Brazil Railways

- **Federal Railways (RFFSA)**
  20,000 line-km, 35 billion ton-km, no passengers

- **Sao Paulo Railways (FEPASA)**
  5,000 line-km, 6 billion ton-km, 1 billion passenger-km

- **CVRD Vitoria-Minas Railway (EFVM)**
  900 line-km, 50 billion ton-km, mainly iron ore

- **CVRD Carajás Railway (EFC)**
  1,200 km, 40 billion ton-km, iron ore
RFFSA in 1995

- Federally-owned Public Enterprise
- 40,000 employees
down from 150,000 in 1957, when created
- Employee Productivity < 1 million TU/Emp
- Wage bill = 75% of expenditures
- Locomotive Availability: 53% decreasing
- Average Deficit: >US$250m./year
- Debt: US$3.0 billion, rapidly increasing
Project Objectives

- **Reduce Cost of Freight Transport**
  in Brazil’s main corridors by 20% over 5 years
- **Improve Performance**
  through restructuring, and concessioning
- **Increase Productivity**
  through staff retrenchment and emergency repairs
- **Minimize Social Costs of Retrenchment**
  through severance pay, retraining, outplacement
- **Enhance Competition**, through regulatory reform
Project Scope

- **Restructure Operations & Assets**
  into 6 regional systems, separating rail/non rail assets

- **Reduce Staff by 22,000**
  to turn operations positive and attractive

- **Repair Locos & Tracks, in the Northeast region**

- **Reform Railway Regulation**

- **Settle Debt & Labor Liabilities**
  through revenues from sale of non-rail assets
Implementation Progress

- Project approved in June 1996 ($350m.)
- Staff retrenchment completed
  retraining & outplacement still underway
- Repairs in Northeast 90% complete
- Concessioning completed
  all 6 concessions in operation from July 96-Jan 98
- Regulatory Reform still underway
- Financial Restructuring on track
Staff Retrenchment Objectives

- **Increase productivity**
  - remaining railway staff
  - laid off employees (retraining & outplacement)

- **Minimize social costs of layoffs**
  incentives, severance payments

- **Turn operations profitable** *prior to sale*
  to sell concessions for a positive price (no subsidy)

- **Reduce labor opposition to privatization**
Staff Retrenchment Design

- analysis of regional labor markets
  - modest qualifications of labor, jobs of poor quality
  - av. probability of being re-employed: .64 to .83

- analysis of redundant staff profiles
  - Avg age 40, limited education, limited skills,
  - paid 10-30% above corresponding market average

- design of training, outplacement programs
  - targeting job or business opportunities

- design of incentives, severance packages
  - avoid reduction of standard of living while unemployed
Staff Retrenchment Components

- **Incentives for early retirement**
  if at least 50 yrs old, 6 months salary

- **Incentives for voluntary separation**
  4-12 month salary (av. $8,000) + legal entitl.(av. $10,000)

- **Severance pay for other redundant staff**
  80% of incentive + legal entitlements

- **Retraining** (official training institutes, 150h. $2,000)

- **Outplacement assistance**
Economic Analysis

- **Costs:**
  - incentives and severance payments
  - training and outplacement costs

- **Benefits**
  - net increase in marginal productivity of redeployed staff
  - marginal gain from avoided labor cost of RFFSA

- **NPV**(12%): US$600m.

- **Rate of Return:** 40% (19% in NE, 50% in SE)
Outcome so far

- 20,000 redundant staff laid off by RFFSA
  14,000 early retirement, 6000 voluntary sep. ($320m.)
- 10,000 staff laid off by concessionaires, using Government schedule of payments
- 600 in residual RFFSA
- 1,000 retrained, mainly for self-employment
- Outplacement delayed, now operational
- Survey of laid-off staff available in March 98
Bank Financing of Severance Pay

- First Investment Project with severance financing
- LEG opposed, productive investment issue, image
- OPR used project as test case to OPC
- OPC decision: minutes of Feb. 9, 1996 meeting
- OPR memo to staff: March 5, 96 “clarifies” policy
- US abstention on Project: June 20, 1996
- Informal Board Meeting: July 17, 1996
Severance Pay Financing Policy

- **Adjustment Lending** (SALs, SECALs, PERLs)
- **Investment Lending: Productive Investment**
  1. in context of reforming public enterprise(s) only
  2. design, justification based on increased productivity
  3. no restriction on share of severance pay in project cost
  4. macroeconomic, sector policies satisfactory, sustainability
  5. avoid over/underpayment, rehiring by public enterprise
  6. address social costs, avoid adverse publicity to Bank
  7. OC review of first several operations
Lessons Learned

- Severance package results from negotiation between management & staff, never optimal, acceptable
- Stimulate, guide mgt dialogue with unions
- Loan turned severance packages credible and reduced labor opposition to privatization
- Timing is tactical
  - regulation, institutional reform can be fixed, refined later
- Training & Outplacement take time