Evaluation of Russian railway projects

EBRD Evaluation department

2016

The EBRD Evaluation Department (EvD) evaluated the EBRD's operations in the Russian railway sector carried out from 1996 to 2013. The portfolio includes 24 rail projects worth €1.8 billion and 34 TC initiatives worth €6 million. EvD assessed relevance, results and efficiency of the activities to produce an overall assessment rating. Several findings lessons and recommendations were made to inform future Bank work.

Highlights

The EBRD's Russian railway portfolio performed well across the multiple dimensions of the Bank's operational mandate. EvD rated overall performance good bordering on outstanding; based on fully satisfactory relevance, results, transition impact and sound banking. Efficiency and additionality were excellent.

Results were delivered on the ground at both the project and sector level.

Strengths of the EBRD's operations were providing financial additionality and crowding in commercial financing.

Russian railway operations demonstrated the principles of sound banking, particularly Bank handling, implementation efficiency and the EBRD's investment return on the debt portfolio.

The Bank's integrity management system worked well and succeeded in ensuring that corruption did not infect the Russian railway portfolio.

Client companies hold Bank staff in high regard and the increased delegation of responsibilities and staff to the Moscow resident office had a positive impact on the quality of services provided to clients.

There were a few areas where actual performance fell short of expectations such as limited support to help complete stalled reforms; use of TC; demonstrated non-financial additionality; limited support to help improve the RZD's financial performance; the EBRD's losses on its equity investments in Russian railway companies.

Findings

Strategic use of combined projects, technical cooperation and policy dialogue

The EBRD led international finance institutions in the sector during the period. It helped shape the broad Russian rail sector reform programme to the early 2000s through a combination of financing, technical cooperation and policy dialogue.

Specifically it assisted in corporatizing and unbundling Rossiyskie Zeleznye Dorogi (RZD, or Russian Railway) and helping develop a competitive, market orientated freight wagon industry through significant lending to private companies.

More vigorous promotion of reforms for greater private sector investment and more effective support of RZD's transformation into a commercially viable company without reliance on government subsidiaries would have increased impact in the sector.

Macroeconomic efficiency gains

The government's reform programme was broadly consistent with the EBRD's advice resulting in lower railway costs as a percentage of GDP, higher combined traffic unites handled per employee and lower real costs per combined traffic unit.

New approach to policy dialogue required

One of the few weaknesses identified by the evaluation related to some unsuccessful attempts to undertake sector level policy dialogue to create more opportunities for the private sector. New ways must be found to engage that will help stalled reforms move forward.

A new niche for the EBRD in the Russian rail sector

Funding for freight wagons has led to an oversupply. Any future operations might focus on private sector investment in traction, passenger services or railway infrastructure and supporting privatisation of RZD.

Better mitigation of macroeconomic and currency depreciation

Prevailing macroeconomic conditions directly impact on the financial performance of Russian railway companies and equity investments in them. During difficult economic times in 1999, 2008 to 2009 and 2013 onward demand and margins fell and significant rouble depreciation adversely affected the financial performance of railway companies, particularly those with significant foreign exchange exposures.

Recommendations

1/ Find innovative ways to undertake sector level policy dialogue in areas that will remove barriers to private sector investment

That will involve:

(i) building close relationships with railway policy and regulatory agencies, state and regional organisations that champion reform, rail industry associations and RZD;

(ii) advocating specific policy changes that are necessary to promote reform in the railway sector and open up more opportunities for competition and private sector investment;

(iii) assessing country ownership of, and commitment to, the priorities for sector reform and the associated timing and sequencing and identifying high-level champions for necessary policy change; and

(iv) developing, a strategy for the policy dialogue, embedded in the country strategy, based on deep diagnostics and political economy considerations, including the policy actors targeted, the policy actions envisaged and the tools to be used to achieve the desired results that draws on a full range of instruments in the EBRD's toolkit like: (a) mobilizing headquarters-based staff with appropriate expertise, including senior Management when needed, to support MRO in undertaking policy dialogue; (b) resourcing the efforts to provide the necessary staff and consultants that have the required world-class expertise; (c) preparing targeted knowledge products; (d) sponsoring/financing conferences on carefully selected topics; and (e) mobilising stand alone, policy oriented TCs in areas where there is strong government ownership.

2/ The EBRD should no longer finance projects where transition impact is primarily to increase the proportion of freight wagons owned by the private sector

The EBRD must find new niches that deliver incremental transition impacts if it continues to support the railway sector. Further policy reforms would be needed to open up some opportunities for projects involving:

(i) private sector investments in traction, passenger services and railway infrastructure, preferably using public private partnerships;

(ii) balance sheet restructuring or mergers and acquisitions in the rail freight wagon industry to promote orderly market consolidation;

(iii) full or partial privatisation of RZD subsidiaries;

(iv) a RZD initial public offering; and

(v) new technologies that improve operational and/or energy efficiency.

3/ Ensure future rail projects are sufficiently robust to withstand major, unanticipated macroeconomic shocks and currency depreciations that cannot be forecast with certainty

That will involve supplementing the comprehensive due diligence process that is in place with:

(i) analysing the impact that past macroeconomic crises have had on Russian railway projects to develop the parameters for more robust stress testing during the project processing phase for unexpected macroeconomic downturns and major currency devaluations;

(ii) seriously discussing with clients currency mismatch risks and the EBRD's options of providing local currency denominated financial support;

(iii) more cautiously assessing the potential risks related to equity investments, including those associated with adverse macroeconomic conditions and reflect those risks in its equity valuation and pricing estimates; and

(iv) searching for equity exit mechanisms that provide greater protection to the EBRD.

4/ Improvements are needed in defining non-financial additionality and transition benchmarks and sharpening the definitions and indicators

This can help to determine whether or not the desired results are realised and are related to the EBRD's participation in the transaction, which will involve:

(i) streamlining the description, monitoring and reporting on the achievement of non-financial additionality and transition objectives and indicators;

(ii) clarifying what is meant by the EBRD's attributes under non-financial additionality;

(iii) determining how claimed demonstration impacts can be independently verified; and

(iv) limiting claims of sectoral impact at the project level and assessing the combined impact of a portfolio of similar projects in periodic sectoral assessments or evaluations, with a focus on contribution rather than attribution.

For more information read the full report at www.ebrd.com/evaluation.

The Evaluation department (EvD) at the EBRD reports directly to the Board of Directors, and is independent from the Bank's Management. This independence ensures that EvD can perform two critical functions, reinforcing institutional accountability for the achievement of results; and, providing objective analysis and relevant findings to inform operational choices and to improve performance over time.

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