# Railway development project

**Summary of the Operation Performance Evaluation Review (OPER)**
**(February 2008)**

## The project

The railway sector of this country emerged from the economic decline of the post-Soviet era fairly unscathed. It suffered however from deteriorating finances and a declining market share. While continuing to fund railway system rehabilitation on a reduced basis, the country's State Administration for Railway Transport has not had access to foreign exchange and to international railway technologies essential to systematic productivity improvements.

In 1998 the European Bank for Reconstruction and Development (EBRD), jointly with the State Administration of Railway Transport, launched the preparation of the Railway Development Project, which consisted of the following investment operations:

- support for a track renewal programme for the main line
- purchase of modern track maintenance machinery equipment
- provision of consultancy services to assist with the development and establishment of the track organisation and management system (TOMS) as well as with project implementation in general.

The objective of the technical cooperation (TC) was to improve corporate efficiency and to assist the transition from a state administration to an independent commercial corporate entity subject to market discipline. In October 1999 the Bank approved a sovereign loan in favour of the State Administration of Railway Transport in the amount of US$ 50 million. This was the first externally funded investment for this country's railways administration and the third loan to the country's transport sector.

## Project rationale

The State Administration of Railway Transport has played an important role in the strategic transport corridor link. This project, which is part of the Bank's strategy of supporting the European Union's Trans-European Railway (TER) initiative, effectively promotes trade facilitation and market expansion within the corridor. Other anticipated transition impacts rested on commercialisation and market efficiency as well as on improved financial and environmental performance.

## Achievement of objectives

Overall, the achievement of objectives is rated "Good". However, due to the lack of firm sector reform targets (no reform schedules were agreed upon at appraisal) the transition impact dimension within the set of objectives has not been rated. Otherwise, the rating would be less favourable because the reform process unfolded considerably slower than expected at appraisal.

### *Investment component*

Overall, the project remained within original cost estimates despite various alterations of individual components. All machines and ancillary equipment procured under the loan are now in use at other priority sections of the railway network as envisaged at appraisal.

The project fulfilled the following objectives:

- undertake deferred maintenance
- demonstrate the application of modern technology, equipment and maintenance practices by using high capacity tamping-leveling-lining machines for maintenance of track and turnouts
- introduce rail grinding technology on the heavy loaded line sections of the railways
- establish new working practices in sub-grade rehabilitation and track formation.

The new working practices have been fully adopted and are now used throughout the system.

***Corporate impact***
The envisaged conversion of the State Administration of Railway Transport into an independent corporate entity, a key expectation under the loan, is still pending due to delays caused by frequent political changes at national government level and the slow path of economic and political reforms in the country. Corporatisation has yet to materialise as proposed legal changes have not been signed into law so far. Notwithstanding this fact, there are clear signs of progress. Expectations concerning timely sector reform are wholly warranted.

***Financial and economic performance/results***
In light of the investment at stake, the State Administration of Railway Transport remains an integral part of the railways line ministry. Therefore, a comprehensive evaluation reassessment of its financial performance would neither be feasible nor meaningful. However, the project has had a positive effect on the State Administration's financial position by contributing towards cost and staff reductions, performance level increase, improvement of the initial track quality and other elements. Hence, the financial performance of the project is rated "Good".

***The Bank's investment performance***
This is a standard sovereign public sector debt with a 1 per cent margin above London Interbank Offered Rate (Libor). Since the loan appears to be serviced normally (following early delays in disbursement) and covers its costs, the Evaluation Department (EvD) arrives at a "Satisfactory" rating.

**Overall assessment**
The project, a sovereign-guaranteed loan, was in compliance with the prevailing country strategy and sector policy. On balance, the achievement of objectives was "Good" and the overall performance of the project is rated "Successful". The project's financial performance is rated "Good" and bank handling is rated "Satisfactory".

The transition impact of the project is rated "Satisfactory", and the rating for its long-term potential is regarded as "Good". There is a "Medium" risk attached to transition potential. Despite the lack of a clear implementation schedule regarding corporatisation, as advocated in the Board document, the project made significant contributions to the country in progressing the railway's commercialisation agenda, in providing good technology/know-how and skills transfer and in promoting new standards for business conduct. In addition, the project succeeded in stimulating joint venture operations and new production lines for railway equipment. It also helped to promote sector reform processes.

The Bank's additionality is "Verified in all respects" since it was the first and only external provider of financing. Consequently, the Bank contributed to the shaping and modernising of a railway system that still remains in its early stages. The environmental performance of the project was "Good" and the environmental change induced was "Some".

## Transition impact and the EBRD's additionality

Overall, the transition impact of the project is rated "Satisfactory" as far as could be verified by EvD. The long-term potential is expected to be "Good". However, there is a "High", perhaps excessive, risk attached to transition potential.

The project made a significant contribution towards the preparation and initiation of the reform process in the country's railway sector. EvD is of the view that the continuous policy-related dialogue associated with this transaction (including the second investment and current considerations focusing on a third investment) generally played a beneficial role.

EvD is, however, less certain regarding the degree of the project's catalytic function, that is, whether the project was instrumental to the reform processes. The Bank's leverage was rather limited, albeit important, given the relatively moderate financial and technical assistance input provided by the Bank. Therefore, the overall transition impact rating should be treated with caution.

***Additionality***

The Bank's additionality undoubtedly deserves the rating of "Verified in all respects". No other international financial institution was active in the country's railway sector at the time of approval. It was agreed with the World Bank that railway sector finance should be channelled through the EBRD. It would have been hard for the State Administration of Railway Transport to raise funds on its own balance sheet or on a limited recourse basis, even if loans from local banks or large-scale internationally operating foreign banks had been available.

***Environmental considerations***

As the environmental action plan (EAP) is being implemented, the environmental performance of the project and of the sponsor is rated "Satisfactory", yet it is still not clear if the project has achieved EU environmental and health and safety standards. The extent of environmental change is rated "Substantial" as the project has improved overall conditions in the sector.

## Bank handling

Overall, bank handling is rated "Satisfactory". The project's appraisal was biased by over-optimistic assumptions regarding the prospects of the desired institutional reform process. It was unrealistic to expect that, with a small investment project like the one at stake, a large transition impact in the short term could be realised.

This fact should have been brought to the Board's attention. Numerous problems ensued during the project implementation. Nevertheless, the responsible transport team performed well in terms of preparation and monitoring of the project. This saved the operation from derailing.

## Key OPER issues and lessons learned

***Articulating transition objectives***

Formulation of transition objectives and impacts towards sector reforms in combination with project asset financing needs careful crafting. The following aspects are pertinent in this respect:

- relevance of sector reform ("corporatisation/commercialisation – corporate self-financing capacity/adoption of commercial principles")
- leverage potential by the Bank ("small loan – large sector")

- reform capacity, willingness and determination by the public authority and political system on the recipient side as well as on the part of the Bank (“long-term process – logical sequencing with clear definition of milestones, timeframes for events and interventions”).

***Technological assessment***
For consultant-recommended “high-tech” proposals the undertaking of plausibility assessments and reassessments (“second-look” study) is advisable. The full range of relevant technological options has to be considered. A re-confirmation through a second independent technical expertise reduces the risk of employing excessively sophisticated technology. The additional cost and time incurred by such reassessment may well be recompensed by the eventual opportunity cost.

***Procurement***
Procurement planning during project preparation requires thorough attention. and is important to reduce the need for subsequent changes that often cause delays to project implementation. Nevertheless, the procurement process needs to be sufficiently flexible to allow for unforeseen changes during the designing stage. In case of any such changes, special attention should be given to their effect on the project’s internal rates of return. That means that the substituting components should not cause the project’s overall economic internal rate of return and financial internal rate of return to drop below the level at appraisal.

***Early assessment***
Early involvement of the Bank’s in-house procurement experts (or related consultant expertise) is advised, if the client’s organisation does not possess relevant procurement expertise. As part of the early stages of project preparation an assessment needs to be undertaken by the Bank to ascertain the client’s familiarity with international competitive procurement procedures, resulting training needs and institutional capacity to carry out related processes during project implementation. The Bank should address any resultant shortcomings as part of the project preparation process, thus mitigating any potential disturbances.

***“Spot-check investigations”***
Spot-check investigations” of mitigation measures, especially in the field of workers’ health and safety, are advised even in projects that are not expected to create serious negative environmental effects. It is proposed that compliance with health and safety requirements (by the Bank) should be monitored more tightly through spot-checks. These comprise occasional site visits by transport team headquarters or resident office staff or by staff from EvD as a matter of course when travelling to the country.

***Unrealistic environmental objectives***
If compliance with EU standards is realistically considered not affordable, achievable or both, the Bank should consider a deviation from the Environmental Policy with respect to EU environmental standards. This has since become standard practice for several municipal and environmental infrastructure public sector projects and should be considered for public sector infrastructure projects as well.