Statistics.

4. Results

The result of ADF and PPU tests for unit roots is shown in table 2. The result of test suggests that the absolute values of test statistics for both the variables on the level are smaller than that of the critical values which implies that these variables on their levels are non-stationary. When the first differences of these variables are considered, the test statistics exceed the critical values at 5%. Thus, we may conclude that all the variables of the model are non-stationary at level but stationary at first difference, i.e. they are integrated of first order I (1).

Table 2. Unit Root Test Results at 1st Difference

Variables	ADF Test Statistic	Order of Integration	PPU Test Statistic	Order of Integration
lnE	-3.5752**	1(1)	-4.036**	1(1)
lnP	-3.886**	1(1)	-3.426**	1(1)
lnC	-3.412**	1(1)	-4.358**	1(1)
lnY	-3.743**	1(1)	-3.472**	1(1)

** Significant @5%

The Johansen Jesulius (1992) methodology is used to test the co-integration between variables. The results from co-integration analysis (Table 3) suggest that the null hypothesis of no co-integrating vector is rejected at 5% using trace statistics test. This indicates the presence of co-integrating vector among the variables and hence one can conclude that both variables are co-integrated i.e. Thus there exists a long run relationship among variables.

Table 3. Johansen Test for Co-integration

Rank	Eigen value	Trace test	P.Value	Lmax Test	P.Value
0	0.64620	66.369	0.0003	36.366	0.0018
1	0.42592	30.003	0.0473**	19.425	0.0856
2	0.25432	10.578	0.2430	10.271	0.1983
3	0.0087322	0.3069	0.5795	0.3069	0.5796

Table 4. Summary of Estimated Regression Results of Export model

Dependent variable: X	Coefficient	STD Error	t- Statistic	Prob.
lnP	-0.4127053	-0.143023	-2.89*	0.008
lnE	-0.1325756	0.2361523	-0.56	0.579
lnC	-0.352668	0.5359096	-2.52**	0.018
lnY	-0.287287	0.4248408	-1.86*	0.005
Const	8.518115	3.643321	2.34	0.027
R-squared	0.814			
Adjusted R-square	0.722			
Root MSE	0.3203			
F-Statistic	0.00164			
Durbin- Watson stat	1.962278			

Table 4 shows the results of estimated regression. The goodness of fit is satisfactory, it stands at 72 percent. This implies the export of leather and leather products is influenced by leather price in the world market, hides and skins collection, export of raw hides and skins and costs of production. The remaining 28% is explained by other factors such as quality of leather, scale of operation, marketing strategy, external trade barriers, and infrastructure problems etc. Similarly, there is no indication of serious autocorrelation problem basing on the information given by the Durbin-Watson (D-W) statistic of 1.962, being close to the desired conventional mark of 2.0. The coefficient of export of raw hides and skins (P) is statistically significant at 1 percent level and it is negative. The coefficient implies that a 1% increase in export of raw hides and skins would reduce export of leather by 41 percent. The result is in line with the hypothesis of the study which explained that, volume of Tanzania leather export is affected negatively by the export of raw hides and skins.

The coefficient of hides and skin collection (E) is not statistically significant though its sign is negative. Based on the findings, hides and skin collection does not have any significant impact on leather and leather products export. The coefficient of cost of production (C) is negative and significant at 5 percent level. This indicates that a one percent increase in the cost of production (C) would lead 0.35 percent fall in export of leather. This is in line with economic theories and empirical studies because it is expected that a decrease in cost of production would result in increase in export of leather.

The coefficient of leather price in the world market (Y) is significant at 5 percent level and has a negative sign. This contrary to the hypothesis that increase price of leather in the world market will have a positive impact on Tanzania leather export. The result suggests that 1 percent increase in leather price results in 28 percent fall in Tanzania leather export. This implies that leather price in the world market has a negative impact on Tanzania's leather exports. The main reason for this could be the fact that, leather price in the world market is influenced by quality (FAO, 2006 and William, 1988), meaning that the higher the quality the higher the price. Therefore despite the increase in leather price in world market, Tanzania leather export went down because its quality failed to attract more buyers.

5. Conclusions and policy implications

The objective of the study was to examine the determinants of leather and leather products export in Tanzania. The findings show that export of raw hides and skins, and cost of production influence leather and leather products export in Tanzania. In order to stimulate more leather exportation, preserving international standards and quality in the leather industry is important. Farmers should be educated on how to improve husbandry practices in terms of flaying techniques, improved preservation techniques, collection methods and proper storage and transportation methods in order to able to comply with competitive quality and standard of leather in the world market.

Moreover, high cost of production is a disincentive in international trade as it makes the leather product not competitive in international market. If the cost of production is high, it threatens leather exportation. For this reason, there is a need for the government to assist leather exporters to become more competitive by lowering/waving some of the taxes. Institutions like the Leather Association of Tanzania, Ministry of Livestock Development and Fisheries need to develop strategies that will help to reduce cost of production, e.g. easing the accessibility to appropriate, relevant and modern technology.

Attracting local and FDI in leather subsector by providing friendly investment climate and addressing the supply side constraints inhibiting leather industry. This will enable leather product diversification which is the strategy applied in different countries like Ethiopia, Vietnam and Italia, and hence realize producing of high quality hides, skins and leather products.

Establishing backward and forward linkages in order to promote networking and clustering is of the utmost importance for the development of this industry. For a developing country this means promoting an integration of the business chain at local level, also through appropriate support infrastructures, and at the international level through subcontracting. There are many ways to promote the sub sector through lessons from better performing countries like Ethiopia, but there are specific features that need to be addressed in the Tanzanian context only.

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