

**REVIEW OF THE PETROLEUM PRODUCTS
PRICING FORMULA**

DISCUSSION PAPER

DAR ES SALAAM – JULY 2011

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DISCUSSION PAPER

1. Background

Petroleum products are essential inputs needed in transportation, industries, agriculture, mining and households, hence a necessity for the economy of any country. Rise in the petroleum products prices is always of public concern since these products are of particular importance to the economy of any country.

The downstream petroleum sector in Tanzania was regulated until 2000 when it was fully liberalized and companies were henceforth allowed to import their supplies and local petroleum products prices were left to be determined by the market. The liberalization of the downstream petroleum industry was part of the fundamental macroeconomic policy reforms that were introduced in 1986. The reforms included introduction of competition, privatization, and establishment of regulatory mechanisms.

One of the major expectations of the liberalized downstream petroleum business was to improve efficiency in the provision of petroleum products and related services to the country by encouraging fair competition within the industry for the benefit of all stakeholders and the economy as a whole. It was the Government's expectation that at all times, the local petroleum prices would move in tandem with world market prices. An assessment carried by the Energy and Water Utilities Regulatory Authority ("the Authority") in year 2008, justified a need to intervene in the Tanzania petroleum market so as to put in place a mechanism whereby consumers of petroleum products would purchase petroleum products prices at fair prices. Most stakeholders, including the Government saw the need of having a pragmatic approach and

having in place a robust retail petroleum pricing mechanism that will protect all stakeholders.

2. The Petroleum Pricing Formula Formulation and Review

On the 31st December 2008, the Authority approved two instruments that are aimed at regulating prices of petroleum products in Tanzania mainland. The present petroleum pricing formula became operational in January 2009, vide GN. No. 5 issued on the 9th January 2009.

In consultative meetings that preceded the adoption of the formula, it was agreed that the same should be periodically reviewed to accommodate changes that are necessitated by economic and operational aspects of the petroleum business environment. The formula has been in use for two and a half years now. The Authority has received various comments on the current pricing formula from various shareholders, and is satisfied that there is a need to review the present the pricing formula. The Government has also reviewed Excise Duty rates for kerosene and diesel. It has also given a policy directive that EWURA looks into the justification and quantum of the different levies and charges in the petroleum pricing formula with a view to eliminating or scaling down some of them, but doing so in a manner that will not weaken regulation, standards monitoring and quality assurance with regard to the petroleum operations in Tanzania.

3. Petroleum Products Pricing

Pricing of all petroleum products is based on almost similar components depending on the location and size of the market. These can be categorized as follows:

- Products Costs;
- Distributors Costs and margins;
- Government Taxes; and
- Local Charges and Costs.

The proposed pricing formula will contain fewer entries to make it more user friendly and to be easily understood by stakeholders. Some of the cost items will

be grouped together. The products cost item will include the FOB cost, Freight and Premium. In that regard, Local charges will all be included in the formula under one name “Pre Discharge Services Costs”.

4. The Pricing Formula

Generally the following are the parameters that are taken into consideration for the calculation of petroleum product prices in Tanzania.

(a) FOB Price

This is the key determinant of the end user price and its level depends on the World Market quotation on the invoice/purchase date. It depends also on the geographical location of the buyer. Most of the products that are brought to the Tanzania market are purchased from India and Arabian Gulf markets. Currently, Tanzania has more than 60 companies that hold wholesale licences and every whole seller is allowed to import petroleum products from such source as they will choose at their own contractual arrangement and own dates. Because prices do change daily in the world market, a basis must be developed for estimating the most reasonable FOB figure that should be included in the pricing template. Currently, the mean Platt’s quotation FOB cost is included in the pricing formula based on 15 days average prices, four weeks prior to the pricing week. Two weeks are allowed for sailing from the load port to Tanzania ports.

It is recommended that average low platts quotations should be used as FOB price, until when the Bulk Procurement System commences. Thereafter, the actual FOB as invoiced by the supplier will be used to compute pump prices.

(b) Freight

This item comprises of sea freight from the port of loading to destination (Dar es Salaam/Mtwara/Tanga), typical average freight rates are assessed and published by Platts (termed as “Clean Tanker Wire” publications). EWURA has subscribed for the Platt’s freight rates and receives daily

publications. The freight assessments are based on the World Scale Tanker Nominal Freight Scale which is accepted by the petroleum industry worldwide. Similar to the FOB computation, the freight figures that are included in the pricing formula are based on 15 days average, four weeks prior to the pricing week, two weeks are allowed for sailing from the load port to Tanzania ports.

It is recommended that the same method of assessing Freight by applying the Platt's quotations be continued until when the Bulk Procurement System commence. Thereafter, the actual Freight cost as invoiced by the supplier will be used to compute pump prices.

(c) Seller Premium

Premium covers the supplier's expenses and profit margin. These are also assessed and published by Platt's, on a daily basis. EWURA has subscribed for the Platt's premium assessments and gets daily publications. Similar to the FOB computation, the Premium rates that are included in the pricing formula are based on a 15 days average quotation, four weeks prior to the pricing week. Two weeks are allowed for sailing from the load port to Tanzania ports.

It is recommended that the same method of assessing Premium by applying the Platt's quotations be continued until when the Bulk Procurement System commences. Thereafter, the actual Freight cost as invoiced by the supplier will be used to compute pump prices.

(d) Exchange Rate Assessment

Petroleum products are internationally priced in US\$ as a standard currency. Conversion to the equivalent Tanzania shillings to pay for the imports is based on the actual exchange (selling) rates. Because importers do import on different dates, a basis must be developed for estimating an exchange rate figure that should be used in the formula. Currently selling rate average for three banks (NBC, Standard Chartered Bank and Stanbic),

for the last three working days before the prices publication week is used in the pricing formula.

Actual invoices by companies to some buyers of products in Tanzania are showing that most companies are billing buyers on lower rates compared to the BOT published figures. It is recommended that BOT selling exchange rates should now be used in the pricing formula.

(e) Insurance

Covers for insurance of petroleum products while in transit from the loading port to offloading ports, the cost provision is negotiable, and currently it is at an average of 0.1% of C&F.

It is recommended that the same method of estimating insurance be continued until when the Bulk Procurement System commences. Thereafter, the actual insurance cost as invoiced by the supplier will be used to compute pump prices.

(f) Wharf age

Wharf age is payable to Tanzania Ports Authority (TPA), it is normally fixed over a period of time and it is non negotiable. Currently, companies are required to pay 1.6% of the CIF cost plus 18% VAT.

It is recommended that wharf age should be charged in shillings. It is further recommended that the charged wharfage be at the same amount of the figure charged by TPA on transit cargoes, which should be fixed in TZS equivalent of \$3.00 per metric ton as of now. Similar rates are being applied in the neighbouring country, Kenya.

(g) Destination Inspection

Destination inspection of 1.2% of the FOB is payable to Tanzania Revenue Authority, this component is also not negotiable. Historically, the BOT used to impose 1.0% of FOB that were being paid along with the Import

Declaration Form (IDF), for overseas inspection of all Tanzania destined cargoes. The fee was later abolished by BOT, but was later picked by TRA in the name of “Pre shipment Inspection” (PSI) of which a fee of 1.2% was payable. This item lasted up to year 2003. It was later named “Destination Inspection Fee” (DSI) payable to COTECNA through TRA. However, TRA/COTECNA does not carry out either pre shipment nor destination inspection on petroleum products imports. These inspections are carried out by agents contracted by petroleum importing companies and paid for by the relevant companies. Oil marketing companies have on several occasions argued that having this cost item in the petroleum pricing template is a duplication and addition of unnecessary cost to the consumer. TRA has indicated that there are certain services which require allowing part of this component in the pricing formula.

It is recommended that the quantum of this cost item be reviewed. The cost to be allowed in the pricing formula should be limited to what TRA can justify in that regard.

(h) TIPER Manifold Fees

Importers through the Dar es Salaam port do discharge petroleum products through the manifold at the KOJ which is owned by TIPER. They are required to pay a fee of \$0.15/MT plus 18% VAT to cover for maintenance and running of the facility.

The Authority is informed that most importers do not pay this fee to TIPER except for some OMCs that stock products at TIPER depot which pay this fee along with the storage charges. It is recommended that this cost item should be not be included in the pricing formula.

(i) TBS Quality Certification

Prior to offloading of any petroleum product consignment, Tanzania Bureau of Standards (TBS) is required to carry out quality certification to control the quality of products in the country’s distribution network. These fees are

charged under Section 12(1) of Regulations: GN No.672 of 25 December 1998 and Section 31 of The Standards Act, 1975. Oil marketing companies complain that they are not sure if TBS does the tests because they have not at any time received analysis report from TBS. A fee of 0.2% of the C&F cost is payable to cover for guarantee costs as well as random market surveillance.

It is recommended that: Only one cost item should be charged by TBS. TBS can continue doing market surveillance but should not charge the cost in the petroleum pricing formula. TBS should cost and cover only, sampling and testing of ship products before being allowed to offload.

The cost item fixed in TZS, be included in the pricing formula under the “Pre Discharge Services Fees” cost item for costs of sampling and testing of ship products before being allowed to offload.

(j) Survey Fees

Before discharging, petroleum products are normally assessed on quantity. This activity becomes more necessary in case of imports by several companies in one vessel, which is a common scenario in our case. Surveyors fee is normally negotiable, at present it is set at an average of \$ 0.15/MT.

It is recommended that this cost item should not be included in the pricing formula. Importers should cover for inspection costs from their margin.

(k) Transit/Ocean Loss Costs

Loaded and paid for, petroleum products quantity doesn't reach the discharge port in full. Because of evaporation, temperature differences and minor leakages, transit losses or gains are always observed. Companies are allowed to recover between 0.25% and 0.50% of CIF cost among

others, depending on the volatility of the product to cover for transit/ocean loss.

It is recommended that actual average loss levels for year 2010 be included in the 2011 pricing formula, and this should also cover for all losses or gains accordingly.

(l) Demurrage Costs

Normally, vessel owners do provide for a certain number of days/hours, depending on the loaded quantity, for a vessel to offload products at the port of destination. It is indisputable that companies should not fix this cost in their price structures but rather parties occasioning delays should be responsible for the compensation, save for delays that are beyond control. However, given the current situation of the port facilities, a minimum number of 3 days is included in the formula.

It is recommended that the same method of assessing allowable demurrage cost be continued until when the Bulk Procurement System commences. Thereafter, the actual and justifiable demurrage cost as invoiced by the supplier will be allowed in the pricing formula.

(m) SUMATRA Charges

This fee of US\$ 0.25/MT is charged by SUMATRA as provided in the Government Notice No. 214 of year 2000. It is computed in US dollars and payable in Tanzania shillings. The fee is applicable to all categories of goods since 1st July 2000 and is one of the revenue sources taken over by SUMATRA from Tanzania Central Freight Bureau (TCFB).

It is recommended that this cost item be maintained in the pricing formula. However, it should be fixed into Tanzania Shillings and should be paid under the “Pre Discharge Services Cost” item.

(n) Financing Costs

Currently, oil marketing companies are allowed to recover 1.75% of the CIF through the pricing formula to cover for financing costs. The basis and quantum of charging of this cost item should be reviewed because very few wholesalers are making direct imports and even for the importing companies, the actual financing cost incurred is low.

It is recommended that this cost item should be reviewed downwards. Only the LC opening charges of 0.25% of CIF be allowed in the formula until when the Bulk Procurement System commences. Thereafter, the actual and justifiable financing cost amount will be allowed in the pricing formula.

(o) Weights and Measures Costs

The Weights and Measures Agency (WMA) is taking an active role in the quantification of petroleum products and in the calibration and inspection of all meters along the petroleum products supply chain. Previously, WMA was being paid directly by companies. Amendments of 4th, 5th, 6th and 7th schedules made under section 54 of Weights and Measures Act Chapter 340, published on 19th November 2010 has allowed WMA to charge TZS 2.00 per litre to cover for the services rendered.

It is recommended that the charge of TZS 2.00 per litre should be paid under the “Pre Discharge Services Cost” item.

(p) EWURA Petroleum Levy

EWURA Regulatory Levy is guided by Sect. 43 and 44 of the EWURA Act, Cap 414 and subsequent rules made to facilitate in collecting levies. The Authority is expected to finance itself from levies paid by the regulated suppliers. Cap 414 makes it mandatory for all regulated suppliers to pay an annual levy of up to 1% of their gross operating revenue to EWURA. Currently, levy collected on petroleum products was fixed in Tanzania Shillings in April 2007 at the rates ranging between 0.52% - 0.79% of the

pump prices by then. Unlike other charges that have increased over time on account of them being linked to the USD, this one has remained fixed at the same level for four years in a row, thus making it susceptible to erosion by inflation. It is now ranging between 0.3% - 0.36% of the current pump prices. EWURA is the main regulator of the downstream petroleum industry in Tanzania. The Authority also partially finances the budgets for the Fair Competition Commission and the Fair Competition Tribunal, and wholly finances the activities of the Consumer Consultative Council and the Government Consultative Council. Furthermore, 10% of EWURA's revenue is contributed to the Treasury as per the Finance Act of year 2009.

(q) It is recommended that this levy be renamed as a "Regulatory Levy" because it finances several Regulatory Authorities. During this financial year, this levy be maintained at the 2007 levels [TShs 6.80/l for Diesel, TShs/l 6.10 for Petrol, TShs 7.10 for Kerosene, Tshs 4.30 for Fuel oil and Tshs. 30.00/kg for lubricants]. Actual amounts of the levy per product should be reviewed annually.

(r) Petroleum Marking Cost

This cost was introduced in September 2010 to cover the cost for marking of petroleum which is designed to promote level playing field, curb fuel adulteration and control fuel dumping. Currently the marking fee is charged as (\$3.3/Cubic Metre + 18% VAT).

It is recommended that this cost be maintained as it curb adulteration, promotes a level playing field for all operators and to control dumping of transit petroleum products in the local market.

(s) Government Taxes

Government taxes are non-negotiable; they are normally reviewed periodically, depending on the Government decision. With effect from 1st July 2011, the Government taxes in the three petroleum products are as follows:

Product	Excise Duty (TShs/Ltr)	Road Levy (TShs/Ltr)	Total Taxes (TShs/Ltr)
Petrol	339.00	200.00	539.00
Diesel	215.00	200.00	415.00
Kerosene	400.30	00.00	400.30

(t) Company margins and overhead Recovery

This item is expected to cover for companies' running costs, return on investment, profits and any other statutory costs associated with the petroleum business in Tanzania.

It is recommended that the current margin levels for OMCs be maintained until a thorough study thereof is conducted to determine new company margins.

(u) Dealers margin

Similar to OMC margins, distributors are also expected get a return for their investment costs, running costs and all other costs related to their petroleum business operations.

It is recommended that the current margin levels for OMCs be maintained until a thorough study is conducted to determine new company margins.

(v) Delivery Charges

Transportation costs for petroleum products from the receiving depots to the end user are recovered from the end user price.

It is recommended that this margin should be reviewed annually and should be based on the actual transport rates that are published by SUMATRA.

(w) Conversion Factors

Petroleum products are quantified in metric tons. However, sales are based on volume quantified in litres. Standard Conversion are used in the pricing formula.

It is recommended that the same method of getting conversion factors be continued until when the Bulk Procurement System will commence. Thereafter, the actual conversion factors will be used in the pricing formula.

(x) Computation of Indicative and Cap Prices

After computation of the indicative prices, a margin of 7.5% of the price is added on the indicative price to get cap prices. This provision was included to cater for computations that might have been underestimated in the formula. Over time it has been observed that almost all items in the pricing formula have been correctly provided for while some of the items are fixed.

It is recommended that in the proposed pricing formula, indicative prices be based on the Low Platt's quotations for FOB, Freight and Premium, and Cap prices be computed as averages of the mean Platt's quotations plus a 7.5% margin for OMC Margins and Overhead and the Dealers' Margin and Overhead.

5. Conclusion

Stakeholders are invited to go through the proposed pricing mechanism for petroleum products and come up with comments which will enable EWURA conclude the review process. The proposed structure of the revised pricing formula is attached herewith as **Annex 1.0**.

Annex 1.0

Proposed New Petroleum Pricing Formula

Average Platt's Average (14 Days)				
CONVERSION FACTORS		0.736	0.833	0.786
		Petrol	Diesel	Kerosene
DESCRIPTION				
	UNIT	PRICE	PRICE	PRICE
	Product Cost (CIF)	TZS/Lt		
	Pre Discharge Services Cost	TZS/Lt		
	Regulatory Levy	TZS/Lt		
	Fuel Marking Costs	TZS/Lt		
	Fuel Levy	Tzs/Ltr		
	Excise duty	Tzs/Ltr		
	OMC's Overheads & Margins	Tzs/Ltr		
	WHOLESALE PRICE	Tzs/Ltr		
	Dealers Overheads & Margin	Tzs/Ltr		
	DSM INDICATIVE RETAIL PRICE			

Note:

Pre Discharge Service Costs is proposed to be introduced to consist of approved Wharfage, TBS, SUMATRA, TIPER and WMA charges