

**PROGRAM INFORMATION DOCUMENT (PID)  
APPRAISAL STAGE**

Report No.: AB6337

<b>Operation Name</b>	First Programmatic Railway Sector Development Policy Loan
<b>Region</b>	Europe and Central Asia
<b>Country</b>	Bulgaria
<b>Sector</b>	Railways (100%)
<b>Operation ID</b>	P124868
<b>Lending Instrument</b>	Development Policy Lending
<b>Borrower(s)</b>	Republic of Bulgaria
<b>Implementing Agency</b>	Ministry of Finance & Ministry of Transport, Information Technology, and Communications
<b>Date PID Prepared</b>	March 7, 2011
<b>Estimated Date of Appraisal</b>	March 8, 2011
<b>Estimated Date of Board Approval</b>	May 17, 2011
<b>Corporate Review Decision</b>	Following the corporate review, the decision was taken to proceed with the preparation of the operation.

**I. Country and Sector Background**

1. *Bulgaria implemented during the years leading up to European Union (EU) accession reforms that laid the foundations for a competitive railway industry and aligned the institutional and legal framework of the Bulgarian rail sector with those of the EU.* Railway services are vertically unbundled. The public railway infrastructure is managed by the National Railway Infrastructure Company (NRIC), and railway transport services are provided by the state-owned Bulgarian Railways Company (BDZ EAD) and several private rail freight operators. A track access charge system enables market access to rail infrastructure and allows some cost recovery. Public service contracts for passenger services make state contributions to the sector explicit and targeted. This industry structure provides the basis to develop transparent relationships between the state as policymaker, regulator, client, and owner on one hand, and the various rail service providers including NRIC and BDZ EAD on the other hand. These reforms coincided with a sustained period of economic growth in Bulgaria and increased business for railways, which enabled the Government to increase its railway funding, decreased the sector's threat on Bulgaria's fiscal position—which was a serious issue in the late 1990s and early 2000s—and by the end of 2007, NRIC and BDZ EAD's accounts were still fragile but balanced, and historic arrears were cleared.

2. *Past railway reforms were extensive, but they stopped short of addressing the sector's difficult and complex structural issues which continue to threaten the sector's sustainability and pose serious threats to Bulgaria's fiscal balances.* Railways in Bulgaria suffer from low asset and staff productivity—less than a third of the EU's average productivity—and from the legacy of an extensive railway network developed during the planned economy that has yet to be adjusted to current market conditions. This not only generates high fixed costs to the railway industry, making it less competitive vis-à-vis road transport, but also leads to higher costs to taxpayers, and misallocation of scarce public resources. For example, the level of state financial contributions to railways has been in line with EU practices for new member states at about 0.4 percent of GDP, but they are predominantly used for operating subsidies—mostly labor cost—with little or no money for maintenance, renewals, or investment. State contributions increased in relative terms during the global financial crisis to 0.6 percent of GDP in 2009 and 2010.

3. *The global financial crisis of 2008-2009 caused a major setback to the very fragile financial stability of Bulgaria's railway industry.* Since mid-2008, the financial situation of railways in Bulgaria significantly deteriorated due to the global financial crisis which led to a collapse in freight volumes and to

the bankruptcy of one of BDZ EAD's major clients—Bulgaria's largest metalworking company Kremikovtzi. The combined passenger and freight traffic in 2009 and 2010 contracted by more than 40 percent from 2007 levels. NRIC and BDZ EAD had severe short term cash problems in 2009 and 2010, including problems to fund their operations. As of December 2010, BDZ EAD had significant short term account payables to debt holders, NRIC, and other suppliers.

4. *While Bulgaria has made some progress in railway reform, the Government recognizes that deepening these reforms has become more urgent than ever, and it has developed a Government Railway Reform Program aimed at establishing a financially sustainable railway sector.* The Government recognizes that postponing decisions to make railways in Bulgaria a viable and flexible industry that adapts to the changing market demand would only increase the risk that railways in Bulgaria may suffer rapid decline and collapse, which would not only be costly—to the economy as a whole, to businesses, and to taxpayers—but also socially disruptive given the large workforce in railways and in the industries that rely on railway services. The Government has therefore developed the Railway Reform Program (GRRP) drawing upon BDZ EAD and NRIC's plans for internal restructuring and reorganization, which were started in 2010. The GRRP has two pillars that address two fundamental issues:

- **Enhance railway sector governance:** This first pillar covers the expectations of public policies for railways, their implementation and funding, and the accountability mechanisms of the various stakeholders. The Government plans to enhance sector governance under the GRRP through: (i) better policy and strategy formulation that is consistent with market demand and budgetary constraints; (ii) better contractual relationships between the state and service providers, with coherent strategic direction, commercial incentives, fair compensation, and adequate cost recovery mechanisms; and (iii) more transparent roles of the state in the competitive rail freight market.
- **Improve corporate governance, management and performance of railway service delivery** by the two state-owned companies NRIC and BDZ EAD in order to provide value-for-money to the state. The GRRP includes actions to: (i) enhance the corporate governance of BDZ EAD and NRIC so that the roles of the Boards of these companies are improved and higher standards for business planning, transparency and accountability are adopted; (ii) strengthen the commercial management of BDZ EAD and NRIC through internal organizational restructuring of both BDZ EAD and NRIC, including the financial restructuring of BDZ EAD. In addition to streamlining the lines of business within BDZ EAD and cost centers within NRIC, the GRRP is expected to support staff and asset restructuring within the two companies; and (iii) enhance corporate social responsibility through the mitigation of social impacts of staff reduction, and develop human resources management to support development of railway staff capacities, encourage merit-based selection and performance contracts for management.

5. *Under the leadership of the Government, strategic investments and technical activities have been mobilized to support railway reforms.* Key to the future of railways in Bulgaria are the strategic investments on European corridors supported by the EU Cohesion Fund. These investments should bring railway infrastructure closer to EU standards. The Government has made considerable efforts to increase the absorption capacity of these funds. The Government additionally requested the World Bank to support the implementation of the Government Railway Reform Program, given World Bank's technical expertise in railway reforms.

## II. Operation Objectives

6. *The development objective of the Railway Sector DPL Program (DPL Program) is to support the Government in initiating the implementation of the Government Railway Reform Program aimed at establishing a financially sustainable railway sector in Bulgaria.* The Government Railway Reform

Program would ensure that public financial support to railway infrastructure and passenger services are consistent with transport market demand, European Union transport policies, and Bulgaria's prudent fiscal policy; and that the state receives value-for-money from service providers in return for that support. The Government recognizes that the World Bank can play a critical role in supporting Government actions to solve the complex problems facing railways in Bulgaria and in sustaining commitment toward effective reform of the sector, and that a DPL program is the best suited instrument to structure such commitment. The overall benefits expected from the DPL Program are related to (i) preventing an abrupt collapse—or slow decline at extremely high costs to taxpayers—of the railway industry in Bulgaria, and (ii) building sound foundations for the railway industry.

7. ***The proposed DPL would be the first in a programmatic series of three single-tranche DPLs (the DPL program).*** For operational purposes, the DPL Program is built around the two pillars of the Government Railway Reform Program: (i) Railway sector governance, and (ii) Corporate governance, management, and performance of railway service delivery. For each of these areas, the Government has identified the needed policy decisions and key actions in line with the issues identified in the Government Railway Reform Program.

### **III. Rationale for Bank Involvement**

8. ***The Government specifically requested the World Bank's worldwide railway sector and economic policy expertise to help it implement solutions to the complex issues facing and stemming from the railway sector in Bulgaria.*** While Bulgaria has secured grant funding from the EU's Cohesion Fund for the development of railway infrastructure in Bulgaria under the Sector Operational Program for Transport (SOPT), the fundamental problems facing the railway industry pose serious threats to the future of railways in Bulgaria and may put into question the sustainability and justification of investments under the SOPT. Investment funding is a necessary condition for the survival of the railway sector, but it is not sufficient. The fundamental structural issues facing railways in Bulgaria have extensive ramifications that go beyond the transport sector with social and fiscal implications, and they require complex policy and institutional solutions. The Government has therefore requested World Bank support and expertise as it develops solutions to achieve its goal of a financially sustainable and viable railway industry in Bulgaria. The World Bank has already accumulated global knowledge on railways in the region and worldwide, and it has extensive experience in helping governments implement multi-year development policy programs that bring together various stakeholders from several fields and sectors. The EU is planning to make available some EUR 600 million for the railways sector in Bulgaria under the SOPT if the reforms adopted establish a sound basis for such investments. World Bank partnership with Bulgaria on the railway sector's structural issues is complementary to the traditional partnership between Bulgaria and the European Commission and European institutions such as the European Investment Bank, who remain Bulgaria's main financiers for railway sector's investments, particularly through the structural funds. The proposed GRRP is also being reviewed by the European Commission as part of its policies on State Aid.

9. ***The DPL Program is also being prepared in parallel with a World Bank investment loan for NRIC to support the modernization of infrastructure maintenance and operations, which is expected to support the DPL Program and complement the investments under the EU-funded SOPT.*** Investments that are critical to sustain the DPL Program's impacts after its completion and that are not eligible for funding under EU programs will be undertaken under the proposed Railway Infrastructure Rehabilitation Project to be presented to the Board at the same time as the present DPL. The development objective of the proposed Railway Infrastructure Rehabilitation Project is to improve the quality and efficiency of railway infrastructure services in Bulgaria. The proposed loan amount is EUR 70 million, and it would finance the acquisition of railway infrastructure maintenance equipment for NRIC. This proposed investment loan will provide NRIC with the necessary tools to implement higher efficiency maintenance working procedures and to reduce NRIC's operating costs, as well as to enhance the safety of railway operations, and improve the working

conditions of railway maintenance staff. Improving NRIC’s operational practices will also benefit investment modernization projects implemented under the EU-funded SOPT, which are expected to bring Bulgaria’s railway infrastructure along European corridors to higher technical standards.

10. *The proposed Bank involvement is consistent with the country partnership strategy being developed concurrently and with the principles of cooperation between the Bank and Bulgaria outlined in the Memorandum of Understanding signed in August 2010.* This memorandum outlines the wish of the government to get Bank support through financing and technical assistance in key sectors including the restructuring of the railway industry.

#### IV. Tentative financing

Source:	(EUR m.)
Borrower	0
International Bank for Reconstruction and Development	80
Total	80

V. **Tranches** (if applicable)  
N/A

#### VI. Institutional and Implementation Arrangements

11. *The Ministry of Transport has overall leadership for the formulation of the Government Railway Reform Program and follow-up of its implementation in close coordination with the Ministry of Finance.* A Working Group was appointed in September 2010 to oversee the development and implementation of the Government Railway Reform Program and to report on a monthly basis to the Government. The Working Group is co-chaired by a Deputy Minister of Transport and a Deputy Minister of Finance and includes management and senior officials in the Ministry of Finance, the Ministry of Transport (MOT), NRIC and BDZ EAD. The MOT will play an important role to monitor the DPL Program’s implementation and to help coordinate the strategies and activities of the various stakeholders involved in the DPL. NRIC and BDZ EAD will be responsible for the technical implementation of the reforms. World Bank supervision of the DPL Program will allow the Bank to continue providing policy advice and technical support to the Government departments and institutions involved in the implementation of the sector’s reform program.

#### VII. Risks and Risk Mitigation

12. Four key risks to delivering the DPL Program’s results are identified:

- i. **Macroeconomic management risks.** These include external and domestic risks. Elements mitigating these macroeconomic management risks include: (a) Bulgaria’s solid track record of fiscal discipline and ongoing reforms implementing fiscal consolidation; and (b) well capitalized and solid level of provisions in the banking sector.
- ii. **Slow implementation risks.** Railway reforms have proven to be difficult worldwide, requiring many years and strong political commitment to accomplish. Risks exist that the DPL Program may proceed somewhat slower than planned. The Government is addressing the slow implementation risks by developing a program of social impact mitigation measures for railway workers, by investment and maintenance mechanization for railway infrastructure in Bulgaria to improve the quality and safety of railway services.
- iii. **Regional economic setback risk.** Should the region’s economy slide back into recession, the pace at which the railway sector in Bulgaria could achieve financial sustainability would be slowed. Progress

toward financial sustainability under the DPL Program would continue to occur, but the point in the program when financial sustainability would be achieved could be delayed. The change in the business culture expected under the DPL Program and the business flexibility that the initial policy actions will provide to railway management should help mitigate this risk.

- iv. **Coordination risks.** Risks exist that the actions to support the reforms, needed from multiple parties, could be poorly coordinated. This risk of poor coordination is mitigated by the commitment of the Government, through the Ministry of Transport—while it also serves as the managing authority of EU funds—and it is setting up appropriate critical resources to ensure the role of the government in its capacity as owner of operators and service purchaser of railway services.

## VIII. Poverty and Social Impacts and Environment Aspects

### *Poverty and Social Impacts*

13. ***A successful railway sector reform program will bring a number of positive social impacts.*** These include: (i) improved quality and safety of service when cost savings are redirected towards improving transport services for passengers and businesses; and (ii) benefits to taxpayers by ensuring a better and efficient use of scarce budgetary resources that are channeled to the railway sector each year. In addition, support for the restructuring of BDZ EAD and NRIC aims at preventing the collapse of the railway sector in Bulgaria, which would have a much more palpable impact on the public that use railways, rail freight customers, and BDZ EAD and NRIC's 31,000 employees (2009 figures).

14. ***The risk of negative social impacts from the proposed operation are likely to result from the reduction of staff, and the disruption of service for railway users on low-utilized lines where service may be reduced.*** Railways have traditionally been one of the largest employers in Bulgaria, their restructuring, related to staff downsizing and reduction of lines, has naturally been socially and politically sensitive.

15. ***Reduction of staff in the railway sector has been gradually conducted since the mid-1990s.*** Between 1995 and 2001 BDZ (then combining both NRIC and BDZ EAD) staff was reduced by 37 percent. The average number of staff in BDZ EAD and NRIC combined was reduced by 2,300 in 2009 and by 2,500 in 2010.

16. ***Bulgaria's Labor Code and collective labor agreements in the railway sector have a strong system of protections against dismissal as well as obligations on the part of the employer to assist in finding alternative employment.*** Bulgaria's Labor Code mandates that, when provided for in the collective labor agreement, dismissal of trade union members may only occur with union consent. Additional permission by the Labor Inspectorate is required in special cases. Generous collective labor agreements for railway union members are an additional source of protection.

17. ***Mitigation measures in case of layoffs due to redundancy are formally provided for in the collective labor agreements for trade union members.*** The employer is required to contribute to the social integration of laid-off workers by redirecting them to other vacancies in the company or organizing and financing re-training courses. The capacity of BDZ EAD and NRIC to provide training is limited to the railway sector. Therefore training and placement services in other areas of the economy will be coordinated with other agencies including the Ministry of Labor and Social Policy (MLSP), the Employment Agency, and the Social Assistance Agency.

18. ***The Government, through the MOT, MLSP, MOF, BDZ EAD and NRIC, is finalizing the action plan for assistance to laid-off staff.*** The Government is finalizing the action plan, which includes assistance measures to released staff as well as opportunities for increasing qualifications of remaining staff, institutional roles and responsibilities for these measures. The assistance measures also cover temporary continuity of key

benefits or access to key services such as housing, health, re-training and placement assistance where relevant.

19. *Impacts associated with the reduction or closure of railway services are relevant for the medium and long-term of the DPL Program.* Analysis of the railway lines that might be closed under the first DPL shows that there have been no railway services on these lines in the past few years—although they have been kept open and maintained—and therefore their closure will not have any major impact. The lines that might be selected by the Government for closure in the second and third DPLs will have very low traffic. It is expected that there will be minimal impacts of closure of these lines with respect to services based on the understanding that: (a) lines/services to be cut are barely used and unattractive to most travelers; (b) bus services are available for most routes that will be cut that are more convenient, comfortable, and at no extra cost; and (c) if bus services are not available, then the adjustment to the Public Service Contract envisaged under the DPL Program will require that that alternative services are put in place in a way that ensures no loss of access for those populations.

### ***Environmental Aspects***

20. *The reforms proposed to be supported under the DPL will have significant positive effects on the environment and very little negative effects.* By nature, the reforms will mainly have positive impacts on the environment and health as a result of the development of the necessary institutional and regulatory framework for the proper functioning of the railway industry. This will enhance the efficiency and safety of railway transport services and infrastructure, prevent modal shift to road transport, and therefore improve air quality and help reduce greenhouse gas emissions. In the absence of the reforms supported under the DPL, railways in Bulgaria may suffer rapid decline, causing Bulgaria to lose an environmentally friendly mode of transport, on which the EU and Bulgaria have put high expectations to help the EU meet its climate change commitments.

## **IX. Contact point**

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