

Document of
The World Bank

Report No: 32520

IMPLEMENTATION COMPLETION REPORT
(IDA-34330 TF-23134)

ON A

CREDIT

IN THE AMOUNT OF SDR 21 MILLION
(US\$27 MILLION EQUIVALENT)

TO THE

REPUBLIC OF ZAMBIA

FOR A

RAILWAYS RESTRUCTURING PROJECT

DECEMBER 20, 2005

**Transport
Africa Region**

CURRENCY EQUIVALENTS

(Exchange Rate Effective)

Currency Unit = Zambian Kwacha (ZMK)
ZMK 3,330 on September 20, 2000 = US\$ 1
US\$ 1 = ZMK 4,700 on May 15, 2005

FISCAL YEAR

January 1 – December 31

ABBREVIATIONS AND ACRONYMS

CAS	Country Assistance Strategy
DRC	Democratic Republic of Congo
ECZ	Environmental Council of Zambia
EMP	Environment Management Plan
ERR	Economic Rate of Return
FRR	Financial Rate of Return
GIR	Government Inspector of Railways
GRZ	Government of the Republic of Zambia
ICB	International Competitive Bidding
IDA	International Development Association
MCT	Ministry of Communications and Transport
MFED	Ministry of Finance and Economic Development
MLSS	Ministry of Labor and Social Security
NCB	National Competitive Bidding
NPV	Net Present Value
NRZ	National Railway Zimbabwe
NSSN	National Social Safety Net
PHRD	Policy and Human Resource Development Fund
RSZ	Railways Systems of Zambia
RWUZ	Railway Workers Union of Zambia
SADC	Southern Africa Development Community
SATCC	Southern Africa Transport and Communications Commission
SDR	Special Drawing Rights
SIDA	Swedish International Development and Cooperation Agency
SOE	State Owned Enterprise
TA	Technical Assistant
TAZARA	Tanzania Zambia Railway Authority
ZPA	Zambia Privatization Agency
ZRL	Zambia Railways Limited
ZR	Zambia Railways
ZRRP	Zambia Railways Restructuring Project

Vice President:	Gobind T. Nankani
Country Director	Hartwig Schafer
Sector Manager	C. Sanjivi Rajasingham
Task Team Leader/Task Manager:	Davies B. Makasa

**ZAMBIA
ZAMBIA RAILWAYS RESTRUCTURING PROJECT**

CONTENTS

	Page No.
1. Project Data	1
2. Principal Performance Ratings	1
3. Assessment of Development Objective and Design, and of Quality at Entry	2
4. Achievement of Objective and Outputs	7
5. Major Factors Affecting Implementation and Outcome	14
6. Sustainability	15
7. Bank and Borrower Performance	17
8. Lessons Learned	19
9. Partner Comments	20
10. Additional Information	21
Annex 1. Key Performance Indicators/Log Frame Matrix	22
Annex 2. Project Costs and Financing	24
Annex 3. Economic Costs and Benefits	26
Annex 4. Bank Inputs	27
Annex 5. Ratings for Achievement of Objectives/Outputs of Components	28
Annex 6. Ratings of Bank and Borrower Performance	29
Annex 7. List of Supporting Documents	30
Annex 8. MAP IBRD 31135 (Revised)	31
Annex 9. Partner Comments	32
Annex 10. Additional Information	38

<i>Project ID:</i> P003227	<i>Project Name:</i> ZAMBIA RAILWAYS RESTRUCTURING PROJECT
<i>Team Leader:</i> Davies Bwalya Makasa	<i>TL Unit:</i> AFTTR
<i>ICR Type:</i> Core ICR	<i>Report Date:</i> December 20, 2005

1. Project Data

Name: ZAMBIA RAILWAYS RESTRUCTURING PROJECT *L/C/TF Number:* IDA-34330; TF-23134

Country/Department: ZAMBIA *Region:* Africa Regional Office

Sector/subsector: Other social services (67%); Railways (25%); Central government administration (8%)

Theme: Export development and competitiveness (P)

KEY DATES

	<i>Original</i>	<i>Revised/Actual</i>
<i>PCD:</i> 01/13/2000	<i>Effective:</i> 01/15/2001	12/22/2000
<i>Appraisal:</i> 05/08/2000	<i>MTR:</i> 06/30/2002	
<i>Approval:</i> 11/16/2000	<i>Closing:</i> 06/30/2004	06/30/2005

Borrower/Implementing Agency: Government of the Republic of Zambia (GRZ)/Ministry of Communications and Transport (MCT); Zambia Railways Limited (ZRL); Zambia Privatisation Agency (ZPA); and National Social Safety Net (NSSN).

Other Partners: Swedish International Development Cooperation Agency (SIDA)

STAFF	Current	At Appraisal
<i>Vice President:</i>	Gobind T. Nankani	Callisto E. Madavo
<i>Country Director:</i>	Hartwig Schafer	Yaw Ansu
<i>Sector Manager:</i>	C. Sanjivi Rajasingham	Maryvonne Plessis-Fraissard
<i>Team Leader at ICR:</i>	Davies Bwalya Makasa	Yash Pal Kedia
<i>ICR Primary Author:</i>	Alberto Nogales	

2. Principal Performance Ratings

(HS=Highly Satisfactory, S=Satisfactory, U=Unsatisfactory, HL=Highly Likely, L=Likely, UN=Unlikely, HUN=Highly Unlikely, HU=Highly Unsatisfactory, H=High, SU=Substantial, M=Modest, N=Negligible)

Outcome: S
Sustainability: L
Institutional Development Impact: SU
Bank Performance: S
Borrower Performance: S

QAG (if available) *ICR*

Quality at Entry: S S

Project at Risk at Any Time: No

3. Assessment of Development Objective and Design, and of Quality at Entry

3.1 Original Objective:

The project development objective was to enable Zambia Railways (ZR) through restructuring and privatization to: (i) increase operating efficiency; (ii) reduce cost of operations; and (iii) make freight services and tariffs competitive, and, consequently, increase the railways' share of the local, international, and transit freight traffic. Additionally, efforts of a privatized and efficient ZR to increase its share of freight traffic were expected to result in:

- Heightening of rail-road competition and, consequently, overall reduction in transport costs, leading to the Zambian economy becoming globally more competitive and growth oriented;
- A significant reduction of traffic on road, particularly the long-haul and bulk traffic, and, therefore, in the budgetary allocation of funds for the maintenance, rehabilitation and expansion of the road network in Zambia as well as in the level of pollution and congestion;
- The ZR-linked international corridors becoming more efficient and cost effective, leading to more trade between countries along these corridors, viz., South Africa, Mozambique, Zimbabwe, Zambia, Democratic Republic of Congo (DRC), Botswana, Uganda (after setting up the inter-gauge trans-shipment facilities in Tanzania), and Angola (after the reopening of the Lobito rail link);
- ZR becoming financially self-sustaining and being in a position to renew its assets and reward its capital providers;
- Government of the Republic of Zambia (GRZ) being able to reduce its budgetary deficit through receipt of concession fees, taxes, and hire and lease charges; and
- Zambia generating more foreign exchange through a shift of considerable transit and international traffic from mostly foreign road haulers to ZR.

The project was in line with the 1999 Country Assistance Strategy (CAS), which in consultation with GRZ was designed to focus on:

- Removal of constraints to sustainable and diversified economic growth;
- Improved governance; and
- Better access to basic services and direct poverty interventions.

Excessively high transportation costs were particularly noted as the major impediment to private sector investment and growth. The Government particularly identified ZR as one of the priority state owned enterprises (SOEs) requiring urgent attention. The railway was fast losing its market share because of poor market orientation, poor and unpredictable quality of service, and erosion of its operating capacity caused by inadequate maintenance, and ever increasing competition from the road haulers. Traffic levels sharply declined during the 1990s, from 1,072 million net-ton-kilometers in 1993 to 540 million net-ton-kilometers in 1999. In order to reverse this trend, the Government decided to concession the railways in March 2000.

3.2 Revised Objective:

The original project objectives were not revised.

3.3 Original Components:

The project components were identified on the basis of: experience gained during the World Bank Fourth Railway Project; the Private Sector Participation study; in-house Social Impact Assessment Study of the staff retrenched by Zambia Railways Limited (ZRL) prior to concessioning; Environmental Impact Assessment and Audit; and the Asset Valuation Study. The components are discussed below.

(a) Railway Concession (US\$1.1 million, 3.0% of Total Project Cost)

This was the principal component of the Project which was designed to ensure successful concessioning of the railways. The underlying hypothesis being that the development objectives can be achieved only through private sector participation in the operation and management of the railways.

At the time of project preparation, the Privatization Options Study had already been completed under a PHRD Grant. Based on the recommendations of the Study, Cabinet approved going ahead with the designing of the concession and preparation of the bidding documents.

This component was implemented by the Zambia Privatization Agency (ZPA) with the help of a TA who provided the transaction advisory services. The bidders had the option to bid separately for any of the following packages:

- Short-haul inter-mine freight operations along with the related infrastructure;
- Passenger operations without any infrastructure;
- Long-haul freight operations with related mainline infrastructure and the passenger services package; and/ or all the above packages together.

The winning bidder bid for all the three packages together. The details of the structure of the concession arrangement and fees are presented in Annex 10.

(b) Staff Rationalization (US\$19.5 million, 62% of Total Project Cost)

Based on staff productivity comparisons of different railways, it was clear that ZRL was grossly overstaffed and the Concessionaire was expected to accept only about 800 staff instead of the 3300 on roll in 2000. Successful concessioning of ZR was contingent on arrangements being made to retrench the staff that the concessionaire would not take over. The component was to be implemented by ZRL in two stages:

- Retrenchment of about 1500 staff to bring the level from 3300 to 1800 prior to concessioning; and
- Retrenchment of about 1000 staff consequent to concessioning on the assumption that the Concessionaire will take over about 800 staff. The component was to finance the retrenchment package as agreed under a collective bargaining agreement between the ZRL management and the Railway Workers Union.

ZRL was also supposed to settle a liability of about US\$1.7 Million, which was accumulated through non payment of staff pension contributions to the Pension Fund in order to enable the retrenched staff to draw their eligible pension. This liability was eventually cleared prior to the commencement of the concession. The details of the retrenchment process, severance package estimates, and pension fund obligations are described in Annex 10.

(c) Assets Rehabilitation (US\$7.2 million, 24% of Total Project Cost)

The objective of this component was to assist ZR prevent further erosion of its operating capacity and address three major operating constraints:

- Inadequate availability and low reliability of locomotives;

- Excessive sidelining of wagons; and
- Poor condition of track.

This sub-component was to be implemented by ZRL, and comprised the following activities:

- Overhaul of five GM locomotives at US\$240,000 per locomotive, with a total IDA allocation of US\$1.2 million;
- Fitting of 1,980 wheel discs to 255 wagons, total IDA allocation US\$1.1 million; and
- Strengthening of the railway track in selected weak sections involving replacement of 40,000 concrete sleepers and 60,000 wooden sleepers. Total IDA allocation for procurement of sleepers was US\$2.4 million and GRZ allocation of US\$2.0 million for fasteners and ballast.

(d) Environmental Mitigation (US\$0.3 million, 1% of Total Project Cost)

The objective of this component was to help the railways liquidate accumulated past liabilities in advance of the concession. The component was to be implemented by ZRL, and comprised the following activities:

- Supply and commissioning of pollution control equipment (fume extractors, and oil separators) at locomotive repair workshops;
- Cleaning-up of contaminated sites, mainly of oil leaks and spills built up over the years; and
- Production of an Environmental Management Plan for ZR;

(e) ZR Restructuring (US\$0.5 million, 2% of Total Project Cost)

The objective of this component was to prepare ZRL for undertaking the following functions in the post-concession period:

- Be the custodian of the railway assets on behalf of the Government;
- Have an oversight of the railway inventory;
- Monitor concessionaire's compliance with the concession agreement;
- Monitor the performance of the concessionaire; and
- In the short term to resolve all outstanding liabilities, dispose of all surplus assets, and wind up all non-core activities.

The component was to be implemented by ZRL, and comprised the following activities:

- Procurement of accounting packages and other software and, computers, and office equipment;
- Refurbishment of the new office premises for the post-concession ZR; and
- Training of staff in skills for the new role.

(f) Regulatory and Legal Framework (US\$0.8 million, 3% of Total Project Cost)

The objective of this component was to assist the Ministry of Communications and Transport (MCT) in developing a regulatory and legal framework appropriate for railway sector in light of the overall economic liberalization in Zambia, and in particular the privatization and restructuring of the railway sector. The component was to be implemented by MCT, and comprised the following activities:

- Assessment of the effectiveness of the existing economic and safety regulatory framework;
- Recommending changes in the regulatory framework including the defining of internal

organization, staffing, operating costs, and financing mechanisms for the new regulatory agency;
and

- Preparation of the required draft legislation.

(g) MCT Strengthening (US\$0.5 million, 2% of Total Project Cost)

The purpose of the component was to strengthen the analytical capacity of the MCT. The component was to be implemented by MCT and comprised the following activities:

- Acquisition of new software and/or upgrading of existing software for analyzing transport trends, costs, and capacities and developing transport models;
- Training of staff in acquiring appropriate skills for dealing with the restructuring of the transport industry; and
- Computer networking within the Ministry for more efficient discharge of its functions.

(h) Social Mitigation (US\$1.1 million, 3% of Total Project Cost)

The objective of this component was to provide a comprehensive and professionally organized approach to mitigating the negative social impact on the employees who were expected to be retrenched from ZR. While funds for the retrenchment were adequately planned for, it was generally observed that, loss of employment would still have an adverse social impact on workers. The program was developed using the results and recommendations of a major social mitigation assessment carried out under the project.

The component was implemented by the National Social Safety Net (NSSN), a department of the Ministry of Labor and Social Security. The component comprised the following activities:

- Psycho-social Counseling;
- Small Business Management Awareness training;
- Vocational Based Training; and
- Agricultural Based Skills Training, and Land Resettlement.

The targets for each of the above intervention activities as set out at appraisal are presented in Table 1. The targets were very ambitious and were set at figures slightly higher than would be expected. This was deliberate as the overall strategy was to make maximum effort for the interventions. Under previous retrenchments in ZR, only about 5% of the retrenched workers had found formal employment while another 20% had opened small enterprises and another 5% had moved to farming.

3.4 Revised Components:

The original components were not revised. The social mitigation component was, however, enhanced by adding a civil works sub-component to enhance accessibility through improvement of feeder roads (30km) and drilling of bore holes (10 Nos.) in selected resettlement areas where former railway staff were provided with plots of land. The Development Credit Agreement (DCA) was accordingly amended in September 2002 to adjust for these needs and allow civil works to be eligible under the project.

3.5 Quality at Entry:

Quality at Entry is *rated Satisfactory*. The core concept of the Project was the involvement of the private sector in the operation and management of the railways. This was triggered by the key lesson learnt under the Bank financed Fourth Railway Project, which was that, as long as ZR remains publicly managed, it cannot achieve and/or sustain financial self-sufficiency. Poor accountability and motivation, frequent changes in top management, pressure to continue provision of unprofitable services, and other forms of

interference from various sources are some of the main reasons preventing the railways from becoming financially sound.

The development objectives were formulated to be consistent with the Bank's Country Assistance Strategy (CAS) and the Transport Policy as defined by the government. The Project aimed at supporting the Government to concession the railway to private sector, which was expected to bring in the required expertise and investments to get the railways back to its peak performance.

A PHRD Grant (TF 23134, Yen 55.5 Million), approved in September 1995, was used to finance a study to define a clear framework for involving the private sector in the ownership and management of the railway system. The Study recommended a vertically integrated concession with flexibility for the bidders to bid separately for short-haul, the inter-mine, and long haul freight operations. The option was presented to the Cabinet and its approval obtained for implementation. .

In a parallel development, assistance was provided by SIDA in improving the performance of the railways or at least preventing it from deterioration during the period required to complete the concessioning process. Under a separate agreement between the Government of Zambia and SIDA, a team of experts took over the top management of ZR. One expert was also inducted into the Board of Directors of ZRL to contribute to better decision-making. The Management Team helped improve operations, operate within the revenue generated by ZRL, avoid increasing ZRL's liabilities, implement the investment and staff retrenchment components of the Project, and effectively bring the railways to a position where the Concessionaire could commence operations with minimum operational and administrative concerns.

The railway concession strategy and design was developed by engaging professional consultants and refined through intensive discussions involving the Consultants, ZPA, ZRL and the expatriate management, the Ministry of Transport, the World Bank, and finally with the potential bidders.

The Project design was developed through intensive interactions with the ZRL management, ZPA, the Ministry of Transport, staff unions, major customers, and other major stake holders. In addition to standard technical, financial and economic considerations, appropriate attention was given to the very complex labor and social issues (retrenchment), legislation and regulation, outstanding environmental liabilities, and maintaining operating capacity during the concessioning process.

A Quality Enhancement Review (QER) of the project was undertaken in April 2000. The QER panel concluded that:

- Just before project appraisal the preparatory work had achieved a very advanced stage;
- The process of engagement and consultation carried out with the Government and the ZR was adequate; and
- That, there was strong leadership in the project. The Panel also made very useful recommendations regarding the concession design, social mitigation measures, and investment proposals.

The Project profile with staff retrenchment and social mitigation details was sent to the World Bank's top management in accordance with the Operational Manual (BP12.00) of March 5, 1996 for approval and advice.

4. Achievement of Objective and Outputs

4.1 Outcome/achievement of objective:

The overall achievement of the project objectives is *rated satisfactory*. The development objectives could be achieved only by involving the private sector in the operation and management of the Railways. The first main milestone to be achieved, therefore, was to select the Concessionaire and for him to commence operations as that would have actually marked the beginning of the railway revitalization effort. This milestone was successfully achieved with the selected concessionaire taking over the management of the railway on December 3, 2003 in spite of the complexity of the concessioning process, apathy of the investors in bidding for the railway concessions in sub-Saharan Africa, persistent verbal campaign against privatization by some stakeholders, and the unavoidability of the accompanying massive staff retrenchment. Along with that, the labor force was downsized from 3,300 in 1999 to about 800 at the time of take over of the railway by the Concessionaire in December 2003.

With the successful concessioning of the railway, the stage was set for commencing the task of revitalization of the railway, but the Concessionaire, after takeover, was faced with huge tasks such as:

- Reorganizing work processes to operate with 800 staff instead of 1800 prior to the commencement of the concession;
- Reintroducing operating and management systems for monitoring and controlling operations, costs, quality, locomotive and rolling stock turnaround as well as for entering into long-term contracts with the customers; rehabilitating infrastructure and operating assets; and
- Establishing effective coordination with the neighboring railway systems. These efforts obviously could take time, between three to five years.

Unfortunately, the start of the concession was marked by some serious problems. On the one hand, the Concessionaire faced problems with its own consortium members and subcontractors and on the other Zambia Railways Limited (ZRL) and the Government Inspector for Railways (GIR) produced a number of highly critical reports about the Concessionaire's performance within a few months of the start of the concession. This led to worsening of relations and a feeling that all was not well with the concession. To stem the worsening relations and rectify the negative perceptions about the concession, the Project Team facilitated a workshop and brought the parties together for a face to face discussion under the chairmanship of MCT. That helped a lot and since then the relations have improved, the concessionaire has made substantial efforts to improve operations and accelerate the pace of rehabilitation of assets, and the perception regarding the concession has improved.

During the last two years since the commencement of the concession, the Concessionaire has focused on long distance traffic and the average haul has increased by about 25% and the freight traffic overall by 20% (based on net ton kilometers). The Concessionaire has introduced a system of independent survey of the customers to improve the quality of service. Rehabilitation of assets is also progressing well. However, a lot remains to be done. The railways in Zambia have been in a state of neglect for a very long period and considerable time would be required to bring it back to good health. The current trends are, however, encouraging as discussed below.

- According to the audit reports of the Auditors for the Concessionaire (RSZ), the Concessionaire has met all his concession fee obligations transferring a total amount of US\$3.7 million (as at third quarter 2005), and also paid to the government a total of US\$1.3 million in corporate taxes, entirely reversing the condition prior to concession, in which the government was subsidizing the railway operations and maintenance. However, the Borrower, in its comments on the ICR (see

Annex 9 para 3.1), has alleged non-compliance by the Concessionaire in fee obligations, and asserted weaknesses in the Concession Agreement which favor the Concessionaire. To review these allegations, Parliament, in December 2005, has commissioned the Government to set up a review committee and report back the findings.

- Labor productivity has increased both as a result of staff reduction and increase in net-ton-kilometers of freight traffic;
- So far, as indicated by the Concessionaire, the level of investment by the concessionaire in terms of rehabilitation of fixed infrastructure and rolling stock has been adequate, with the emphasis on first addressing critical areas. The regular and systematic rehabilitation has now picked up with the highlights being as follows: (a) 266 kms of track has been rehabilitated and another 450 kms is in progress; (b) 8 remanufactured engines have been ordered and 4 of them have been received in order to strengthen the locomotive fleet; (c) wagons are being rehabilitated at a rate of 80 per month; (d) telecommunication equipment, plant and machinery, and station buildings are also on regular rehabilitation schedule; and (e) about 298 good second hand passenger coaches have been procured from the Republic of South Africa, and an additional 28 are expected by mid 2006.

Based on the above considerations, there is reasonable certainty that the development objectives will be fully achieved and sustained in the medium to long term.

4.2 Outputs by components:

The figures provided in parenthesis after each component, present the cost estimates at appraisal (including contingencies) as contained in the PAD, and final project costs at the time of drafting the ICR.

(a) Railway Concession (PAD US\$1.1 Million, ICR US\$1.28 Million)

This component is *rated satisfactory*. The railway was successfully concessioned, and the Concessionaire took over operations on December 3, 2003. The initial target was to concession the railway by September 2001. There were three main reasons for the delay:

- The Ministry of Communications and Transport at one point constituted a committee of eight cabinet ministers to oversee the process and the committee took a long time to convey approvals for the concession design and eventually the committee was scrapped;
- The second-ranked bidder made a representation to the Government and dealing with that also delayed the approval of the concession by the Attorney General; and
- The negotiations between the preferred bidder and the Government-appointed negotiating team took an inordinately long time.

The first cause for delay has to be viewed in the light of the Government's anxiety over concessioning and eagerness to get assurance at various stages of the concessioning process as well to keep most Ministers and officials involved in the process. Though this step delayed the process, it also led to more Government acceptance and ownership. The second cause of delay was also part of the process and meant to ensure transparency, though the representation could have been disposed off faster. The third cause for delay could have been reduced considerably. Based on the lessons learnt from this third cause, subsequent railway concessioning processes in other countries have been designed to almost eliminate the need for protracted negotiations. This is further explained in this report under the section on lessons learnt.

(b) Staff Rationalization (PAD US\$19.5 Million, ICR US\$21.1 Million)

This component is *rated satisfactory*. All the retrenched ZR employees were paid their severance packages

and those who crossed over to the concessionaire were paid their early retirement dues. The output of this component is as follows:

- *Staff Retrenchment (PAD US\$17.5 Million, ICR US\$19.1 Million)*: A total of 2,500 employees were retrenched, reducing the number of employees from 3,300 at the start of the project to about 800, at the time of the concession. IDA contributed US\$19.11 million against the appraisal estimate of US\$17.5 million. The increase in cost was partly caused by: (a) retrenchment of 2,500 staff compared to 2,400 for which the provision was made; and (b) delay in the takeover of the concession, which increased the cost of packages.
- The *Pension Fund arrears of US\$2 Million* were cleared by ZRL before the commencement of the concession.

The process and management of the staff retrenchment was highly successful as the number of court cases pending (24 cases) from the litigations of former employees is less than 1% of the total staff retrenched.

(c) Assets Rehabilitation (PAD US\$7.2 Million, ICR US\$5.8 Million)

This component is *rated satisfactory*. IDA contributed \$4.71 million and ZR contributed US\$1.1 million against its planned contribution of US\$2 million. The output of this component is as follows:

- 4 locomotives were overhauled from project funds, and put into service in 2003. This contributed to improving the locomotive availability and quadrupling its reliability from about 8,000 km between failures in 1998 to about 33,000 km between failures in 2003;
- 1,980 wagon wheels were purchased, and used to repair approximately 255 defective wagons; and
- A total length of about 22 km of main line track between Lusaka and Karubwe section was relayed with about 40,000 concrete sleepers. Additionally, a total length of about 377 km selected derailment prone sections north of Kabwe were strengthened by interlacing (1:4) with approximately 66,000 wooden sleepers.

This component allowed ZR to sustain its operating capacity and prevented a serious deterioration of its operational and financial performance during the transition period leading up to the concession and gave the concessionaire a good start especially on the availability and reliability of locomotive power and wagons.

(d) Environmental Mitigation (PAD US\$0.3 Million; ICR US\$0.3 Million)

This component is *rated satisfactory*. An environmental mitigation study conducted through a consultancy in 2001 provided the base line information for the environmental mitigation program for which the following was accomplished:

- An Environmental Management Plan was produced and adopted by ZR in September 2002;
- Pollution control equipment (emission detectors, and fume extractors) was procured and is awaiting installment by the concessionaire;
- Oil separators were constructed at three selected, major locomotive repair sheds, at Ndola, Kabwe and Livingstone. However, at the time of the ICR, these oil separators had not yet been commissioned; and
- Contaminated sites were cleaned at three selected major locomotive repair sheds, at Ndola, Kabwe and Livingstone.

(e) ZRL Restructuring (PAD US\$0.5 Million, ICR US\$0.6 Million)

This component is *rated satisfactory* for the following reasons: ZRL has been downsized to about 25 staff and its role redefined to manage the railway concession instead of being a railway operator. ZRL now has an oversight function over the railway inventory, and it monitors the concessionaire's compliance with the concession agreement. In the short term, ZRL is also expected to resolve all outstanding liabilities, and dispose off all surplus assets, and disengage from non-core activities.

However, the approach to appoint former railway staff, more specifically the expatriate Managing Director, to monitor the performance of the private operator created serious problems in the beginning. However, ZRL is now acting by itself and is progressively becoming more experienced in monitoring the concession.

(f) Regulatory and Legal Framework (PAD US\$0.8 Million, ICR US\$0.9 Million)

This component is *rated moderately satisfactory*. In June 2003, MCT contracted a consulting firm to Review the Regulatory and Legal Framework for the Railways Industry. In early 2004, a draft report was produced and widely circulated and discussed. The consultant presented a final report and a draft Railway Legislation in April 2005 which includes:

- An outline of the existing legal framework;
- A draft of an enabling new railway legislation to reflect the changed railway structure and a liberalized business environment;
- An overview of the agencies currently and potentially involved in railway regulation;
- A discussion on the need for railway sector-specific economic regulations and the application of environmental regulations; and
- Specific proposals for licensing of railway operators and institutional structure for railway safety regulations.

While it is true that a final decision on the form of the regulatory body did not emerge, it was not due to slow decision-making or implementation; the way forward was simply not at all clear – and experience in other countries did not point to an obvious answer. The need for economic regulation for the railways was questionable as there is reasonable competition from road transport services and the Concessionaire is free to set freight tariffs and select the freight that it wants to carry. Moreover, passenger tariffs and frequency of passenger services are well articulated in the concession agreement. Additionally, Zambia, like many other countries, has an agency to deal with complaints of anti-competitive behavior. For these reasons establishing a separate regulatory body was not a clearly felt need, and the justification for incurring the additional expenditure was not apparent. Furthermore, concessioning experience in other countries does not point unequivocally to the need for an economic regulator.

The need for a safety regulator is more apparent. In this regard, the Government has filled the vacancy of a Government Inspector of Railways (GIR), whose main role is to inspect the railways for any safety violations. For the time being, the Bank has agreed that no additional agency be created for safety regulation. The experience of the GIR will form the basis of any future action. The proposed amendment of the Railways Act has been processed. However, it needs to be emphasized that the legal authority to concession the railways was already present in the old Railways Act and the Concessionaire commenced under that authority by obtaining a valid permit from the Minister of Transport. The proposed legislation is meant to make the provisions in the Concession Agreement and the Railways Act consistent and also pave the way for any future restructuring such as introduction of third party operations. The delay in the

enactment of the legislation is therefore of no immediate material consequence. The moderately satisfactory rating reflects the fact that the amendment need not have been delayed to this extent.

(g) MCT Strengthening (PAD US\$0.5 Million; ICR US\$0.7 Million)

This component is *rated satisfactory*. The following outputs were achieved under this component:

- The project provided a computer network system for MCT headquarters that will be used, among others, to maintain a transport data base to collect and register transport statistics and to provide internet access and internal electronic communications for MCT staff. The system is being tested and commissioned;
- More than 40 staff participated in the training activities on the following subjects: transport economics, railway safety, financial management, procurement, information technology, and human resource management;
- Computer equipment, office furniture and vehicles were procured to support the project coordination activities and the duties of the Government Inspector of Railways.

The study report on Regulatory and Legal Framework contains a set of recommendations to strengthen MCT to adequately monitor the railway concession in collaboration with ZRL and improve the capacity of MCT to deal with railway policy and broader transportation issues.

(h) Social Mitigation. (PAD US\$1.1 Million; ICR US\$1.3 Million)

This component is *rated highly satisfactory*. Based on international experience in staff retrenchment, there was widespread skepticism about the possible impact of this component. The argument was that given the high unemployment rate in Zambia, the retrenched staff has very little chance of gaining employment in the formal sector, more so, if the retrenched staff possesses only railway-related skills. In many countries, where the retrenched staff was provided vouchers for training, only 20% or so actually made use of the training and even a lesser percentage was successful in gaining employment. In spite of the skepticism, the Project Team decided to make a vigorous effort at assisting staff in many different ways and very ambitious targets were set for the various sub-components as indicated in the table below, even though it was known that the targets may not be realized. The overall strategy was to make the maximum effort.

As indicated in Table 1 below, a total of 932 retrenched employees of ZRL, about 40% of the total staff retrenched, received social counseling. More than 50% of the retrenched staff also received training of some sort or the other. In addition to achieving a comprehensive package, 10 boreholes were drilled and two feeder roads (30 km, and 20 km) were fully rehabilitated to benefit more than 200 retrenched staff that chose to acquire land in the Katikulula and Masasabi resettlement schemes for farming purposes.

Table 1. Social mitigation Statistics

Training Type	Social Counseling	Small Business Awareness	Agriculture Skills Training	Vocational Skills training	Land Resettlement
Planned	1,463	932	250	250	500
Actual Trained	932	632	330	510	224

Overall, the implementation of this component was highly successful. Most retrenched staff appreciated the

social counseling; about 80% of those that received training on small business awareness have actually established their businesses; about 80% of those that received agricultural based skills derive their primary income from agriculture; and many of those who received vocational training have found alternative employment. Moreover, the group that was selected to participate in the land resettlement have benefited from a professional and comprehensive package that includes improved infrastructure (feeder roads and boreholes) and social services like education and health in these resettlement areas.

Three random comparative study cases which compared business performance between those who undertook training with those who did not take training indicated that, those with training were doing better economically than those without training. It was generally felt that, for maximum benefit, training could have been conducted before the beneficiaries received their terminal benefits. The beneficiaries observed that, in most cases, training came long after the terminal benefits had been received and spent. They advised that, in the situation where the retrenched staff is deceased or too old to undertake training, immediate family members such as sons or daughters could have been allowed to attend the skills training programs.

4.3 Net Present Value/Economic rate of return:

The economic analysis was carried out for the “with” and “without” project scenarios. Economic benefits accruing from the project are in the form of: (i) transport cost savings on the traffic that is anticipated to shift from road to rail; (ii) reductions in rail operation costs resulting from improved productivity of the privatized railway. For example, labor productivity is currently very high compared to that which existed in the state owned railway which employed an excess of staff; and (iii) the multiplier effect of the retrenched staff investing in alternative businesses and getting productively employed.

(a) Without concession: In the “without” project scenario, the NPV is negative. This entails that, had ZRL continued to operate as a state owned enterprise (SOE), it would have continued to make losses; government would not have received any fiscal revenue from ZRL and instead would have been forced to continue subsidizing the firm to keep it afloat. Additionally, Government fiscal burden from the railways would have increased from year one to twenty, as ZRL would have continued making losses and carrying progressively declining freight traffic. In this scenario, the following assumptions were made:

- Traffic would have continued to decline in the absence of any investments and discontinuation of the SIDA management contract, from the actual of 545 million net ton kilometers in 1999 by about 2% every year;
- Staff would have declined to 1,800 but very slowly and mostly due to natural attrition. This is because ZRL would not have the resources to pay for retrenchment benefits;
- No more than US\$10 million of own resources would have been invested over ten years just to keep the railway operational;
- Economic cost has been calculated using a maximum staff establishment of 2400 employees or actual, if less than 2400, in that particular year;
- Variable cost has been assumed as USD.0156/NET TON KM, based on the ZRL records of costs.
- Fixed costs are assumed to be US\$5.1 million;
- Staff-related unit costs as in the PAD were taken from ZRL records.
- Economic costs differ from financial costs only in terms of staff costs;
- Revenue is proportional to traffic and follows the current tariff structure; and
- Opportunity cost of capital is 12%.

(b) With Concession (Base Case): In this scenario, the following assumptions were made:

- Traffic would increase at the rate of 10% per year for the first five years and then at the rate of 2% per year;
- Staff would decline to 800 by the time of the commencement of the concession and then increase in proportion to the traffic;
- Apart from the investment under the Project, the Concessionaire would make adequate investment to generate adequate capacity;
- Economic cost has been considered the same as the financial cost since the staff would be reduced to the optimal level;
- Variable cost has been assumed to increase to reflect adequate maintenance.
- Fixed costs are assumed to remain unchanged at US\$5.1 million even though it could show some reduction;
- Staff-related unit costs have been retained as in “without” scenario;
- Economic costs and financial costs are the same;
- Revenue is proportional to traffic and follows the current tariff structure; and
- Opportunity cost of capital is 12%.

The NPV and the EIRR calculations were based on traffic projections in the concessionaire’s reference financial model (RFM), but using the actual for traffic volumes and revenues for 2004. The positive NPV, and a relatively high EIRR in comparison to the employed discount rate of 12%, shows that the concession has economic benefits to the economy. The results of the economic analysis for the base case are indicated in Table 2 below.

Table 2. Economic Analysis Results (Base Case)

	ICR	PAD
NPV (USD Million)	83.9	47.9
EIRR (%)	30.0	28.1

4.4 Financial rate of return:

The assumptions used in the calculation of revenues and costs are summarized in Annex 3 under economic costs and benefits. The results of the financial analysis for the base case (with concession) are indicated in Table 3 below.

Table 3. Financial Analysis Results (Base Case)

	ICR	PAD
NPV (USD Million)	106.92	65.6
FIRR (%)	41.6	38.12

The project has a positive NPV, and a relatively high FIRR well above the employed discount rate of 12%. The project is, therefore, financially viable. However, a sensitivity analysis based on changes in traffic levels and tariffs indicates that the result is very sensitive to traffic levels. This would mean that, for the railway to survive, it should not only be cost effective, but also operate trains efficiently in order to capture the required levels of traffic in the market to keep it profitable. This also strongly justifies the decision by government to concession the railway to the private operator. The following assumptions were made:

- For year 1 of the concession operation, which is 2004, actual results from Railways Systems of Zambia (RSZ) have been used i.e. K129.026 Billion was realized as revenue ([Source: RSZ management accounts extracts]. 563,117,383 net ton-kilometers were achieved. Assuming a dollar

to kwacha exchange rate of k4,650, gives us US\$ 0.0492 per net-ton-km as freight tariff charged by RSZ;

- On the cost side, K68.690 [Source: RSZ Management Accounts extracts] billion was spent. This is approximately US\$ 0.0262 per net-ton-km in direct variable cost incurred by RSZ;
- Actual investment figures were used for 2004, shortfall was assumed to be spent within the agreed period or phase I (First 5 years);
- Total tax assessed and paid as of 14th April 2005 is assumed for period up to December 2004, the accounting year for RSZ (\$649,952); tariff projections in net ton-kilometers follow the concessionaire's reference model; and
- Opportunity cost of capital is 12%.

4.5 Institutional development impact:

The institutional development impact of the project is *rated substantial*. Concessioning of Zambia Railways marks an important institutional change, from public ownership and management of the railways to public- private partnership. Under this arrangement, while the Government continues to own the strategic railway infrastructure, the responsibility for the operation and management of the railways rests with the private sector. The private sector's profit motivation, entrepreneurial skill, and management expertise will ensure a significant increase in operating efficiency and achievement of development objectives.

The single most important impact of the institutional change is that the financial support from the Government to the operation of the railway sector, in terms of providing subsidies or writing off loans, has been reversed. There is no longer a fiscal burden from the railways. Instead, the Government is now receiving revenue, and so far in the last 17 months of the concession operation, the concessionaire had already paid to the Government of Zambia an estimated total amount of US\$3.7 million by end of the third quarter of 2005, in variable and fixed fees, as well as US\$1.3 million in corporate taxes.

The social mitigation component was well designed, its implementation was properly conducted, and remarkable achievements were obtained. The comprehensive approach adopted, which included social counseling, retraining and re-orienting workers to alternative employment, and even providing assistance in resettlement, was successful in mitigating the adverse social impact of retrenchment on the former railway workers. The project's social mitigation has great influence and a positive impact in developing new methodologies and approaches to handling retrenchment issues in Zambia.

The concessioning of Zambia Railways will also trigger the concessioning of Tanzania Zambia Railway Authority (TAZARA) network.

5. Major Factors Affecting Implementation and Outcome

5.1 Factors outside the control of government or implementing agency:

The initial project concept had envisioned that the concession would take effect in late 2001 or early 2002. However, due to lack of Government experience in railway concessions and other reasons already expressed earlier, viz., representation by the second-ranked bidder and the Government's keenness to oversee the process in much more detail, the process took longer than anticipated and was completed in December 2003. The long delay for the concession to materialize had a negative effect on the morale of employees at ZR as employees were anxious and did not know their fate. As a result of the above, project activities which were implemented by ZR staff proceeded at a much slower rate of progress than planned.

Additionally, at the time of project approval, it was very difficult to judge the level of interest of the private

sector due to the lack of experience in this type of projects in Zambia, and there was a great deal of uncertainty about Zambia's economic prospects and investment climate.

5.2 Factors generally subject to government control:

The presence of a number of influential persons within the Government who were opposed to concessioning had a sustained negative impact before, during, and after the concession. While the Government policy was clearly articulated and the government had also approved the privatization of ZR, many bureaucratic methods were subtly employed to delay the process. Even within the ZRL's external Management Team, all were not equally keen to expedite the concessioning process. A more forceful attitude from the Government could have ensured quicker results. On the other hand, it must be emphasized that concessioning is very much a political process and too quick a conclusion can have its own backlash. All in all, though some delay did take place compared to the original schedule, this was not serious.

5.3 Factors generally subject to implementing agency control:

The monitoring and report consolidation of all four implementing agencies remained as the weakest area of the project. The coordinating role of the MCT and the inter-ministerial coordination (e.g. with MOFNP) could have been improved with regard to providing cohesiveness to key elements of the project that were carried out by different agencies. The overall quality of the reporting practices on project implementation activities was deficient. This particular feature was not overcome, even after the concession took place, and the quality and accessibility to basic data was a particular problem in drafting the implementation completion report.

5.4 Costs and financing:

At the time of appraisal, the total cost of the project was estimated at US\$31 million (including US\$3.3 million for physical and price contingencies) and total actual cost was US\$31.99 million or about 103% of the appraisal estimate.

The staff retrenchment component for which more than half (56%) of the financial resources were originally allocated (US\$17.5 million) was implemented in full.

An amendment to the Development Credit Agreement was approved to allow civil works to be eligible for financing. An allocation of US\$0.9 million for civil works was agreed, but only about US\$0.02 million was actually disbursed.

About US\$1 million, which is the gain over the life of the project due to the exchange rate fluctuations between Special Drawing Rights and US dollars, is planned to be canceled.

With regard to the financing sources, the central government financed US\$3.1 million on items identified in the DCA, which is about three fourths of the agreed counter part funds (US\$4 million). However, the accounting of these transactions is not clear and straightforward. The amount that ZRL owed the pension fund was also changing with the retirement of staff. Finally, ZRL appears to have cleared the pension liability and that is no more an issue. Moreover, the Government finally agreed with the staff unions and actually spent much more in clearing the pension dues of the staff transferred to the Concessionaire. Though the ICR cost tables reflect that US\$2 million was provided by the government towards clearing the pension arrears, the total contribution by the Government was much more.

6. Sustainability

6.1 Rationale for sustainability rating:

The overall sustainability of the project is *rated likely*. The sustainability of the project has been analyzed in terms of its fiscal, institutional, environmental, and technical resilience as discussed below.

- *Fiscal sustainability is most likely.* The relative importance and location of the railway system in the overall national economy and its role in providing transportation services to key industries, business and agriculture centers, and exporters and importers is well recognized. The railway transport demand for bulk long-haul traffic is projected to increase substantially as a result of the sustained production growth of the mining sector, rapid development of the cement production industry, increased sugar production for export, increased coal production and transportation to the mines from Mamba collieries, and improved traffic in agricultural products. During 2004, the Concessionaire increased the traffic (in terms of net ton km) by about 30% compared to 2003, though the traffic in net tons decreased. The freight traffic decreased in terms of net tons as the Concessionaire focused on long-haul traffic, which in any case should be the railways' first priority. This became possible as the Concessionaire focused more on long haul traffic and in the process increased the average haul from 323 kilometers in 2003 to 477 kilometers in 2004. The prospects of increased traffic will on the one hand ensure continued viability of the concession and on the other ensure continued commitment of the Government to maintaining a functioning railway.

The work force has been down sized from 3,300 at the beginning of the project to 800 at the commencement of the concession. A major element of operating cost has, therefore, been controlled. Costs will further come down as utilization of assets improves, accidents and derailments come down, and wastages of energy and materials are brought down.

Traffic is expected to increase further when the neighboring railway systems (DRC, TAZARA, NRZ) are also privatized or otherwise improved. The railway is on its way to becoming financially self-sufficient, which means that the operating surplus will support all future rehabilitation of assets as well as reward the investors.

- *Institutional sustainability is likely,* however, considerable effort will be needed in the coming three years. Even though the relations between the Concessionaire and the conceding authority have shown improvement, the risks inherent in any reform involving privatization persist. As often, the beneficiaries of the concession are reluctant to express their opinion whereas the losers, tend to be very vocal. Retrenched staff, road transporters who may see their share of traffic decline, politicians who may feel their influence declining with the curtailment or discontinuation of uneconomic services, or politicians ideologically opposed to privatization could continue a campaign against the concession with exaggerated data and emotional pronouncements. These have the potential to bring down the concession, and thus steps need to be constantly taken to bring out authentic information about the performance of the railways, involve the critics in seminars and debates, and ensure all parties operate within the framework of the formal agreements. This is being done and the major institutional change is likely to be sustained.

Moreover, appropriate railway legislation has been drafted and is awaiting approval by the parliament. While the Concession Agreement itself provides for complete freedom of the Concessionaire to set tariffs and decide on what traffic to carry, the enactment of the legislation will further limit economic regulation of the railways by the Government and reduce the risk of failure of the concession. The legislation encourages the Government to concentrate on environmental and safety regulation of the railways. This will further enhance the sustainability of

the concessioned railway.

- *Environmental sustainability is most likely.* The concession agreement requires the Concessionaire to meticulously follow the environmental regulations. In addition to this, all railway operations in Zambia are subjected to stringent environmental regulations under the Environmental Protection and Pollution Control Act of 1990, Cap 204 of the laws of Zambia administered by the Environmental Council of Zambia (ECZ). Regarding safety, it is in the interest of the Concessionaire to eliminate derailments and accidents as such accidents increase the operating costs. Additionally, there are provisions for safety and environment certifications and regular inspections. Based on the above, one can expect drastic reduction in the incidence of safety and environmental violations.
- *Technical sustainability is likely.* The concessionaire has already invested in the rehabilitation of locomotives and rolling stock as well as infrastructure and is now geared to increase the traffic further and to reduce operating costs as a direct consequence of increased reliability of assets. He now has the incentive to prevent any backsliding and is, therefore, likely to continue to invest and improve the infrastructure and operating systems in order to capture all the traffic on offer and thus improve the profitability of operations.
- *Political Sustainability is likely.* The Government has liberalized the economy, and has put in place enabling policies and legislations that encourage divestiture of SOEs and therefore, participation of the private sector in the running of the economy and as an engine of growth. However, from the political economy point of view, the Government has faced a lot of political pressure resulting from the public's past experiences with some of the unsuccessful SOE divestitures. The public is now increasingly demanding for tangible results in the short term, which may not be possible for the railways because investments and the impact of such investments in the railway sector can only be felt in the medium to long term. Therefore Government has to carefully manage this public expectation to ensure political sustainability of the project.

6.2 Transition arrangement to regular operations:

There were no major problems faced during the transition from ZRL to the concessionaire. This is mainly because the senior management, middle management and operatives were retained by the concessionaire. The only new staff was the managing director, and the general manager. Additionally, rolling stock was also available for use by the concessionaire, including the locomotives rehabilitated under IDA support. The above arrangements ensured continuity in the operations of the railways. Nevertheless, the concession was not without its teething problems in the initial period. Timely intervention by World Bank staff and Government officials to resolve differences proved highly useful.

The main transition problems faced were the misunderstandings that emerged immediately after the concession award between ZR, the concession manager and the concessionaire regarding the articles of the concession agreement. However, this was resolved swiftly and relationships have since been relatively smooth. Secondly, during the run-up to concession award, employees were anxious as they did not know whether they would be employed by the concessionaire or not, and because of this ZR suffered losses in productivity, and thefts and sabotage of equipment by the employees.

7. Bank and Borrower Performance

Bank

7.1 Lending:

The Bank's performance at the project identification and preparation is *rated satisfactory*. The task team ensured that the project objectives were consistent with the Government and Bank strategies. The Bank assigned a qualified team with an appropriate skill mix that delivered a well designed project based on the extensive previous Bank experience on railway restructuring initiatives in the Africa region. Standard economic and financial analyses were performed, the environmental and social aspects were properly appraised, and the main risks were identified and dealt with appropriately. During project preparation, lessons learned from the previous four Bank financed railway projects in Zambia were properly incorporated. The project documents and project implementation plan were adequately detailed and of high quality.

7.2 Supervision:

The Bank's supervision is *rated satisfactory*. The project had three task team leaders over the life of the project. The first team leader was responsible for project preparation, appraisal and substantial part of the implementation; the second, performed primarily supervision activities; and the last one, closed the project and led the project completion evaluation. The task management transition processes were performed smoothly and the Bank's policies and procedures were applied consistently throughout the project cycle. A key feature of the supervision was that, towards the end of the project, its task management was successfully transferred to the Bank's Country Office in Lusaka, contributing to a more extensive and frequent supervision of the project.

7.3 Overall Bank performance:

The overall Bank performance is *rated satisfactory*. The Bank staff assigned to the project provided timely attention to the client demands while adhering to agreed procedures and maintaining good control of the project and the monitoring quality. The Bank staff assigned to the project over a six-year period was instrumental in: (i) preserving the original project concept; (ii) giving continuity to the process that involved frequent changes of government officials; and (iii) facilitating GRZ efforts to achieve the participation of the private sector in the operation of the railway.

Borrower

7.4 Preparation:

Borrower performance is *rated satisfactory*. During project preparation, Government counterparts provided all the necessary information required by the task team. The detail and quality of the technical studies performed partly by international consultants and partly by local entities was instrumental in overcoming potential problems experienced in previous Bank railway restructuring operations in the region. The set of comprehensive activities that were performed prior to project appraisal had a positive impact in accelerating the credit effectiveness. The staff and local counterpart team assigned by government to the project were very committed and the selection of implementation agencies was adequate to ensure the ownership of the project.

7.5 Government implementation performance:

The performance of the central Government during project implementation is *rated satisfactory*. The government provided overall support to the project and disbursed a significant part of the required counter part funds in a timely manner. The Government demonstrated a strong commitment to the project as reflected in their forthright support to all project components, and although late in some cases, complied with all the agreed financial and legal covenants. However, the overall project monitoring and coordination role of the Ministry of Communication and Transport could have been improved. All the components were completed before the revised closing date, except for the implementation of a renewed regulatory and legal framework for the rail industry, for which a study was completed, but the new legislation has yet to be enacted.

7.6 *Implementing Agency:*

The performance of the implementing agencies is *rated satisfactory*. All four agencies maintained a high level of commitment in spite of serious challenges posed by substantial delays in completing the concession, the technical complexity of the project, and frequent changes of Government officials. The implementing agencies were very responsive in taking corrective implementation measures; dealt effectively with some complex environmental, social and retrenchment issues; and complied with the high level of standards set by the Bank's policies.

7.7 *Overall Borrower performance:*

The overall performance of the Borrower is *rated satisfactory*. Although project activities proceeded slower than planned, the Borrower managed to implement all planned project activities, including the railway concession which was the major activity under the project.

8. Lessons Learned

The lessons drawn from the project experience include the following:

- *Concession bid process should be designed so as to avoid protracted negotiations.* Assuming negotiations to be unavoidable, the bid process for the Zambia Railways Concession had provision for negotiations with the preferred bidder. In retrospect, this provision did not prove advantageous for the Government of Zambia as negotiations with the preferred bidder took inordinately long and almost every clause in the draft concession agreement was revisited. The practice of after-bid negotiations has many other dysfunctional aspects. **First**, the bidders can use this provision to play games, i.e., offer a very good proposal to win the concession and then use negotiations to directly or subtly dilute the proposal. Being seasoned businessmen, they are most likely to be also more experienced in negotiations. **Second**, as in the case of Zambia, the concession always takes more time to finalize. **Third**, transparency of the bid process is compromised even if the key provisions of the proposal such as the concession fee and concession duration are maintained. Relaxing other provisions relating to change of circumstance, change of law, termination, track standards, etc. also puts other bidders to disadvantage. If the revised conditions had been offered to other bidders as well, their bids could have been different. **Finally**, if there are few bidders, the negotiations tend to become one-sided.

In recent times, the bid process has been designed to avoid negotiations. Under this process, the privatization agency and its advisors undertake very intensive discussions with the pre-qualified bidders to reach a consensus on the concession agreement and make it mandatory for the bidders to submit unconditional proposals. The only discussions that take place prior to signing the agreement pertain to refinement of the contract and ensuring that the concession agreement accurately reflects all understandings reached during pre-bid discussions. Moreover, during the pre-bid discussions, the advisors to the Government can play an active role and to a large extent compensate for the shortcomings in the Government capacity. The same is not true of post-bid negotiations because of the formal nature of negotiations.

- *The Project should cover all aspects of the concessioning and restructuring process.* The Zambia Railways Restructuring Project (ZRRP) supported the design and implementation of the concessioning process, retrenchment of surplus staff, social mitigation, selective rehabilitation of infrastructure and operating assets, establishment of an appropriate legal and regulatory framework, and enhancement of the analytical capacity of the Ministry of Transport. This ensured that the project did not get stalled at any point and for any reason. A number of examples can be

cited where the project focuses only on a few aspects and leaves the others either to the Government or other donor agencies. In that case, it is important to ensure the timing of the other projects. It can be quite disastrous if, for example, the concession is finalized but the financing for staff retrenchment is not available or the operating capacity goes down because the Project failed to include any investments, particularly for critical assets.

- *Every aspect of the proposed Concession Agreement should be fully discussed with all relevant arms of Government and stakeholders.* It is clear that a number of issues arise immediately after effectiveness of the concession because Government was either not fully aware of, or did not fully understand every clause in the terms and conditions of the Concession Agreement (as is the case here, where officials now feel they got a “raw deal” in the concession). This risk can be minimized by investing in greater effort to explain every clause of the proposed agreement to key officials not only in the Government but also the relevant parliamentary and Cabinet sub-committees. This implies the need for greater effort also in building capacity in relevant agencies (such as the Privatization Commission and the AG’s office) to understand and negotiate privatization deals.
- *The Bank should stay involved for at least two years after the concession has become operational .* Experience in almost all concessions, more so in Zambia, has shown that, in spite of a well written concession agreement and good intentions on both sides, many unforeseen problems arise, which could disrupt relationship, generate mistrust, and adversely affect progress. If the concession agreements are not well written or the parties have reached an agreement after contentious negotiations, then even the smallest of the teething problems can retard progress. At that stage, the presence of the Bank could prove useful not exactly for mediating but for bringing the parties together, facilitating analysis, providing a voice of reason, and, if necessary, putting a little pressure. This has already proved effective in Zambia itself, where an ever escalating campaign of criticism from both sides was halted and good relations restored as a result of the Bank’s intervention and involvement.
- *Vigorous social mitigation measures can adjust the adverse impact of retrenchment.* During preparation of the Project, even the staff unions were skeptical of any benefit of any social mitigation measures. The staff unions were more focused on retrenchment package and other terms of retrenchment. However, in spite of the view that counseling and staff training will be ineffective in the Zambian environment with high unemployment rate, serious plans were made for providing social, financial, and psychological counseling, assessment of training needs, actual provision of vocational, agricultural, entrepreneurial training and assistance for job search. The social mitigation measures have brought relief to the retrenched staff and helped majority of the staff to invest their severance payments, and settle down to post-railway life. There have been almost no demonstrations and legal actions.

9. Partner Comments

(a) Borrower/implementing agency:

The Borrower’s evaluation report is presented in Annex 9. The general conclusions of the Borrower are not different though the Borrower has highlighted the ways in which the concessionaire’s performance in the first year of operation did not meet the Government’s expectations.

The project had four implementing agencies as follows: Ministry of Communications and Transport; Zambia Privatization Agency; Zambia Railways Limited; and National Social Safety Net, a department in the Ministry of Labor. The Ministry of Communications and Transport was the overall project coordinator.

The comments from the Ministry of Communications and Transport are, therefore, an aggregate of all the comments from the other mentioned implementing agencies.

(b) Cofinanciers:

There were no co-financiers on the project.

(c) Other partners (NGOs/private sector):

The Swedish International Development and Cooperation Agency (SIDA) were partners to the railway concessioning process. However, at the time of compiling this ICR, SIDA had not yet compiled a report.

10. Additional Information

Additional information regarding the concession design, retrenchment package is presented at Annex 10.

Annex 1. Key Performance Indicators/Log Frame Matrix

Outcome / Impact Indicators:

Indicator/Matrix	Projected in last PSR ¹	Actual/Latest Estimate
Date of take over of the railways by private concessionaire	December 2001	December 2003
Freight traffic on railways	2003 (ZRL) 2.4 million tons	2003 (ZRL) 1.5 million tons 2004 (RSZ) - 2003 (ZRL) ** 311 million ntkm 2004 (RSZ) 340 million ntkm 2005 (RSZ) 340 million ntkm
Amount of income tax paid by the concessionaire to the government	2003 (ZRL) Nil	\$1.3 million Cumulative cash flow to Government from Concessionaire as of September 2005
Amount of fixed and variable concession fees paid by the concessionaire to the government	2003 (ZRL) Nil	\$3.7 million Cumulative cash flow to Government from Concessionaire as of September 2005
Total cash flow paid by the concessionaire to the government	2003 (ZRL) Nil	\$5 million Cumulative cash flow to Government from Concessionaire as of September 2005

**RSZ concentrated on long haul, while ZRL concentrated on inter-mine short haul. Thus net ton kilometers (ntkm) increased under RSZ.

Output Indicators:

Indicator/Matrix	Projected in last PSR ¹	Actual/Latest Estimate
Commencement of concessioning negotiations	By June 2001	February 2002
Signing of the concession agreements	By September 2001	February 2003 – Freight concession agreement August 2003 – Passenger concession agreement
Retrenchment of surplus staff completed	By September 2001	Reduced from 3,300 in 1999 to 800 in December 2003
Staff retraining and re-deployment completed	By June 2002	By June 2005 932 staff retrenched participated in the Social Counseling program. Of the 932: - 632 were trained in small business awareness; - 330 received agricultural based training; and - 510 vocational training.
Social mitigation measures completed	By June 2002	Completed June 2005
Asset rehabilitation completed	By June 2001	By December 2003 - 4 locomotives overhauled - 106,000 sleepers procured and installed and - 1,980 wagon wheels purchased and used to repair 248 defective wagons
Regulatory framework agreed and the inspectorate established	By June 2001	By June 2005: The Government Inspectorate of Railways has been established and the Inspector appointed; The regulatory framework is not yet in place. As of April 2005 only the Review of the Regulatory and Legal Framework has been completed but the implementation of the recommendations is pending.
Strengthening of MCT completed	By December 2003	By June 2005 More than 40 staff received training

Spin-off remaining activities and assets	By December 2002	-computer system installed in MCT - equipment, furniture and vehicles procured for the Government Inspector By December 2003 The government down sized ZR to 25 staff responsible for spinning-off the remaining activities
Winding up of ZR	By June 2003	The government has designated ZR as a holding company and appointed it to monitor and supervise the concession agreement.

¹ End of project

Annex 2. Project Costs and Financing

Project Cost by Component (in US\$ million equivalent)

	Appraisal Estimate	Actual/Latest Estimate	Percentage of Appraisal
Component	US\$ million	US\$ million	
A. Railway Concessioneing	1.00	1.28	116
B. Staff Rationalization	16.90	21.11	108
C. Assets Rehabilitation	6.70	5.81	81
D. Environmental Mitigation	0.30	0.30	100
E. ZRL Restructuring/Winding Up	0.50	0.60	120
F. Regulatory and Legal Framework	0.80	0.89	111
G. MCT Strengthening	0.50	0.70	140
H. Social Mitigation	1.00	1.30	118
Total Baseline Cost	27.70		
Price and Physical contingency (*)	3.30		
Total Project Costs	31.00	31.99	103
Total Financing Required	31.00	31.99	

(*) 15% on staff retrenchment and 10% on the rest rounded to nearest figure.

Project Costs by Procurement Arrangements (Appraisal Estimate) (US\$ million equivalent)

Project Categories		Appraisal Estimate (US\$ million equivalent)				
		ICB	NCB	Other 2/	NBF	Total
1	Goods	6.4 (4.3)	1.0 (1.0)	1.0 (1.0)	0.0	8.4 (6.3)
2	Consulting/Services/Training	0.0	0.0	3.4 (3.4)	0.0	3.4 (3.4)
3	Severance Payments	0.0	0.0	17.3 (17.3)	0.0	17.3 (17.3)
4	Works	0.0	0.0	0.0	0.0	0.0
	Pension Payments	0.0	0.0	1.9	0.0	1.9
TOTAL		6.4 (4.3)	1.0 (1.0)	23.6 (21.7)	0.0 0.0	31.0 (27.0)

Project Costs by Procurement Arrangements (Actual/Latest Estimate) (US\$ million equivalent)

Project Categories		Actual/Latest Estimate (US\$ million equivalent)				
		ICB	NCB	Other	NBF	Total
1	Goods	5.95 (4.85)	0.90 (0.90)	0.51 (0.51)		7.36 (6.26)
2	Consulting/Services/Training			3.50 (3.50)		3.50 (3.50)
3	Severance Payments			19.11 (19.11)		19.11 (19.11)
4	Works	0.02 (0.02)				0.02 (0.02)
	Pension Payments				2.00 0.00	2.00 0.00
TOTAL		5.95 (4.85)	0.90 (0.90)	23.12 (23.12)	0.00 0.00	31.99 (28.89)

Project Financing by Component (in US\$ million equivalent)

Component	Appraisal Estimate			Actual/Latest Estimate			Percentage of Appraisal		
	IDA	Govt.	CoF.	IDA	Govt.	CoF.	IDA	Govt.	CoF.
A. Railway Concessions (ZPA)	1.10	0.00	0.00	1.28	0.00	0.00	116.4	0.0	0.0
B. Staff Rationalization (ZRL)	17.50	2.00	0.00	19.11	2.00	0.00	109.2	100.0	0.0
C. Assets Rehabilitation (ZRL)	5.20	2.00	0.00	4.71	1.10	0.00	90.6	55.0	0.0
D. Environmental Mitigation (ZRL)	0.30	0.00	0.00	0.30	0.00	0.00	100.0	0.0	0.0
E. ZRL Restructuring/Winding Up	0.50	0.00	0.00	0.60	0.00	0.00	120.0	0.0	0.0
F. Regulatory and Legal Framework (MCT)	0.80	0.00	0.00	0.89	0.00	0.00	111.3	0.0	0.0
G. MCT Strengthening	0.50	0.00	0.00	0.70	0.00	0.00	140.0	0.0	0.0
H. Social Mitigation (NSSN)	1.10	0.00	0.00	1.30	0.00	0.00	118.2	0.0	0.0

Annex 3. Economic Costs and Benefits

Year	W.O Project benefits (\$ million)				With Project Benefits (\$ million)						
	Workers	Workers	Govt	Total	Workers	Retrenchee	Retrenchee	Govt	Pensions	Pensions	Freight
	Income	Pensions	Fiscal +/-	without	Income	Alt Income	Interest	Fiscal +/-	Concession	Govt	Users savings
1	10.40	0.83	-4.03	7.20	2.70	0.52	0.63	6.23	0.00	0.00	0.72
2	10.09	0.83	-4.25	6.67	2.72	0.52	0.63	4.48	0.00	0.00	3.47
3	9.77	0.83	-4.45	6.16	2.74	0.52	0.63	4.41	-0.01	0.00	6.46
4	9.46	0.83	-4.62	5.67	2.70	0.52	0.63	4.83	0.02	0.00	9.69
5	9.14	0.83	-4.78	5.19	2.72	0.52	0.63	4.95	0.09	0.45	10.72
6	8.83	0.83	-4.91	4.74	2.73	0.48	0.63	5.64	0.11	0.43	11.74
7	8.51	0.83	-5.03	4.31	2.75	0.44	0.63	6.40	0.14	0.41	12.77
8	8.20	0.83	-5.13	3.89	2.76	0.40	0.63	7.17	0.16	0.38	13.81
9	7.88	0.83	-5.22	3.49	2.77	0.36	0.63	7.95	0.18	0.36	14.85
10	7.56	0.83	-5.29	3.11	2.79	0.32	0.63	8.74	0.20	0.34	15.90
11	7.25	0.83	-4.34	3.74	2.80	0.29	0.63	9.55	0.23	0.32	16.95
12	6.93	0.83	-4.38	3.39	2.82	0.25	0.63	10.37	0.25	0.29	18.01
13	6.62	0.83	-4.40	3.05	2.83	0.21	0.63	11.20	0.27	0.27	19.08
14	6.30	0.83	-4.41	2.72	2.84	0.17	0.63	12.05	0.29	0.25	20.15
15	5.99	0.83	-4.41	2.41	2.86	0.13	0.63	12.91	0.32	0.23	21.24
16	5.67	0.83	-4.39	2.11	2.87	0.09	0.63	13.78	0.34	0.20	22.33
17	5.67	0.83	-4.68	1.82	2.89	0.05	0.63	14.67	0.36	0.18	23.43
18	5.67	0.83	-4.96	1.54	2.90	0.01	0.63	15.57	0.38	0.16	24.54
19	5.67	0.83	-5.23	1.28	2.92	0.00	0.63	16.48	0.41	0.14	25.66
20	5.67	0.83	-5.48	1.02	2.93	0.00	0.63	17.41	0.43	0.11	26.79

Annex 4. Bank Inputs

(a) Missions:

Stage of Project Cycle	No. of Persons and Specialty (e.g. 2 Economists, 1 FMS, etc.)		Performance Rating		
	Month/Year	Count	Specialty	Implementation Progress	Development Objective
Identification/Preparation					
	02/27/1999	1	Lead Railway Specialist (1)		
	09/27/1999	1	Lead Railway Specialist (1)		
	03/12/2000	1	Lead Railway Specialist (1)		
Appraisal/Negotiation					
	06/23/2000	3	(TTL) Lead Railway Specialist (1) Senior Transport Economist (1) Procurement Analyst (1)		
Supervision					
	02/10/2001	1	(TTL) Lead Railway Specialist (1)	S	S
	08/31/2001	1	(TTL) Lead Railway Specialist (1)	S	S
	02/17/2002	1	(TTL) Lead Railway Specialist (1)	S	S
	02/12/2003	2	(TTL) Lead Transport Specialist (1); Lead Railway Specialist (1)	S	S
	08/19/2003	2	(TTL) Lead Transport Specialist (1); Transport Specialist Consultant (1)	S	S
	09/30/2003	1	(TTL) Lead Transport Specialist (1)	S	S
	12/13/2004	3	(TTL) Transport Specialist (1); Lead Transport Specialist (1); Railway Consultant (1)	S	S
ICR					
	04/25/2005	6	(TTL) Transport Specialist (1); Transport Specialist Consultant (1); Economist Consultant (1)	S	S

(b) Staff:

Stage of Project Cycle	Actual/Latest Estimate	
	No. Staff weeks	US\$ ('000)
Identification/Preparation	47.1	167.1
Appraisal/Negotiation	12.5	65.1
Supervision	54.2	230.4
ICR	10	30
Total	123.8	492.6

Annex 5. Ratings for Achievement of Objectives/Outputs of Components

(H=High, SU=Substantial, M=Modest, N=Negligible, NA=Not Applicable)

	<u>Rating</u>				
<input type="checkbox"/> <i>Macro policies</i>	<input type="radio"/> H	<input type="radio"/> SU	<input type="radio"/> M	<input type="radio"/> N	<input checked="" type="radio"/> NA
<input type="checkbox"/> <i>Sector Policies</i>	<input checked="" type="radio"/> H	<input type="radio"/> SU	<input type="radio"/> M	<input type="radio"/> N	<input type="radio"/> NA
<input type="checkbox"/> <i>Physical</i>	<input type="radio"/> H	<input type="radio"/> SU	<input checked="" type="radio"/> M	<input type="radio"/> N	<input type="radio"/> NA
<input type="checkbox"/> <i>Financial</i>	<input type="radio"/> H	<input checked="" type="radio"/> SU	<input type="radio"/> M	<input type="radio"/> N	<input type="radio"/> NA
<input type="checkbox"/> <i>Institutional Development</i>	<input type="radio"/> H	<input checked="" type="radio"/> SU	<input type="radio"/> M	<input type="radio"/> N	<input type="radio"/> NA
<input type="checkbox"/> <i>Environmental</i>	<input type="radio"/> H	<input type="radio"/> SU	<input checked="" type="radio"/> M	<input type="radio"/> N	<input type="radio"/> NA

Social

<input type="checkbox"/> <i>Poverty Reduction</i>	<input type="radio"/> H	<input type="radio"/> SU	<input type="radio"/> M	<input type="radio"/> N	<input checked="" type="radio"/> NA
<input type="checkbox"/> <i>Gender</i>	<input type="radio"/> H	<input type="radio"/> SU	<input type="radio"/> M	<input checked="" type="radio"/> N	<input type="radio"/> NA
<input type="checkbox"/> <i>Other (Please specify)</i>	<input checked="" type="radio"/> H	<input type="radio"/> SU	<input type="radio"/> M	<input type="radio"/> N	<input type="radio"/> NA
<input type="checkbox"/> <i>Private sector development</i>	<input type="radio"/> H	<input checked="" type="radio"/> SU	<input type="radio"/> M	<input type="radio"/> N	<input type="radio"/> NA
<input type="checkbox"/> <i>Public sector management</i>	<input type="radio"/> H	<input checked="" type="radio"/> SU	<input type="radio"/> M	<input type="radio"/> N	<input type="radio"/> NA
<input type="checkbox"/> <i>Other (Please specify)</i>	<input type="radio"/> H	<input type="radio"/> SU	<input type="radio"/> M	<input type="radio"/> N	<input checked="" type="radio"/> NA

Social Other -- Social Mitigation

Annex 6. Ratings of Bank and Borrower Performance

(HS=Highly Satisfactory, S=Satisfactory, U=Unsatisfactory, HU=Highly Unsatisfactory)

6.1 Bank performance

Rating

- | | | | | |
|--------------------------------------|--------------------------|------------------------------------|-------------------------|--------------------------|
| <input type="checkbox"/> Lending | <input type="radio"/> HS | <input checked="" type="radio"/> S | <input type="radio"/> U | <input type="radio"/> HU |
| <input type="checkbox"/> Supervision | <input type="radio"/> HS | <input checked="" type="radio"/> S | <input type="radio"/> U | <input type="radio"/> HU |
| <input type="checkbox"/> Overall | <input type="radio"/> HS | <input checked="" type="radio"/> S | <input type="radio"/> U | <input type="radio"/> HU |

6.2 Borrower performance

Rating

- | | | | | |
|--|--------------------------|------------------------------------|-------------------------|--------------------------|
| <input type="checkbox"/> Preparation | <input type="radio"/> HS | <input checked="" type="radio"/> S | <input type="radio"/> U | <input type="radio"/> HU |
| <input type="checkbox"/> Government implementation performance | <input type="radio"/> HS | <input checked="" type="radio"/> S | <input type="radio"/> U | <input type="radio"/> HU |
| <input type="checkbox"/> Implementation agency performance | <input type="radio"/> HS | <input checked="" type="radio"/> S | <input type="radio"/> U | <input type="radio"/> HU |
| <input type="checkbox"/> Overall | <input type="radio"/> HS | <input checked="" type="radio"/> S | <input type="radio"/> U | <input type="radio"/> HU |

Annex 7. List of Supporting Documents

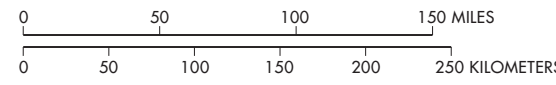
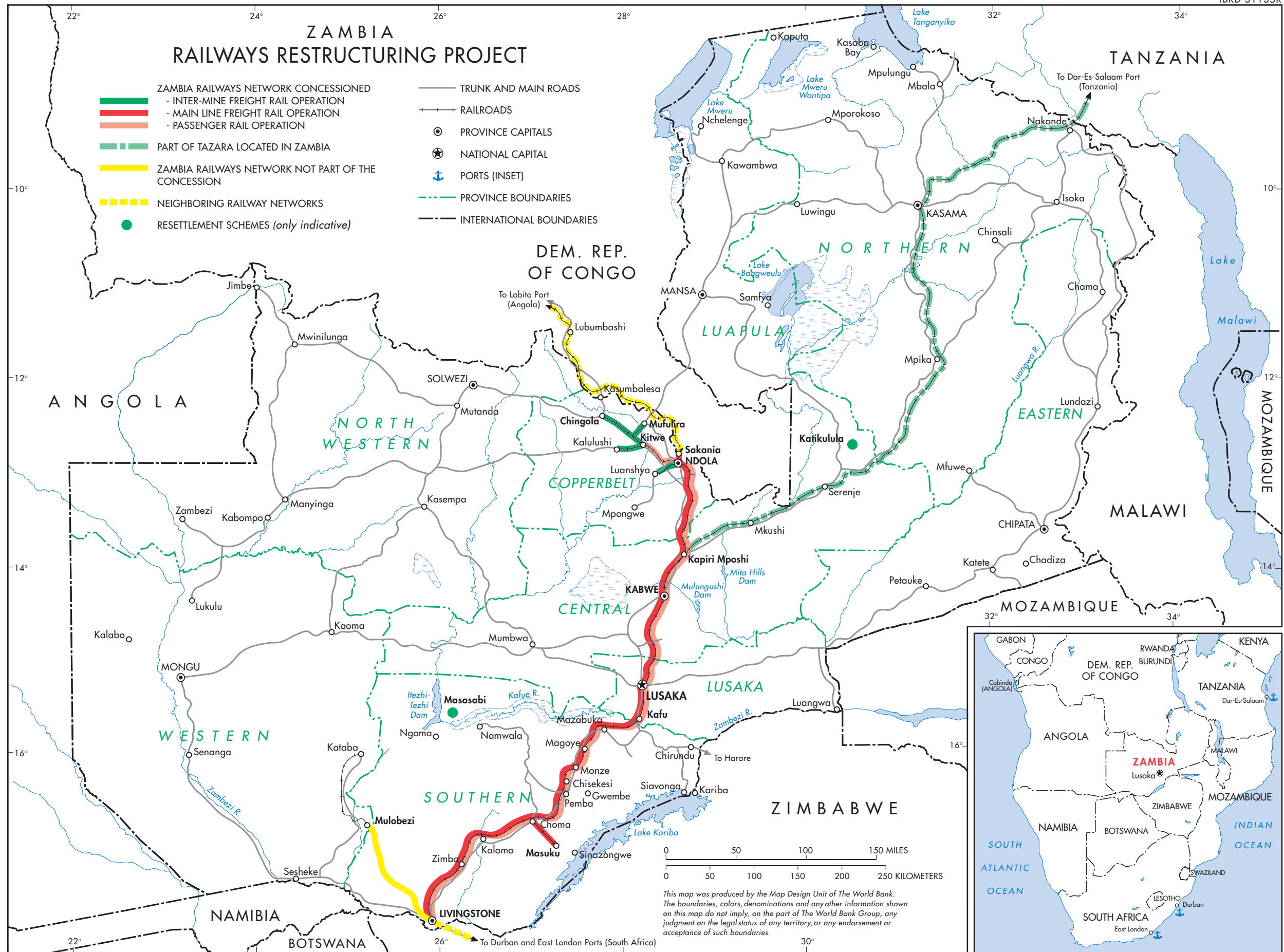
1. Review of Regulatory and Legal Framework of the Railway Industry in Zambia and the Strengthening of the Ministry of Communications and Transport. Final Report. CIE Consult. April 2005.
2. Study on the Options for Private Sector Participation in the Tanzania Zambia Railways Authority (TAZARA). Price Waterhouse Coopers. Final Report. March 2005.
3. Report on the Concessions Process, Handover, and Monitoring of the Concession of Zambia Railways' Assets and Operations. ZPA. March 2004.
4. Transport Policy. GRZ. May 2002.
5. Audit of Separation Package. Phase 1. ZRL. Grant Thornton Associates Limited. January 2001.
6. Zambia Railways Restructuring Program. Program Implementation Plan. MCT. October 2000.
7. Project Appraisal Document. Zambia: Railways Restructuring Project. The World Bank. October 2000.
8. Zambia Railways Private Sector Participation Study. Phase 2 Report. CPCS Transcom Ltd. ZPA. May 2000.
9. Zambia Railways Environmental Assessment Study. Final Report. ZPA. University of Zambia, Department of Civil Engineering. April 2000.
10. Collective Agreement Relating to Salaries, Wages and Conditions of Service. Zambia Railways Limited and Railways Workers Union of Zambia. March 2000.
11. Country Assistance Strategy for the Republic of Zambia. The World Bank. November 1999.
12. Zambia Railways Private Sector Participation Study. Phase 1 Report. CPCS Transcom Ltd. ZPA. May 1999.
13. Zambia: The Business Environment for Foreign Direct Investment in the Country's Infrastructure. Foreign Investment Advisory Service (FIAS) and International Finance Corporation (IFC). The World Bank. January 1999 (Draft).
14. Three Year Revival Plan. ZRL. Hifab and DE-Consult. December 1998.
15. Concession Options for Zambia Railways. Southern Africa Transport and Communications Commission Technical Unit. August 1998.
16. Inception Report by HiFab and DE-Consult Management Team. Zambia Railways Limited. May 1998.
17. Staff Appraisal Report. Zambia: Road Sector Investment Program. The World Bank. September 1997.

18. Implementation Completion Report. Zambia: Fourth Railway Project for Republic of Zambia. The World Bank. June 1995.
19. Zambia Railways Traffic Forecast Study. Netherlands Economic Institute. June 1994.
20. Ten Year Development Plan. ZRL. January 1990.

Additional Annex 8. MAP IBRD 31135 (Revised)

ZAMBIA RAILWAYS RESTRUCTURING PROJECT

- █ ZAMBIA RAILWAYS NETWORK CONCESSIONED
 - INTER-MINE FREIGHT RAIL OPERATION
 - MAIN LINE FREIGHT RAIL OPERATION
 - PASSENGER RAIL OPERATION
 - █ PART OF TAZARA LOCATED IN ZAMBIA
 - █ ZAMBIA RAILWAYS NETWORK NOT PART OF THE CONCESSION
 - █ NEIGHBORING RAILWAY NETWORKS
 - RESETTLEMENT SCHEMES (only indicative)
- TRUNK AND MAIN ROADS
 - RAILROADS
 - PROVINCE CAPITALS
 - ★ NATIONAL CAPITAL
 - ⚓ PORTS (INSET)
 - - - PROVINCE BOUNDARIES
 - - - INTERNATIONAL BOUNDARIES



This map was produced by the Map Design Unit of The World Bank. The boundaries, colors, denominations and any other information shown on this map do not imply, on the part of The World Bank Group, any judgment on the legal status of any territory, or any endorsement or acceptance of such boundaries.



Additional Annex 9. Partner Comments

Borrower/implementing agency

MINISTRY OF COMMUNICATIONS AND TRANSPORT

ZAMBIA RAILWAYS RESTRUCTURING PROJECT (ZRRP) IDA CREDIT 3433-ZA IMPLEMENTATION COMPLETION REPORT - MAY 2005

1. Introduction

The Project Appraisal Document (PAD) of October 2000, provided for an IDA standard credit financing to the Zambian Government amounting to US\$31 million. The Zambian Government as a borrower, appointed responsible agencies to implement the project as follows: (i) Zambia Railways Limited (ZRL); (ii) Ministry of Communications and Transport (MCT); (iii) and National Social Safety Net (NSSN). The MCT was appointed as the Project Coordinator to oversee implementation of its component and those under the other three Agencies.

2. Project Design Objectives

The project was designed based on a number of objectives as follows: -

- 2.1. Country Assistance Strategy (CAS) related objectives considered three strategic areas.
 - removing constraints to sustainable and diversified growth;
 - improving governance;
 - increasing access to basic services and direct poverty intervention. Inadequate transport infrastructure was identified as a major bottleneck for private investment and concessioning of Zambia Railways Limited was specifically identified as a priority area.

- 2.2. The project development objective was therefore to enable ZRL through restructuring and privatization, to substantially increase its operating efficiency, reduce its cost of operations, and configure its freight services and tariffs to meet customers' requirements and expectations. This would then increase its share of local, International and transit freight traffic. It was anticipated that the effort would result in: -
 - Heightening of railroad competition consequently reducing overall transport costs;
 - Balancing of the respective share of freight traffic between rail and road modes thereby reducing traffic on roads for long distance bulk traffic. This would lead to reduce budgetary provision for costly road maintenance, rehabilitation and expansions country wide;
 - ZR linked to other International railway corridors becoming more efficient and cost effective. This would lead to more trade between countries along the corridors;
 - ZR becoming self sustaining financially and be able to reward its capital providers;
 - Government reduction on budgetary deficit through receipt of concession fees, taxes and hire and lease charges;
 - Government, generating more foreign exchange through transit and International freight traffic.

3. Project components and analysis

The project has eight (8) components as follows: -

- Railway Concession;
- Zambia Railways staff rationalization;
 Staff retrenchment;
 Pension obligations;
- Assets rehabilitation;
- Environmental mitigation;
- ZRL Restructuring and winding up;
- Railways Regulatory Framework;
- MCT capacity strengthening;
- Social Mitigation;

Analysis of each component therefore provides an assessment of project performance as determined by the project coordinator.

3.1 Railway Concession (RSZ)

The concession started in December 2003 and has been in operation for approximately 15 months. Zambia Railways Limited was appointed as the monitor. The component provided financing to cover:

- Costs of advisory services to design negotiate, implement and monitor the concession agreements;
- Legal support during preparation and negotiation of concession, articles of incorporation and shareholder agreements as well as contract interpretation and dispute resolution;
- Assistance in addressing questions of concession finance, accounting, asset valuation and resource mobilization;
- Assistance in specialized technical matters including environmental issues;
- Assistance in market intelligence and assessment.

While the concession has demonstrated a considerable enhancement of performance in the past 15 months, there are still a few issues of concern. It should however be noted that the concession in the railway sector is the first experience of this kind and provides a number of learning lessons: -

- Lack of agreed monitoring schedule framework or procedures between RSZ and the Government Inspector of Railways GIR under ZRL. This caused considerable friction between RSZ and the monitors in their efforts to manage the concession; However, this is being addressed and confidence is slowly building between RSZ and ZRL/GIR. The schedule is now being considered by both ZRL and RSZ;
- RSZ not adhering to concession agreements regarding to timetable for effective rehabilitation of the main railway track. The quick fix approach for trouble spots is inadequate to meet the desires as agreed in the concession. May be the concessionaire was a bit ambitious in its negotiating strategy;
- Limited investment in rolling stock maintenance leading to obsolete wagons and passenger coaches;
- The market share of RSZ to International rail freight traffic is uncertain due to the lack of

agreement between TAZARA and RSZ and the upcoming direct threat to loss of freight traffic to the proposed Chipata/Mchinji railway and the North Western railway lines when they become fully operation in approximately 36 months;

- Other ideas are floating to build a spur between Ndola and Serenje just to avoid unfavorable business conditions offered by RSZ between Ndola and Kapiri Mposhi;
- The concession fees so far paid by RSZ to GRZ only constitute 50% of total amount that should have been paid at this point in time;
- Passenger services on the main line between Kitwe and Livingstone are not regular as agreed due to lack of security especially between Choma and Lusaka, and Kapiri-Mposhi and Ndola during the night;
- Freight and passenger trains travel at very low speed leading to slow turn over of goods and services between Kitwe and Livingstone;
- The analysis of the ZRL in part 11.2, 13.0 and 14.0 are fully supported. However, considering the problems faced in the ongoing implementation of the concession, it is quite clear that Zambia had a raw deal in concessioning the railway line;
- Regarding participation of Zambia Privatization Agency in the Concessioning process and the subsequent out come agreement, it appears that ZPA did not at the time of negotiating the concession have adequate capacity to closely scrutinize the clauses especially regarding how such clauses would impact on the Zambian economy and the investor's economic interest. It appears, there was too much leeway in favor of the investor in coming up with the concession agreement. This is a lesson that needs to be considered in all future concession negotiations.

3.2. Zambia Railways Staff rationalization

At the beginning of project, ZRL had a staff strength of 3,300 employees out of which 800 were taken or employed by the concessionaire, and 2500 were retrenched. 25 continued with ZRL ongoing. This component has two sub-components:

- staff retrenchment;
- pension obligation.

The component was implemented by ZRL and provided funds for severance packages of retrenched staff. GRZ had to meet the pension scheme obligations.

Analysis:

The analysis made by ZRL in part 5.0 is fully supported. However, the number of outstanding court cases for residual payments and sale of housing units is a source of concern. ZRL will still be held liable to meet the outstanding costs to these cases. The component therefore performed satisfactorily.

3.3. Asset Rehabilitation

This has substantially been done. RSZ though need to decide what to do with scrap metal and other disused assets that they don't wish to maintain. This component was substantially and satisfactorily completed.

3.4 Environment Mitigation

This component was implemented by ZRL and was provided to procure pollution control equipment especially in the areas surrounding the ZRL workshops. The exercise required preparation of an Environment Management Plan, buying and Installation of pollution control equipment and specialized services for cleaning of all contaminated sites.

The component has substantially been completed although minor work still needs to be done i.e.:

- Complete cleaning the contaminated sites especially at the railway workshops yard;
- Installation of fume extraction at the workshops;
- Equipping of oil separators at the workshops site in order to avoid direct pollution of river systems close to the site.

3.5 ZRL restructuring and winding-up

This component deals with remaining works after restructuring of the ZRL and concessioning of the main line. These include:

- Maintenance of office structures, plant and equipments, disposal and account of residual assets;
- Procurement of accounting and mechanical software for use in Monitoring the concession;
- Procurement of equipment and staff training;
- Plan for management and maintenance of the Victoria Falls Bridge.

This component was satisfactorily completed. It is hoped that by end of project in June 2005, the consultants engaged to assess the integrity of the Victoria Falls Road/Rail Bridge would have completed the works and a decision made on the way forward. It is also not clear whether the monitoring soft ware has been procured, installed and applied.

3.6. Railway Legislation and Regulatory Framework

This component was implemented by the MCT together with ZRL. The component provided for a study to assess and identify the effectiveness of the existing scope, functions, and instruments for the economic regulatory frame work, recommend the sectoral coverage and accountability relationships for the regulatory institutions; to define the staffing, internal organization, operating costs and financing mechanisms for a new safety and environment – related regulatory agency and to prepare supportive legislation, provision of plant and equipment and staff training.

This component has been substantially completed. The study has been done and final report submitted to MCT by CIE consult in April 2005. Although the original plan was aimed at implementing the recommendations of the study within the project period, this is not possible due to delays in completing the study. A decision will soon be made to plan for the implementation of recommendations there in. The report in summary presents:

- An overview of the agencies currently and potentially involved in the railway sector in Zambia, including proposals for the licensing of Railways operators and regulations of the railway safety;
- Discussions on the need for railway sector specific economic regulation and application of environmental regulation to the railway sector, including the role that can be played by the Zambia Competition Commission and the Environment Council of Zambia;

- An outline of the existing legal framework and a draft new forward-looking railway legislation that caters for a liberalized sector that encourages private sector participation; and
- Arrangements for concession monitoring and a review of the capacity skills and training requirements of Ministry of Communications and Transport with special reference to the Planning Unit.

3.7. Ministry of Communications and Transport Capacity Strengthening

This component was implemented by the Ministry of Communications and Transport and covered the following aspects: -

- Review and define the framework for developing and overseeing transport policy;
- Define the new functions of the Ministry of Communications and Transport to discharge its role;
- Assess Ministry of Communications and Transport's organizational structure in the framework of its evolving role;
- Determining staffing requirements taking into account Government Civil Service reform program;
- Consultancy services and office equipment.

The component is related and is partly covered by works/studies done under the Railways Regulatory framework component. The computer networking of all its major offices will assist to properly maintain a transport database in the country. The facility will assist monitoring trends in implementation of the transport policy and further facilitate internet for ease of access to information and communication amongst the staff.

The Transport and Communications sectors are undergoing structural reforms. The new functions of the Ministry of Communications and Transport together with its organizational structures will therefore finally be determined after completion of the reform process. Staffing requirements will thereafter be decided and placements carried out. The Ministry of Communications and Transport, has however, procured a number of plant and equipment for an effective operation. These will largely be used by the planning department and the Government Inspector of Railways. A plan to procure additional plant, equipment and furniture is being implemented.

On staff capacity building, the Ministry of Communications and Transport has trained over 90 members of staff in various disciplines relevant to its operation.

The component can therefore be considered to have performed quite satisfactorily.

3.8. Social Mitigation

This component was implemented by the National Social Safety Net (NSSN) Department under the Ministry of Labour and Social Security. The component provided support for mitigating the impact of retrenching the Zambia Railways Limited employees using results and recommendations of a major social mitigation assessment study. Counseling was done well in advance of actual retrenchment using experienced professional organizations. Retrenched workers were retrained and prepared for alternative employment. Those who opted to resettle on land were assisted.

A number of former Zambia Railways Limited workers benefited in social counseling (932); small business awareness (632) out of which 533 underwent entrepreneurship training; Agriculture based training (330); 510 underwent vocational training and 224 were allocated land to settle. 10 boreholes were sunk and are under use while two feeder roads are being fully rehabilitated.

Once the feeder roads are done, the component could be said to have performed satisfactorily.

4. Conclusion

The project implementation period underwent very trying moments especially at the beginning when there was a strenuous political climate in the country. The policy shift towards privatization of state enterprises was however a major booster towards concessioning of the railway line. The concessioning process being the first of its kind in the sector proved quite challenging especially for the Zambia Privatization Agency. The country at the time lacked competent capacity to negotiate for a better concession deal. Some of the currently observed shortcomings in the implementation of the concession are as a result of short sightedness on the part of the negotiating team regarding what the country would benefit from the concession. However all other components of the project performed quite satisfactorily.

The project was however implemented in accordance with the set objectives and in line with both Government and World Bank standard project implementation frameworks. Capacity building for negotiating such a concession is a must and must be encouraged in all future development programs involving private sector participation.

It is therefore recommended that the little savings towards the end of the project be ploughed back to strengthen operational capacity of the Ministry of Communications and Transport especially the Government inspectorate unit and the Planning Department.

The few areas of action that were not completed within the project period need to be identified and actioned by ZRL in conjunction with MCT. This may entail budgetary provisions in the 2006 national budget.

Additional Annex 10. Additional Information

Zambia Railways Concession

Background: Zambia Railways Limited was formerly the North-Western Region of Rhodesia Railways with its regional headquarters at Kabwe, while the company's headquarters was in Bulawayo I Southern Rhodesia, now Zimbabwe. The construction of the railway line started at the Victoria Falls Bridge back in 1903 at the border with Zimbabwe, and was connected to what is now the Democratic Republic of Congo (DRC) in 1909. In 1967, the Zambian government passed the Zambian Railways Act, which gave birth to the Zambia Railways Board. In 1978, the government decided that Zambia Railways should transfer to Zambia Industrial and Mining Corporation (ZIMCO) with effect from January 1979. This transfer required the incorporation of a new company limited by shares and the dissolution of the Zambia Railways Board. In 1982, the Railways Act vested all assets and liabilities of Zambia Railways Board into Zambia Railways Limited (ZRL), a company incorporated under the Companies Act of Zambia. The transfer provided greater autonomy to ZRL to take its own managerial decisions and to determine its own tariffs. The mission of the company was to provide effective and efficient freight and passenger rail services operated on commercial principles.

Railway Performance: Traffic volumes of ZRL have been falling for many years. Freight traffic exceeded 6 million tons in 1975, representing over 1.4 billion net ton-kilometers (net ton km). By 1988, traffic levels had declined to 4.5 million tons, and by 1998 to 1.4 million tons. The decline in traffic volumes was attributed mainly to the inefficiency, excess employment, low productivity, waste, poor management of train operations, lack of incentives, and inadequate accountability of staff normally associated with state owned railway enterprises.

Linkage to the Country Assistance Strategy: The 1999 Country Assistance Strategy (CAS) addressed three strategic areas, based on consultations with the Government of the Republic of Zambia as follows: (i) the removal of constraints to sustainable diversified economic growth; (ii) improved governance; and (iii) better access to basic services and direct poverty interventions. Excessively high transportation costs due to poor transport infrastructure was particularly noted as one of the major impediments to private sector investment and growth. Government particularly identified Zambia Railways Limited, a state railway transportation enterprise as one of the priority entities which required privatization. In line with the CAS, and the government's own policy of economic liberalization and divesting of state owned enterprises (SOEs), the government approved the privatization of the Zambia Railways Limited in March 2000.

Concession Structure: The proposed concession model was a vertically integrated, but fragmented into geographical and business segments as follows: (i) *Package A*- short haul inter-mine Freight Services, encompassing lines running between mining towns: from Kitwe to Chingola, Chililabombwe, Mufulira,, and from Ndola to Luanshya, with access rights on the mainline from Kitwe to Ndola. This was to be a twenty years (20) concession with two possible extensions of five (05) years each, to bring the total possible concession duration to Thirty (30) years; (ii) *Package B*- long haul mainline freight services, encompassing the current mainline running from The Zimbabwe boarder to Kitwe, and from Ndola to Sakanian to the border with the Democratic Republic of Congo, including the branch line from Choma to Masuku. This was to be a twenty years (20) concession with two possible extensions of five (05) years each, to bring the total possible concession duration to Thirty (30) years. Bids for package B were required to also bid for passenger services, package C, as described below; and (iii) *Package C* - Passenger Services between Livingstone and Kitwe. Bidders were allowed to bid for package C alone. However, any bid for package B were to also include a bid for C. This was to avoid a situation where no bidder would have bid

for C. The concession period for this concession was to be seven (7) years with two possible extensions of two (2) years each, to bring the total possible concession to eleven (11) years.

The main features of the concession were: (i) that the concession would include infrastructure as well as an identified number of core operating assets such as locomotives, wagons, workshop equipment, etc; (ii) infrastructure and core operating assets would be owned by Government or an asset holding company, but maintained and rehabilitated by the concessionaire during the period of the concession; and (iii) at the end of the period, the track, rolling stock, land and buildings along with the other fixed railway infrastructure will revert to the Government. Mulobezi branch, which runs from Livingstone to Mulobezi, was not included in the concession packages, as it was deemed to be un-attractive at the time, and would have only reduced the attractiveness and value of the concession, if included.

Concession fee structure: The proposed concession fee structure comprised: (i) a one off entry concession fee of USD250,000.00 for package A, USD500,000.00 for package B, USD750,000.00 for package A+B. (ii) variable concession fee of 5% of total annual revenues; and (iii) a fixed annual concession fee for each year of the concession term, which was to be proposed by the bidders. The bidder was not required to pay either an entry or variable concession fees for package C.

The Selection Process: The Zambia Railways Concession was advertised in both local and international print media including Internet on July 4, 2001. During the tender period, 8 prospective bidders purchased bidding documents at a cost of \$5,000. A bidders' conference was conducted on August 28, 2001 at which all issues relating to the bidding documents and the concession were clarified. The final bidding documents were issued on September 21, 2001. On December 7, 2001, the tender closed and four bidders submitted technical and financial proposals as shown in table below.

Table 1. Prospecting Concessionaire Participating

	BIDDER	Package A	Package B	Package C	Package A+B
1	Edlow Resources (Bermuda)	X	X	v	v
2	Sheltam Group (South Africa)	v	v	v	v
3	CANAC (Canada) in cooperation with Norconsult (Norway)	X	X	v	v
4	New Limpopo Bridge Project Investments Ltd. (NLPI) and Spoornet (South Africa) Consortium	X	X	v	v
v	Bid submitted for the package				
X	No bid submitted for the package				

Technical and Financial Evaluation: Two bidders obtained the minimum score to pass the technical evaluation. These were CANAC/Norconsult and NLPI/Spoornet. The financial proposals of the two qualified bidders were opened on January 18, 2002. NPLI/Spoornet offer to pay GRZ a total of \$253.5 million spread over a period of 20 years in respect to the freight packages A+B; and a negative inflow of \$7.4 million for package C for a 7-year period. CANAC's offer reached \$20.9 million for the freight packages A+B and a negative inflow of \$16.7 million for package C for a 7-year period.

Negotiations and Signing: Zambia Privatization Agency Board appointed an independent negotiating team chaired by the Deputy Vice-Chancellor for the Copperbelt University. The legal advisors were Linklaters and Alliance of the United Kingdom and the railway concessioning experts were from CPCS Transcom of Canada. Local advisors included a financial expert from DCDM Consulting of Lusaka, Director of

Planning from the Ministry of Communications and Transport, a senior legal expert from the Attorney General's Chambers, and senior ZPA technical staff. Negotiations commenced with NLPI/Spoornet Consortium on February 13, 2002 while the bid by CANAC/Norconsult was put on reserve. The freight concession agreement was cleared by the Attorney General and signed by Honorable Minister of Finance and National Planning, ZRL, NPLI and RSZ, the concessionaire, on February 14, 2003, while the passenger concession was signed on August 8, 2003.

Financial Closure and commencement of operations: The closing of the transaction, including the legal formalities and completion of conditions precedents, took place on November 25, 2003 and the concessionaire RSZ took over both the freight and passenger operations on December 3, 2003. RSZ paid the entry fee of \$750,000. The concessionaire will be paying concession fees of 5% of revenue (variable fees) on a quarterly basis. In addition, the concessionaire will pay pre-agreed fixed concession fees (fixed fees) amounting to \$253 million spread over a period of 20 years. The fixed concession fees will be payable annually at the anniversary of the concession.

Railway Systems of Zambia is owned by a consortium consisting of the following companies as presented in the concession agreement: (i) New Limpopo Project Investors (NLPI); (ii) Mr. Mordechai Tager Israeli/UK; (iii) Elani Family Trust Israeli/UK; (iv) Sanlam Insurance South Africa; (v) Old Mutual Assurance South Africa; (vi) Nedcor Bank South Africa; (vii) Spoornet South Africa.

Bank guarantees and investment commitments: As part of the concession agreement signed, the concessionaire submitted two bank guarantees of \$2 million and \$125,000 for the freight and passenger concession agreements, respectively. The guarantees will be released after RSZ has invested a total of \$15 million in the track, rolling stock and railway equipment within the first five years.

Performance of the Concession: The railway concession was awarded in December 2003, and the concessionaire has now been in operation for more than a year. During the first twelve months of operation, the concessionaire experienced several startup problems, and the level of investment on periodic maintenance and rehabilitation of the main line has been modest and did not reach the level expected by the government. However, in 2004, the concessionaire was able to increase the net ton kilometer of traffic in comparison to the 2003 base year. With the opening up of the copper mines in the north western province, and the increasing copper production on the Copper belt, there are now greater prospects for the concessionaire to scale up traffic tonnage in the short to medium term. It is too soon to properly assess the performance of the concession, though the prospects of achieving a competitive and safe rail service provided by a private operator are very good.

Key Characteristics of the Railway Line

- Gauge 1,067 mm
- Route Length 1,266 Km
- Number of Interchange Stations 3
- Number of Goods Stations 20
- Number of Private Sidings 205
- Number of Marshalling Yards 6
- Freight services and rolling stock included: general purpose wagons, covered wagons, containers, tank wagons, and livestock wagons.
- Signaling and Telecommunications. The main line between Livingstone and Kitwe was controlled by means of a microprocessor-based Centralized Trains Control (CTC) system from a control centre in Kabwe

- Motive Power. The company owned 59 main line and 12 branch line/shunting diesel electric locomotives of 2,150 hp and 1,650 hp rating respectively. Of the total number of locomotives about 45 were active in 2000.
- Workshops. The central workshop located at Kabwe was reasonably equipped with general and specialized equipment for performing heavy repairs and overhauls of rolling stocks. It also carried wagon assembly works. Minor and running repairs were done at line points.

Staff Rationalization: The objective of this component was to ensure that retrenched employees from ZR are timely and adequately paid their severance and pension packages. The component was to be implemented by ZR, and had two subcomponents as follows:

Staff Retrenchment - Based on ZR railway operations experience at the time of project appraisal, and as confirmed by the consultants who undertook the Private Sector Participation Study, it was estimated that, the concessionaire would engage between 800 to 1800 staff of the 3,300 staff as at March 2000. To be on the safe side and avoid the situation of shortfall of funds to finance retrenchment, the allocation of funds for this component was based on an estimated staff compliment of 900 by the concessionaire and a corresponding staff retrenchment of about 2,400 staff. In 2000, ZR had negotiated with the RWUZ a retrenchment package which comprised 3.2 months of salary for every year of service. Using this package and assuming that all staff (3,300) would be retrenched, Zambia Railways Limited had estimated the cost of retrenchment to be about US\$21.0 million. The proportionate cost of retrenchment of 2,400 staff was estimated to be about US\$15.2 million. In addition, a contingency of 15% was provided to cope with any variations in the package or the number and categories of staff to be retrenched. The sequence of retrenchment, as developed in agreement with ZPA, ZR and the government was as follows: (i) 700 staff would be retrenched immediately after the credit became effective; and (ii) the remaining staff would be retrenched after the Concessionaire was in position and had selected the required staff. The criteria to be used for identifying surplus staff was already agreed with the union as follows: (a) the Concessionaire was to select the staff required from among the ZRL staff; and (b) the remaining staff were to be retrenched after the concessionaire had selected the staff according to his requirements.

Pension Fund Obligation – Over several years, ZR had defaulted on transferring pension contributions of staff to the Pension Fund. Consequently staff who were entitled to pension Benefits under the Zambia Railways Pension Rules (either a refund of contributions or a deferred pension on reaching the retirement age), could not be paid their dues by the Pension Fund. The responsibility for this accumulated liability rested upon ZR. It was quite certain that the retrenchment efforts would have been stalled unless ZR met this liability prior to commencement of the retrenchment process. ZR assured that the balance of about US\$1.0 million equivalent would be paid to the Pension Fund by December 31, 2000, and the remaining areas of about US\$0.7 million would be paid within six months of the credit effectiveness by April 2001. This liability was met by ZRL prior to the commencement of the concession.

