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A New Approach to Restructuring Railways in Sub-Saharan Africa

Concessioning of Rail Transport

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The concessioning of rail operations is a partnership between the state and a private operator (the concessionaire) in which, while maintaining ownership of rail infrastructure, the state transfers railway operations to the concessionaire under conditions spelled out in a concession agreement. Railway operations are handled by the concessionaire as a commercial activity, at its own expense and risk. Depending on the mode of investment financing, the railway concession is generally made up of two distinct legal structures: the concession itself and a leasing arrangement. Railway concessioning is not a complete privatization of rail activity since the state retains ownership of the infrastructure and, conceivably, some of the railway equipment.

The primary goal of concessioning rail transport is to increase efficiency. This happens when the railway operator manages the operations in a solidly commercial way, adapted to the needs of the market. Concessioning also clearly defines relationships between the state and the rail operator and, in particular, prevents the state from mismanaging day-to-day railway operations, which is often at the root of railway corporations' problems. Whatever formal measures may exist concerning the management autonomy of the railway, the railway's status as a public enterprise still leaves it open to state mismanagement.

Finally, concessioning is the opportunity — in the same way other restructuring plans would be — to free the railway sector of "past sins," especially railway corporations' weak financial structure and overstaffing. Concessioning should bring an improvement in the financial performance of the rail sector, which would then cease imposing a heavy burden on public finances. The state's financial contributions in the sector would then be limited to whatever compensation its public service obligations might impose on the railway.

Concessioning's "Rules of the Game"

The concession's mechanisms are defined by the concession agreement, a contract signed between the state and the concessionaire. The principal mechanisms cover the scope of the concession, the regulatory framework for rail activity, the management of railway infrastructure and the locomotives and railway wagons, the concessionaire's staff, the concession fee, the tax scheme applicable to rail activity, the duration of the concession, and the monitoring of

At the end of the 19th and the beginning of the 20th centuries, many railroads were built and operated by private enterprises under a concessioning scheme, most notably in Europe, Latin America and North Africa. Beginning in the 1930s, this railway management method gave way, for the most part, to state management, generally through national corporations. Today, State management is the rule in almost all the railroads of Sub-Saharan Africa. While in the past few years many railroads in developing countries have suffered through a major crisis, private sector operation of rail activity in a concessioning framework now appears to be a promising method for restructuring, thus permitting railroads to be converted to commercial enterprises. The formula was first used in the early 1990s in Argentina, where the existing rail network was restructured, forming six freight railways and three groups of suburban railways, all concessioned. In Sub-Saharan Africa, Côte d'Ivoire and Burkina Faso signed a joint concession agreement in December 1994 with the private corporation SITARAIL for the operation of the Abidjan/Ouagadougou/Kaya railway. The agreement was to take effect in August 1995. In light of the (still rare) recent experiences on the subject, Karim-Jacques Budin, Railway Specialist in the Transport division of the World Bank, here introduces the main features of railway operations concessions and examines the options and methods which might be recommended for putting a concession into practice.

the concession by the state and the resolution of conflicts between the state and the concessionaire.

Scope of the concession. The concessionaire will usually be responsible for (i) the technical and commercial operation of freight and passenger rail transport services and activities linked to transport; (ii) the operation, maintenance, refurbishment and expansion of existing rail infrastructure (excluding new construction of infrastructure expansion, which generally remains the responsibility of the state); and (iii) routine management of the public railway domain. Generally, separating the management of transportation services (carried out by the concessionaire) from management of infrastructure (carried out by a separate public agency) is not a solution. On the other hand, it may be advantageous to assign the operation of passenger services to a different operator than the concessionaire. In such a case, the passenger operator would run its trains — for a fee — on the infrastructure managed by the concessionaire.

Railway activity regulatory framework. The regulatory framework for railway activity must encourage the concessionaire to adopt commercial behavior as well as encourage competition with other transport modes. Since railway activity is essentially commercial, operated in a competitive and deregulated environment, the concessionaire must be free to set configuration, fix public tariffs, and negotiate individual contracts with large freight forwarders. At the request of the state, or locality, the concessionaire might also be required to run certain operations as a public service, particularly those for local, rural, or sub-urban passenger transport. These operations should be conducted under specific agreements signed with the state or locality, with the concessionaire receiving compensation for deficits incurred while carrying out the public service obligation.

The state would also compensate the concessionaire for other public service obligations imposed, such as fare reductions for certain clients, or the maintenance of infrastructure for national defense. To dissuade or prevent either rate abuse by the concessionaire on market segments where the railway might enjoy a monopoly, or rail activity falling under the influence of a cartel, the concession agreement should allow for other operators on the infrastructure managed by the concessionaire. This would be allowed after a period of exclusive operation granted to the concessionaire for a few years at the beginning of the concession. Any third-party operators that the state assigned after examining the concessionaire would use the infrastructure, on a non-discriminatory basis, for a fee paid to the concessionaire.

Management of railway infrastructure. Although owned by the state, railway infrastructure is managed and maintained under the technical and financial responsibility of the concessionaire. The concessionaire should be able to establish maintenance standards and methods, with the caveat that rail traffic safety, according to the nature of the operations, not be compromised. The concessionaire also has responsibility for initiating, establishing, and supervising infrastructure improvement and expansion programs.

Management of locomotives and rolling stock. The concessionaire must be granted complete responsibility for determining the number, features, and origin of the locomotives, freight wagons, passenger coaches, and other rail equipment. The concessionaire decides whether to purchase, rent or lease equipment, and selects equipment for the operation from among that available at the outset of the concession. This equipment is generally bought or, more often, rented by the concessionaire from the state on commercial terms. New equipment needed to develop or expand the concession during its course will be acquired or rented directly by the concessionaire, without state intervention; however, the state should maintain the right to lay first claim on equipment sold by the concessionaire, particularly during the last years of the concession.

Concessionaire's Staff. For effective management, the concessionaire's staff must be governed by legislation and regulations (work code, collective agreements) applicable to private sector companies and be affiliated with the private sector's health insurance and retirement funds. The special status which railway workers in many railway corporations enjoy (often like that of civil servants) cannot be preserved. When a railway corporation is handicapped by redundant staff, as is often the case, the concessionaire cannot be required to hire all the existing staff. At the start of the concession, the concessionaire selects the employees whom it wishes to hire from among the staff of the railway corporation. The state bears responsibility for severance programs and for training and re-employment for personnel not hired by the concessionaire. The state will also have to deal with questions of rail workers previously covered by special social benefit plans (special fund for the railway corporation, civil servants' funds).

Concession fees. In exchange for the use of rail infrastructure and the right to operate rail services, the concessionaire will pay the state a concession fee. This fee can be either a fixed annual sum, which could vary from year to year, and be indexed to inflation, or established according to the physical volume of rail traffic; or, it can be set as a percentage of the concessionaire's receipts. In addition to this fee, the concessionaire pays rent to the state on rolling stock, as well as specific annuities owed on any investments the state has made in infrastructure upgrading and expansion.

Taxation. The tax scheme applicable to the concessionaire must be the common law applicable to private corporations in the transport sector. In the concession agreement, the state must guarantee that it will not impose any special taxes which might introduce distortions into competition between the railway and other transporters. Since the concessionaire will bear the expense of maintaining, upgrading, and developing railway infrastructure, petroleum products used in locomotives and other engine cars should be exempted from the portion of the fuel tax collected by the state as user costs for road infrastructure.

Duration of the concession. The concession should last long enough to allow the concessionaire to form and carry out adequate policy on investments, staffing, and marketing. However, the state should also be wary of choosing too long a concession, which could reduce the concessionaire's incentive to remain competitive. These two contradictory needs can be reconciled by adopting a "rolling" concession, of an initial 20 years or so, which can be extended by both parties after each five-year period for successive five-year periods.

State Monitoring of the Concession and Dispute Resolution. The state's monitoring of the concession should not interfere with the management of the concessionaire's company. In practice, monitoring should apply to the safety of rail operations and environmental protection. The concessionaire should send the state information on its activity in documents whose content and issuing are clearly specified in the concession agreement. An annual audit of the concession, exploring the conditions in which the mechanisms called for in the agreement are applied, should be carried out by an independent auditor. Finally, litigation concerning the concession agreement should be handled through arbitration, preferably, for example, according to the arbitration rules of the International Chamber of Commerce.

Choosing the Concessionaire

Once the rules have been defined to promote the business-like management of rail transport, in healthy competition with other transport modes, the concessionaire must be carefully chosen.

To be effective, the concessioning company must possess strong leadership which is committed to the idea that rail transport management be on commercial grounds, and is commited to implementing this approach. This requirement will be met by having a strategic investor within the concession corporation who holds a majority on the board of directors and designates the company's general manager. The strategic investor must hold a significant — not necessarily a majority — share of the company's capital. International competitive bidding to choose the strategic investor is strongly recommended; this guarantees the transparency of the selection and, if done properly, yields the most favorable proposals. Choosing the strategic investor by direct negotiation would be acceptable only in very special cases, such as when the concession is awarded to an almost exclusive user of the railroad.

The concession corporation's shares, other than those held by the strategic investor, would be acquired according to mechanisms defined by local capital market conditions. When a stock exchange exists locally, listing the stock on the stock exchange (following, if necessary, a period of stock carrying either by the strategic investor or by other organizations) is one way of fulfilling the company's equity subscription. The concession corporation's staff can also enjoy privileged conditions for acquiring shares of the capital. At first glance it may seem inadvisable for the state to acquire capital in the concession corporation; but this is acceptable if its share is a minority one and its stock does not form part of that of the strategic investor. State shareholding should also be planned so as not to open the door to meddling in the company's management. In fact, if public minority shareholding in the concession company's capital becomes necessary, the shares should be held by a public establishment which has a direct interest in the smooth running of railway operations, such as, for example, a port enterprise.

In all cases, local private stockholders should be encouraged to invest in the capital of the concession corporation, including the strategic investor. If necessary, a minimum percentage of local private stockholders could be imposed on candidates.

Recent experiences involving the choice of strategic investors for concessioning companies — whether for railways or in more-or-less similar sectors (water, electric energy, telecommunications) — point to a three-step set of recommendations for the use of international competitive bidding:

- The first step concerns the pre-qualification of candidates for strategic investor. In practice, it is always made up of consortia. The pre-qualification process is based on technical capacity and financial stability criteria. This step must be preceded by an intense effort to find potential candidates in order to open up competition.

- The pre-qualified candidates receive a complete consultation file which will include, most importantly, the proposed concession agreement. The candidates will be invited to present a draft medium-term business plan, including their comments and suggestions on the proposed concession agreement. The state and the candidates will then discuss these matters. Following these discussions, for the final step of the procedure, the state will select the candidates that present a satisfactory business plan and will finalize the text of the concession agreement.

- In a final selection phase, the candidates chosen after the second phase will be invited to make an offer of their proposed concession fees, based on the concession agreement details as finalized by state decree. The candidate with the highest offer will then be selected as strategic investor for the concession company.

Ideally, this bidding process should take about twelve months. Four to six additional months would be required for the concessionaire to prepare the railway's operational start-up (creation of a corporation, employee selection, etc.).

The state must set up a structure for liquidating the former public railway corporation (this could be the public railway corporation itself). The liquidation structure will carry out a staff redeployment and reduction plan for those not hired by the concessionaire, resolve questions concerning employee retirement funds for those belonging to special retirement schemes, and sell the railway assets not taken by the concessionaire. This liquidation structure must also ensure the financial settlement (payment of debts and arrears) of the former railway corporation.

As with many railways in developing, and developed, countries, Sub-Saharan Africa's railways are now at a crossroads. Facing increased competition, the African railways will play an important role in the national and regional transportation systems *only* if they reform their management practices and redefine their economic role by concentrating on the market segments where they perform better than their competitors.

Where the state has the will to reform railway transport completely and wishes to make full use of the strengths of the private sector, both foreign and national, the concessioning of railway operations seems one of the most promising techniques for transforming the railroad into a true commercial enterprise.