UNITED REPUBLIC OF TANZANIA

MINISTRY OF WATER

ENERGY AND WATER UTILITIES REGULATORY AUTHORITY (EWURA)

REVIEW OF THE BULK PROCUREMENT SYSTEM TENDERING MODALITY TO HARMONISE LANDED COSTS OF PETROLEUM PRODUCTS

DISCUSSION PAPER

DODOMA – AUGUST 2020

BACKGROUND

1. Petroleum products (particularly petrol, diesel and kerosene) are imported into the country using a Bulk Procurement System (BPS), which commenced in January 2012. Since its inception up to July 2015, procured products were offloaded at the Dar es Salaam port alone. Moreover, before October 2016, BPS tenders were floated as one tender on monthly basis where the winning bidder had to supply the total quantity of petroleum products required for a given month. From November 2016, BPS tenders were floated as cargo-by-cargo tenders where each vessel that delivered products in the country was considered to be a tender.

2. Changes in tender modality and the introduction of Tanga and Mtwara ports for receiving imported petroleum products in the country, led to complexity in pricing of products at the three ports. There have been differences in landed costs between the ports that ultimately lead to differences in wholesale prices.

3. This has, to a noticeable extent, caused disruption in the supply of petroleum products in the country. This paper is meant to highlight the challenges and provide possible solutions thereon.

OBJECTIVE

4. The objective of this Discussion Paper is to collect comments from all stakeholders and the general public on the available options of BPS tendering modalities and the recommended changes to the EWURA (Petroleum Products Price Setting) Rules.

BULK PROCUREMENT SYSTEM TENDERING MODALITY AND CAUSES OF DIFFERENCES IN LANDED COSTS

5. Petroleum products (particularly petrol, diesel and kerosene) are imported into the country using a Bulk Procurement System (BPS), which commenced in January 2012. Since its inception up to July 2015, procured products were offloaded at the Dar es Salaam port alone. Moreover, before October 2016, BPS tenders were floated as one tender on monthly basis where the winning bidder had to supply the total quantity of petroleum products required for a given month. From November 2016, BPS tenders were floated as cargo-by-cargo tenders where each vessel that delivered products in the country was considered to be a tender.

6. Changes in tender modality and the introduction of Tanga and Mtwara ports for receiving imported petroleum products in the country, led to complexity in pricing of products at the three ports. Specifically, the difference in landed costs between the ports in a given month is mainly caused by differences in:

a) timing of importation of petroleum products at each port resulting in differences in Freight on Board (FOB) prices;

b) quoted premiums for products received at each port; and

c) variations in wharfage charges.

Timing of Importation of Petroleum Products at each Port

7. Petroleum products are imported into the country every month based on the quantity requirements specified by the Oil Marketing Companies (OMCs). Prices of petroleum products for a particular month is based on, among other things, landed costs of products received in the previous month, local costs and charges, taxes, and wholesalers' and retailers' margins.

8. Based on demand and available storage facilities, large volumes of petroleum products are imported through the Dar es Salaam port on monthly basis. OMCs with depots at Dar es Salaam port procure products on a monthly basis to meet their customers' demands. Due to this, regional and district prices of products sourced from Dar es Salaam terminals tend to reflect changes in prices in the world market.

9. On the contrary, importation of petroleum products through the other two ports of Tanga and Mtwara is not done on monthly basis due to limitations in demand and storage facilities. Thus, to maximise economies of scale, OMCs with depots at Tanga and Mtwara ports tend to procure products that are sufficient to meet the demand of two or more months. Consequently, local petroleum prices for the two regions are not adjusted on monthly basis. This in turn leads to mismatch between prices of petroleum products in the Northern and Southern regions and that of products procured through the Dar es Salaam port let alone the world oil market prices.

10. As Dar es Salaam's wholesale petroleum prices change on a monthly basis while those of Tanga and Mtwara change every other month or so, there tends to be differences

in the cost of the available products in any given month which in turn results in uncompetitive behaviours in the market.

11. During months of continued decline in world oil market prices while Tanga or Mtwara depots have products procured in previous months, products at Dar es Salaam end up being cheaper compared to those at Tanga or Mtwara resulting in an influx of retailers from the Northern and Southern regions purchasing products from Dar es Salaam. This behaviour causes losses to efficient OMCs in Tanga and Mtwara as their products lose markets while the consumers in the Northern and Southern regions also don't benefit from decreases in the world oil market prices. This situation has been observed on several occasions in the Northern regions including a recent occurrence in February 2019. A similar situation was also observed in the Southern regions between July and September 2018 where products in the Southern regions were expensive compared to other regions as Mtwara storage terminals had products procured during the month when petroleum products prices were high at the world oil market.

12. On the other hand, during months of continued increase in world oil market prices while Tanga and Mtwara depots have products procured in previous months, products at Dar es Salaam port end up being expensive compared to those at Tanga or Mtwara. This results in an influx of retailers, from regions that are to be supplied by Dar es Salaam, purchasing products from Tanga or Mtwara. This behaviour causes losses to efficient OMCs in Dar es Salaam as it results in slow movement of petroleum products which in turn creates ullage constraints and hence increasing the cost of business to OMCs in Dar es Salaam. This situation was recently observed between June and August 2018 where products in the Northern regions were quite cheap compared to other regions. This is because Tanga storage terminal had products whose world oil market prices were that of March 2018 while from April 2018, the world oil market prices assumed an increasing trend month after month. Moreover, as more and more retailers purchase products at Tanga or Mtwara due to lower prices as compared to Dar es Salaam, this tend to bring along another challenge of depletion in stock in the two ports before end of the month when new prices are required to be set. With this situation, EWURA has been compelled to review prices in a mid of the month to allow retailers purchase products from Dar es Salaam.

Quoted Premiums:

13. Quoted premiums (Freight, Insurance & Margin) by BPS suppliers/trading companies for products deliveries at the three ports are normally different for the same type of petroleum product. Usually, premiums of products received through Tanga and Mtwara ports are higher than those received through DSM port. As a result, the same product delivered or received at the three ports for a given month/period, tends to have different landed costs i.e Cost Insurance and Freight (CIF) cost causing different ex-Terminal/Depot costs and prices. Even with the same FOB prices for petroleum products procured in the same month, higher premiums for products delivered at Tanga and Mtwara ports result in high landed costs for products received at the two ports.

14. Once the wholesale prices are higher in Tanga and Mtwara when compared to those in Dar es Salaam, Retailers of petroleum products are enticed to source products from Dar es Salaam, particularly from OMCs that do not have storage or hospitality arrangements at Tanga or Mtwara depots and are able to offer products at a price that is competitive than that of Tanga or Mtwara. In such events, products at Tanga and Mtwara depots move at a slow place causing losses to OMCs with products in Tanga and Mtwara and for Mtwara, there are also incidences of ullage constraints.

15. In an effort to reduce premiums, GBP, who is the depot owner at Tanga port, has been purchasing petroleum products that will fill up one vessel which implies procuring products sufficient to cover GBP's market share for more than two months. Nonetheless, placing an importation order for petroleum products to be delivered through Tanga port in one full vessel has not resulted in discounted premiums for Tanga deliveries to match premiums attained for DSM deliveries.

Difference in Wharfage Charges

16. All local charges in importation of petroleum products at each port is the same except for wharfage charges whereby, at DSM and Mtwara ports, there is a wharfage charge of US$ 10/MT while at Tanga port instead of a wharfage charge there is a wayleave charge of US$ 3/MT. If premiums and timing of importation is going to be harmonised, the difference in wharfage charges will later create imbalances in landed cost at the ports.

17. It is thus a challenge in ensuring a fair competitive market, where the same product is received at three different ports, during the same period but at different landed cost (CIF). The situation creates imbalances in the supply of petroleum products which eventually brings market instability.

POSSIBLE SOLUTIONS TO CHALLENGES FACING THE EXISTING BPS TENDERING MODALITY

18. Due to intrinsic challenges facing the exiting BPS tendering modality as far as petroleum products pricing is concerned, Management has highlighted some possible solutions to improve the existing tendering modality or recommend for a change thereof. Discussed below are possible solutions to challenges facing the existing BPS tendering modality.

Continue with the Existing BPS Tendering Modality (*Cargo by Cargo*) and Amendments to the EWURA (Petroleum Products Price Setting) Rules, 2020

19. The earmarked changes to the existing BPS tendering modality of *cargo-by-cargo* by computing weighted average premiums for each product thereby levelising premiums at all the ports in a bid to eliminate differences in landed costs between the ports. With this option:

a) BPS Tenders will continue to be *cargo-by-cargo* which in average there are about 6 tenders per month for imports through Dar es Salaam port (3 cargoes for petrol; 2 for diesel; and 1 for JetA1 / kerosene) and one tender for the three products through Tanga and Mtwara ports;

b) For each product, a *weighted average premium* will be considered when computing a landed cost of a particular product regardless of where the product is offloaded. However, this will consider products for local consumption and not transit products. Since it is highly likely that premiums for each cargo will differ with the computed *weighted average premium*, the following need to be taken into account to mitigate the differences:

   (i) If *premium* of a particular vessel/cargo is less than the weighted average premium, it is obvious that all OMCs receiving products from such a vessel would get more money than what they were obliged to pay the supplier of the said cargo. Thus, all OMCs receiving products from such a vessel would be required to settle the difference by depositing the amount into a special account to be managed by a competent authority as far as financial matters are concerned.

(ii) In the contrary, when the *premium* is higher than the *weighted average premium*, then all OMCs receiving products from an expensive vessel would be compensated accordingly. This time, a manager of the deposits / fund will settle the difference.

(iii) This is not applicable to transit products. However, should transit products change their status after localization, then the *premium* of the localized products will be used to clear the differences when the same is different from the *weighted average premium*. If the *premium* of the localized product is higher than the weighted average, then the OMC will be compensated accordingly. In contrary, when the *premium* is low than the *weighted average premium*, the OMC will be required to settle the difference by depositing the account into a special account.

20. The benefits of the proposed changes to the exiting BPS tendering modality are highlighted below:

a) There will be similar landed costs for a particular product at all the ports where products are imported into the country;

b) Due to several tenders, there is a reduction in risks should a winning supplier fail to honour its contract; and

21. As highlighted before, this option would relieve the existing BPS modality from a challenge of differences in landed costs of petroleum products from one port to another. However, implementation of the proposed changes may lead to the following challenges:

a) OMCs receiving products from a vessel whose premium is less than the weighted average premium would be required to deposit into a specialized account the different amount;

b) Increase in administrative costs and time. A competent authority that will be entrusted to manage the specialized account will need to allocate time and money for logistical issues with regard to settling of differences between the weighted average premium and respective premium for each vessel.

c) The likelihood for the Dar es Salaam premiums to increase due to the use of weighted average premium in the computation of petroleum products prices. It should be noted that premium for Tanga and Mtwara have been higher than those recorded at the Dar es Salaam port due to efficiency considerations as compared to the other ports;

d) There would be a need to ensure that all vessels offload products before the first Wednesday of the month for consideration in the pricing computations.

Change in BPS Tender Modality to Product by Product

22. The introduction of a *product-by-product* tendering modality is aimed at having the same premium for respective imported products. With this option, there will be three tenders each month: tender 1 for petrol, tender 2 for diesel and tender 3 for Jet-A1/kerosene. That means, a winning bidder would be required to offload a particular product to all the ports in proportion to allocated quantities at each port.

23. Moreover, the effectiveness of the *product-by-product* tendering modality would require amendments to the existing EWURA (Petroleum Products Price Setting) Rules to allow computation of prices be conducted on monthly basis regardless of receipt of products at a particular port. If this is not considered, the challenge of differences in timing of stocks would not be mitigated and would lead to differences in prices from one port to another. The benefits of introducing the *product-by-product* tendering modality are highlighted below:

a) Premium will be the same at all the three ports for a particular product, thereby leading to competitive prices of petroleum products in the country;

b) Local participation will continue to be enhanced through petrol and Jet-A1 / kerosene tenders which are a bit lower, in terms of quantity, as compared to diesel tenders. Moreover, local companies can participate in tenders through syndication in a bid to circumvent financial limitations when it comes to huge tenders that require financial capability;

c) To be effective, the EWURA (Petroleum Products Price Setting) Rules will be required to be amended to allow a monthly computation of prices in response to changes in FOB prices of petroleum products from where they are sourced. This will have to be conducted regardless of receipt of products at Tanga and Mtwara; and

d) Administrative costs will be minimized. That, there would be no need for following up with OMCs to pay additional amount should the weighted average premium be higher than their vessel's premium or the other way round where the agency entrusted to manage the funds will be required to make the OMCs wholly should the weighted average premium be less than their vessel's premium.

24. Challenges of Product-by-product tendering modality are:

a) Due to huge volumes, chances for local OMCs to participate in tendering process would be minimized. Though the companies can unite through syndication, it is likely that the OMC may not reach agreement to that effect.

b) A possibility to increase Dar es Salaam's premiums as the same would be reflecting inefficiencies from Tanga and Mtwara ports thereby making the Dar port uncompetitive to neighbouring ports including Mombasa of Kenya and Beira of Mozambique. On the other perspective, given the size of the tender, a product-by-product modality would increase economies of scale and therefore cut down costs including premium at the Dar port as well as Tanga and Mtwara.

RECOMMENDATIONS

25. Based on the foregoing, EWURA urges stakeholders to review the two options and provide comments that will enable EWURA to recommend an effective BPS tendering modality which will ultimately circumvent existing challenges. Also, the EWURA (Petroleum Products Price Setting) Rules will be reviewed to enable the petroleum products prices be reviewed on a monthly basis regardless of whether products have been received at a port or not. The review of prices will be based on the new FOB prices and BPS premiums. This will be a change from the current practice where the review of prices is done only when products are received at a given port.

CONCLUSION

26. Stakeholders are invited to go through the proposed options and provide comments with suggested solutions to enable EWURA to conclude and make an informed decision on the matter. Comments should be sent to EWURA offices or by email no later than **8th September 2020.**