The value of face-to-face: Search and contracting problems in Nigerian trade

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A 2009 article from *The New Yorker* on African traders living in Guangzhou, in southern China, describes a pivotal experience in the career of Emmanuel, a Nigerian importer:

> *Emma is a shoe man by training. He first came to do business in China ten years ago, and had achieved modest success by 2004, when he placed a large order—ten shipping containers of shoes—only to discover, upon delivery, that his supplier had used cheap glue. En route from China to Nigeria, the shoes had disintegrated. "I couldn't even salvage one container," he said. He started over, by* ***moving to China full time to oversee every detail*** *of his trades.* [Emphasis mine.]

Emmanuel's reaction may seem extreme, but it is revealing about how trade works in developing countries in several ways. First, it goes without saying for Emmanuel that he has no viable legal solution for recouping his losses, but that doesn't mean that he simply accepts opportunistic suppliers as an unavoidable risk of doing business. Instead, he changes the *way* he goes about importing to guard against future losses. Second, there is something important being in China to do business in-person: the value of conducting transactions face-to-face.

If Emmanuel were an unusually diligent or risk-averse businessman, his story would be merely intriguing. However, with support from Sylff Research Abroad, I have collected unique data that shows that traveling to distant source countries to do business in-person is common among Nigerian importers of consumer goods. My research shows that this travel is a costly but effective way of dealing with two problems that arise when conducting transactions with partners in far-away places: the difficulty of finding out what goods are available around the world (which economists often refer to as a “search” problem) and the difficulty of ensuring that goods or money actually get sent when there is no legal system to rely on (which we call a “moral hazard” problem). By traveling to the source country, an importer effectively turns a remote transaction into one that is face-to-face. Once in China, a trader like Emmanuel can see what shoes are currently available with his own eyes, and exchange goods and money on the spot, leaving no room for suppliers to behave dishonestly after they have been paid.

Although these search and moral hazard problems may have a large effect on trade, and consequently on the goods and prices that are available to consumers in developing countries, they are hard to quantify because they are not directly “visible” or measurable. (In contrast, we can often measure the physical costs of trading goods across long distances, by looking at information such as international shipping freight prices.) My approach is to quantify these problems by focusing on the easily observable strategies that importers use to cope with them, particularly travel. Traders’ choices about paying for travel – who decides to do so, how often, to which countries, to buy which goods – tells us how much value they place on solving the underlying search and moral hazard problems.

Unique data I collected from Nigerian importers allows me to do this by connecting traditional trade data (e.g. the type and value of goods traded) to variables describing the actual process of firm-to-firm trade (e.g. travel and payment terms) on a transaction level. The data cover 620 importers of differentiated non-food consumer goods such as clothing, electronics, and furniture, who were randomly sampled from a census I conducted of over 50,000 shops in commercial districts of Lagos.

Using this data, I document four novel and surprising empirical patterns relating travel and importing. First, travel is common but not universal—used by 62% of traders and in 32% of all shipments—and is less likely when importing from countries that are costly to reach. Second, travel expenditures are large, at nine percent of the value of imported goods—equivalent to amounts spent on transporting goods and regulatory costs such as tariffs and port fees combined. Third, travel is persistent over time, and does not decline significantly in experience with particular countries or suppliers. Finally, transactions that involve travel look different from those that don't. In purchases conducted in-person, traders pay lower costs, and are more likely to buy new product varieties and buy from new suppliers.

My estimates suggest that search and moral hazard problems are a large barrier to doing business with far-away partners in a country like Nigeria. They reduce the variety of goods that are available to consumers, as well as making those that are available less up-to-date and more expensive. This finding matters, because traditionally trade policy has focused on reducing physical trade costs (e.g. by building better roads or infrastructure) and regulatory trade costs (e.g. by lowering tariffs). Although important, those policies are not likely to help much with search and moral hazard problems, which we can think of as "information" trade costs. Instead, my research suggests that we may be able to improve life for consumers in developing countries substantially through a different set of policies, such as improved travel regulations, better financial services, and coordinating programs like trade fairs and international credit bureaus.

The question that drew me into this project was what we can learn from *how* trade works, whether internationally or across long distances within developing countries. Stylized economic models have typically represented importers and exporters as simply choosing whether or not to buy a particular good from a particular country, and if so, how much of it. My SRA research shows that individuals and firms also make important choices about the process through which they do business, and that these choices are revealing about what type of barriers they face. Traders in developing countries are resourceful, flexible, and sophisticated in responding to challenges and changes in the global economy. There is a great deal to be learned from them about how international trade really works, and what sort of policies are likely to bring the most benefit to the world's poorest consumers.