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REPUBLIC OF POLAND

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THE STUDY ON PRIVATIZATION OF POLISH STATE RAILWAYS IN POLAND

FINAL REPORT
SUMMARY

February 1998

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JAPAN RAILWAY TECHNICAL SERVICE
DAIWA INSTITUTE OF RESEARCH LTD.
TONICHI ENGINEERING CONSULTANTS, INC.

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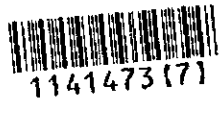
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PREFACE

In response to a request from the Government of Poland, the Government of Japan decided to conduct a Study on the Privatization of the Polish State Railways and entrusted the study to the Japan International Cooperation Agency(JICA).

JICA sent to Poland a study team headed by Mr. Naofumi Takashige, Executive Vice-President of Japan Railway Technical Service (JARTS), 3 times between November 1996 and December 1997.

The team held discussions with the officials concerned of the Government of Poland, and conducted field surveys at the study area. After the team returned to Japan, further studies were made and the present report was prepared.

I hope that this report will contribute to the promotion of the project and to the enhancement of friendly relations between our two countries.

I wish to express my sincere appreciation to the officials concerned of the Government of Poland for their close cooperation extended to the team.

February 1998



Kimio Fujita
President

Japan International Cooperation Agency

Letter of Transmittal

February 1988

Mr. Kimio Fujita
President
Japan International Cooperation Agency


We have the pleasure of submitting herewith our report for the Study on Privatization of Polish State Railways. The report describes the results of the Study conducted by Japan Railway Technical Service, Daiwa Institute of Research Ltd., and Tonichi Engineering Consultants, Inc. in accordance with the contract with the Japan International Cooperation Agency (JICA).

In the Study, our Study Team carried out field surveys three times during the period between November 1996 and December 1997. The Team held sufficient consultations with the Polish Government and organizations concerned regarding the results of the field surveys and study activities in Japan, and drew up plans for contributing to the implementation of the privatization of the Polish State Railways. In close cooperation with the Polish side regarding these plans, the Team thereafter studied such subjects as the form of management, procedures for step-wise privatization, main measures for privatization, and setup for promoting privatization, in order to ensure smooth implementation of the railway privatization, and then prepared this report.

We would like to express our heartfelt gratitude to the Government of Poland and the organizations concerned in the country for the kind cooperation they extended to our Team regarding the implementation of the Study as well as for their warm hospitality provided during our stay in Poland.

Our thanks are also due to the Japan International Cooperation Agency, the Ministry of Foreign Affairs, the Ministry of Transport, the Japanese Embassy in Poland, and the JICA Austria office for their valuable advice and support rendered to us throughout the Study.

Yours faithfully,



Naofumi Takashige

Leader of the Japanese Study Team
for a Study on the Privatization
of the Polish State Railways

The Study on Privatization of Polish State Railways

Study objective	<ol style="list-style-type: none"> 1. To produce a master plan relating to support for the privatization of PKP. To this end, the study reviews the Polish government's PKP privatization program, and proposes the most appropriate plan for the PKP's move to privatization. 2. To carry out technical transfer to Polish counterparts through the implementation of the study.
Study method	<ol style="list-style-type: none"> 1. The study team conducts an on-site study, exchanges views with the Polish steering committee and Polish counterparts, and gathers and analyzes information. 2. Based on the results of the on-site study Japan's experience of national railway reform, and the guidance of the JICA Advisory Committee, the team draws up a study report.
Study overview	<p>To assist the smooth realization of PKP privatization, the study reports on matters such as management form, the step-by-step privatization method, key policies in the preparation for privatization and the organization to promote privatization.</p> <ol style="list-style-type: none"> 1. Management form <ul style="list-style-type: none"> • PKP will be divided into an infrastructure sector and a transport sector and will be privatized in this form. • The transport sector will be divided into 3 passenger transport companies, two freight transport companies and three companies for related businesses, for a total of eight companies. All companies will be integrated by a holding company. 2. The approach to step-by-step privatization <ul style="list-style-type: none"> • Step 1 (1997 - 1998) PKP is an organization that will be divided into key areas, such as infrastructure, passenger transport, freight transport, power & maintenance, and other business sector. • Step 2 (1999 - 2000) The infrastructure sector and transport sectors will be made into separate companies, and the power & maintenance sector will be integrated into the passenger transport and freight transport sectors. Key sectors such as related business divisions will be integrated into three areas, namely related business, telecommunication and data processing. • Step 3 (2001 - 2002) Transport sectors will be made into a special company whose stock is all government-owned, and passenger transport and freight transport will be divided into five sectors. Since self-supporting accounting is possible for maintenance work and on-site operations, sectors will be separated from each other and made independent. • Step 4 (2003 - 2005) The special company will be made into a holding company and under the control of the holding company, three passenger transport companies, two freight transport companies and three related business companies, among others, will be established as independent enterprises. The stock of the eight independent companies will be floated when strategically feasible. • Step 5 (From 2006) The infrastructure company will be converted into a special company, and will become listed when stock meets stock market requirements. The stock of the main holding company will also be floated according to stock market requirements. 3. Key policies in preparation for privatization Analysis of the current situation and proposals for improvements are made in relation to the separation of PKP assets, treatment of low-density lines, related businesses, investment, subsidies by the government, human resource development, management of passenger transport and management of freight transport. 4. Organization to promote privatization Proposals are made to establishment of a Committee on the Privatization of PKP and to reinforce of the Railway Bureau of the Ministry of Transport. 5. Responsibility of the government and PKP <ul style="list-style-type: none"> • It is proposed that the government should tackle issues such as financial assistance, countermeasures for surplus employees, and countermeasures for low-density lines. • It is proposed that, in addition to examining the key policies proposed in the study, PKP should tackle issues such as cooperation between labor and management, improvement of employee awareness, improvement of corporate constitution and the modernization of railways.

**THE STUDY ON PRIVATIZATION
OF POLISH STATE RAILWAYS
(EXECUTIVE SUMMARY)**

1. Main Objective

The objective of the study is to establish a master plan for supporting the privatization of Polish State Railways (PKP). To this end, the study reviews the PKP privatization program, which is a part of the Polish Government's policy of shifting to a market economy, and proposes the most appropriate plan for PKP's move over to privatization. Furthermore, the implementation of the study enables technology transfer to Polish counterparts.

2. Study method

The study team conducted on-site surveys in order to gain an understanding of the actual situation in Poland. It exchanged views with the Polish steering committee and Polish counterparts, and gathered information. Based on the results of the survey in Poland and Japanese experience, the team drew up a report.

3. Study overview

Although PKP is heavily subsidized each year by the government, it continues to run up a deficit. PKP's also carrying out its own managerial reforms, but there are many structure-related problems inherent to the management form particular to national railways, and privatization of PKP has become necessary to improve PKP's finances. Consequently, this study, aimed at assisting the smooth realization of PKP privatization, covers such matters as management form, the method of step-by-step privatization, key policies in preparation for privatization and the organization to promote privatization.

(1) Management Form

We recommend that PKP should be divided into the following privatized companies.

- ① PKP must be divided into two entities, i.e., an infrastructure sector company and a transport sector company, with surplus assets held by the former.
- ② The transport sector will be divided into the passenger transport, freight transport and related business divisions, all of which will be controlled by a holding company, transferred from PKP.
- ③ Passenger and freight sectors will further be divided step by step into different companies for inter-city transport, urban passenger transport, local line passenger transport, freight transport and complex freight transport.

- ④ As the management form, a special nationalized company will control these companies in the transit phase, which will eventually become a stock company.
- ⑤ Finally, PKP will become a holding company (stock company) consisting of an infrastructure company and eight other companies (three passenger companies, two freight companies, a related business company, an information telecommunication company and a data processing company).

(2) The approach to step-by-step privatization

1) Step 1 (1997 - 1998)

- PKP's organization will be divided into key areas, such as infrastructure, passenger transport, freight transport, and power & maintenance.
- Surplus assets of PKP will be transferred to the infrastructure sector.
- A staff investment fund (SIF) will be established and stock coupons will be transferred to staff.

2) Step 2 (1999 - 2000)

- The infrastructure sector will be separated from PKP (as a state-owned enterprise) and the power & maintenance sector will be integrated into the passenger transport and freight transport sectors.
- A public service contract fund (PSC) will be established and part of the rail access charges will be transferred into the fund to subsidize the passenger transport sector.
- Separate accounts for each sector will be created for field-work units for maintenance of the infrastructure, passenger transport and freight transport sectors. Preparations will be made for self-supporting accounting and corporate independence.
- Key sectors, including related business divisions, will be integrated, relocated or abolished, and activities will be concentrated in three areas, namely related business, telecommunication and data processing.

3) Step 3 (2001 - 2002)

- PKP will be made into a special company whose stock is all government-owned and the passenger transport and freight transport sectors will be divided into three passenger transport sectors and two freight transport sectors.
- Fifteen percent of the stock of the incorporated PKP will be transferred to the SIF.
- Separation and independence will be made when self-supporting accounting for field-work units for maintenance of infrastructure, passenger transport and freight transport sectors is possible.

4) Step 4 (2003 - 2005)

- The special nationalized company will be made into a holding company and under the control of the holding company, three other companies including related-business company will be established.
- The stock of the eight independent companies will be floated, starting with the corporate stock which meets stock market requirements.

5) Step 5 (From 2006)

- The infrastructure company will be converted into a special company, the stock of which will later be floated depending upon the market requirements. The stock of the main holding company will also be floated according to stock market requirements.
- The proceeds from the sale of the stock of holding company will be paid into national coffers and the proceeds from the sale of the stock of infrastructure company will be transferred to the PSC fund.
- SIF will transfer stock to each employee (including retired employees) in exchange for stock coupons.

(3) Key policies in preparation for privatization

We recommend that the following measures should be taken toward privatization.

① Preservation of Railway Transport

For public transport services including bus services, the Law on Local Autonomous Bodies was enacted in 1990 to clarify the responsibility of local autonomous bodies. To preserve local lines, the government, local autonomous bodies and railway enterprises are required to negotiate the operation of these lines based on contracts between railway enterprises and local autonomous bodies. To offer transport services that meet the needs of communities, it is also necessary to discuss a system to entrust the responsibility of inter-city transport service to local autonomous bodies or local self-governing organizations.

② Environmental Preservation

Railways are an environment-friendly transport system. Railways must be utilized more, therefore, to prevent environmental deterioration due to increasing automobiles. Railways must educate employees on the importance of environmental preservation, increase specialists in environment divisions and expand the existing environment monitoring system. Energy-saving must further be promoted. Hazardous materials must not be used in investment projects. Contractors must be trained on environmental preservation. Measures for the aged or handicapped must be improved. Railways must continue sustainable

development, while taking into consideration environmental preservation measures in neighboring countries.

③ Fares

To improve the financial situation and prepare for privatization, PKP must increase revenue by raising fares. As the inter-city passenger transport is elastic in regard to operation time and services, fares may be raised by offering better services including higher scheduled speeds. As urban transport is less elastic against values, whether fares may be raised must be discussed as a policy on transport. In freight transport, charges for coal, which are suppressed at low levels, must be raised. Systems of discount fares and complimentary tickets must be abolished or scaled down.

④ Separation of Assets

The infrastructure sector must be separated as a new nationalized company. Field units of maintenance divisions must be privatized, self-subsistent ones first, to compose a system to lease them to employees or strategic investors. Excess rolling stock must be scrapped. Land and buildings must be disposed of on a long-term basis by qualified experts of management and development.

⑤ Treatment of Low-density Lines

In this study, we set a criterion on the abolition of lines in terms of passenger transport density and freight transport density, and determined that it is desirable to abolish 153 lines with a total length of 5,000km. To do this, understanding and cooperation of communities are essential. It is recommended, therefore, to set up an organization to consult and agree with local autonomous bodies, determine procedures for abolition and discuss complementary transport means based on the proposal in this study.

⑥ Treatment of Excess Employees

The number of employees required for the infrastructure, transport and related business divisions in 2005 is estimated to be 160,000. This means that 71,000 employees out of the present 231,000 employees will become excessive. For these excess employees, an early retirement system must be offered, while transferring some to related business companies simultaneously. Conditions for early retirement must desirably be offered step by step with different programs. To staff each division with an appropriate number of employees, those in marketing in passenger divisions must be transferred to freight marketing divisions or to complex transport divisions.

⑦ Related Businesses

Related businesses, which will further develop in the future, must be promoted by an independent organization with the business of immovable property as a core.

With the cooperation of external experts, businesses that seem viable must be separated first. Start a business first in the vicinity of railway stations and then evolve it to city centers. Advertising and other businesses in station compounds are preferential, as they are highly profitable but do not require initial costs much. Invest capitals not only in new businesses but also in companies related to PKP. Success depends on human resources. Send employees to specialist companies to make them acquire expertise.

⑧ Investment

Given the present status of superannuated rolling stock and ground facilities of PKP, funds must be invested more than ever before PKP is privatized. Locomotives and EMUs must be renewed and automatic ticket vending machines must be introduced for passenger transport. Locomotives must be renewed and container cars must be increased for freight transport. Funds must be invested in the infrastructure to improve tracks, introduce a CTC system and modernize signal and telecommunication facilities on a preferential basis. We propose to the government to additionally invest two billion PLN (400 million PLN per year) into infrastructure divisions before PKP is privatized.

⑨ Subsidies by the Government

Subsidies by the government must be determined in consideration of the finance of the government, necessity to assist PKP and compatibility with EU directives. The balance between revenue and expenditure of PKP and its estimates in the future suggest that subsidies by the government are still required for passenger transport and investment in the infrastructure in the future. It is desirable that the investment in the infrastructure be assisted with a sum of two billion PKP in five years. The effects of subsidies must be analyzed on a regular basis

⑩ Upbringing Human Resources

PKP must prepare training programs for newly introduced technologies. In their career, employees must be positioned at various work places. PKP must attach importance to the development of expertise. Overseas training programs must also be considered. For the personnel affairs management system, job rules and a capability-base salary system must be adopted. Extra pays must reflect the business achievement of the organization and be linked with merits of individual employees. PKP must discuss introduction of extra pay systems for multi-function and transfer to different work places.

⑪ Management of Passenger Transport

It is required to improve inter-city train operation to effect rapidity, convenience and comfort and strengthen selling and marketing systems, in order to promote positive business management. For urban transport, a high-frequency, equal-

headway and fixed-composition train operation system must be established in conjunction with other transport facilities in urban areas. It is important to improve the efficiency of local lines by adequately utilizing employees and introducing rail buses.

⑫ Management of Freight Transport

For ordinary freight transport, PKP must abolish or scale down low-density stations and freight yards to switch cargos to direct transport, improve terminals and strengthen the link with road transport agencies, review the distribution of yards and shunting bases to reduce the number of employees, and apply fare systems elastically. For complex freight transport, PKP must improve container bases at Warsaw and other major stations, organize affiliated companies to smoothen off-rail transport, clarify arrival date and time and increase container cars.

(4) Organization to promote privatization and the responsibilities of the government and PKP

① Organization to Promote Privatization

To positively and steadily promote the privatization of PKP, we propose to set up or strengthen the following organizations in the government and PKP.

1) Committee on the Privatization of PKP

In the Ministry of Transport, organize a Committee on the Privatization of PKP (Privatization Committee) composed of members from related ministries and other governmental organizations, representatives of companies who have experienced privatization, specialists on privatization who have expertise and executive members of PKP, to discuss basic policies on privatization and prepare basic plans.

Under the Privatization Committee, organize three Sub-committees on assets, excess employees and local lines.

2) Reinforcing the Railway Bureau, Ministry of Transport

The Railway Bureau, Ministry of Transport, which is the actual secretariat organization for privatization of PKP, has 13 members including a director. As new jobs have already arisen after the Railway Transport Law was enacted, the Bureau must be reinforced to deal with jobs related to the privatization of PKP in the future.

3) Privatization Promotion Project Team

Organize a privatization promotion project team directly under President, with managers and staff of Strategy Restructuring Bureau and other divisions, to support the Privatization Committee and prepare detailed implementation plans

for privatization.

② Responsibility of the Government

For the smooth implementation of PKP privatization, the government will take the following action.

1) Financial Assistance

One of the purposes of the privatization of PKP is to cut subsidies by the government. As seen in other countries, however, there are few privatized railways that are operating without requiring financial assistance by respective governments. Railway management should be vitalized based on appropriate financial means including subsidies for passenger transport and additional investment into the infrastructure.

2) Excess Employees

How to deal with excess employees in the process of PKP's reform is an important subject for the government. As this is a socially important issue involving problems that cannot be solved by PKP alone, the government must extend support for measures taken by PKP including the early retirement system and re-employment in other industries.

3) Low-density Lines

To abolish low-density lines, it is important to obtain understanding and cooperation of community people who tend to oppose abolition of railway lines. In this study, we have proposed to abolish lines to a total length of 5,000km by the end of 2005. To implement this proposal, the government must secure coordination between PKP and local autonomous bodies, and consult with local autonomous bodies on the funds required to abolish lines or operate preserved lines.

4) Regulations to Protect Public Interests

An age when railways monopolize transport businesses has gone with their responsibility to protect public interests diminished. Therefore, regulations on fares for public interests must be minimized. When the government imposes economic burdens on railways as a means of public transport, the costs involved must be compensated for by the government.

③ Responsibility of PKP

To convert PKP into an efficient private company which displays vitality, in addition to examining the policies at (3), PKP will take the following action.

1) Cooperation with Privatization Committee

PKP's positive cooperation is expected with the Privatization Committee that will be set up in the government, by submitting data required for discussions in the Committee, for example.

2) Cooperation between Labor and Management

To attain successful privatization, it is essential to obtain cooperation of labor unions. Labor and management must exchange opinions, establish close relations based on mutual trust and cooperate with each other for the development of their organization, or a target they share in common.

3) Reform of Consciousness

In nationalized railway organizations, both labor and management tend to lose consciousness of the financial status of the organization, morale to improve productivity and consciousness of operation costs. Before it is privatized, therefore, PKP must make employees have the consciousness seen in workers of private companies, as well as the morale to increase revenue, cut expenditure and develop themselves. Spirit of devotion must also be introduced. To do this, PKP must improve training systems, have lectures on management by external instructors, make employees experience working for private companies, encourage tool box improvement activities, participation in workplace opinion forums and contribution to workshops on field study results, and introduce a capability-based personnel management system.

4) Improvement of Corporate Constitution

As a merit of privatization, the newly born railway organization will be able to attain self-subsistent operation through free and positive business promotion under clarified responsibility for management. The private railway company must be drastically oriented to a profitable management and business fields where the advantageous features inherent to railway transport are unsparingly demonstrated. This requires new conceptions, such as introduction of talented human resources from outside, selection and preferential treatment of capable and development-oriented employees, decentralization of authorities for personnel affairs and financial management and establishment of an organization with duties and responsibilities clarified.

5) Modernization of Railways

A purpose of privatization is to improve productivity by using modern facilities and equipment and performing efficient management. To do this, the new railway organization must take measures for modernization, such as appropriate investment, mechanization, systematization and utilization of external capabilities, promote marketing to offer attractive products and services, implement minutely designed policies to reflect local conditions, develop diversified businesses and pursue modernized management incorporating information systems.

TABLE OF CONTENTS

1. INTRODUCTION	1- 1
1.1 BACKGROUND OF THE STUDY AND DEVELOPMENT IN THE PAST	1- 1
1.2 OBJECTIVE OF THE STUDY	1- 2
1.3 SCHEDULE OF THE STUDY	1- 2
1.4 ORGANIZATION OF THE STUDY	1- 2
1.5 MEMBERS OF THE ORGANIZATION OF THE STUDY	1- 4
2. CURRENT SITUATION AND FUTURE DIRECTION OF THE PKP	2- 1
2.1 CURRENT SITUATION OF RAILWAY TRANSPORTATION	2- 1
2.1.1 Railway Network	2- 1
2.1.2 Passenger Transportation	2- 1
2.1.3 Freight Transportation	2- 7
2.2 MANAGEMENT AND FINANCIAL SITUATION	2- 13
2.2.1 Analysis of the 1996 financial statements	2- 13
2.2.2 Analysis of PKP's 20-year forecasts	2- 15
2.2.3 Requirements for PKP restructuring / privatization	2- 16
2.3 RESTRUCTURING PLAN PKP ITSELF	2- 17
2.3.1 Main Objectives	2- 17
2.3.2 Actual Progress made to date	2- 17
2.3.3 Evaluation of the Pilot Program in the Eastern DOKP	2- 18
2.3.4 Timetable for the Future	2- 20
2.4 RESTRUCTURING PLAN SUPPORTED BY THE WORLD BANK	2- 23
2.4.1 Basic Concepts	2- 23
2.4.2 Role and Functions of the Restructuring Agency	2- 23
2.4.3 Treatment of Employees and Assets	2- 25
2.4.4 Financial Evaluation of the Selected Restructuring Variant	2- 26
2.5 REQUIREMENT FOR PKP PRIVATIZATION	2- 26
2.5.1 History of Polish Privatization	2- 26
2.5.2 Various Methods of Privatization	2- 27
2.5.3 Relationship with EU Directives	2- 28
2.5.4 Requirement for the PKP Privatization	2- 29

3. ISSUES TO BE SOLVED TOWARDS PRIVATIZATION	3- 1
3.1 ROLES OF RAILWAY TRANSPORT	3- 1
3.1.1 Railways Position in Transport System	3- 1
3.1.2 Traffic Demand Outlook	3- 3
3.1.3 Direction of Transport Market Policy	3- 6
3.1.4 Consideration of Environment	3- 8
3.1.5 Maintaining of Railway Transport	3- 9
3.2 EXPERIENCE OF PRIVATIZATION OF RAILWAYS IN JAPAN AND WEST EUROPEAN COUNTRIES AND SUGGESTION TO PKP REFORM	3- 10
3.2.1 Reform of Japanese National Railways	3- 10
3.2.2 Reform of British Rail	3- 12
3.2.3 Reform of Swedish State Railways	3- 12
3.2.4 Reform of German National Railway	3- 13
3.2.5 Reform of French National Railway	3- 13
3.2.6 Suggestion to PKP Reform	3- 14
3.3 TARIFF STRUCTURE AND FARE ANALYSIS	3- 16
3.3.1 Existing Tariff Structure	3- 16
3.3.2 Fare level	3- 19
3.3.3 Fare elasticity analysis	3- 22
3.3.4 Fare policy	3- 23
3.4 PASSENGER TRANSPORT	3- 25
3.4.1 Passenger Transport Sector	3- 25
3.4.2 Profitability of Passenger Transport Sector	3- 26
3.4.3 Management Form of Different Divisions in the Future	3- 28
3.5 FREIGHT TRANSPORT	3- 29
3.5.1 Subjects for Freight Transport	3- 29
3.5.2 Profitability of Freight Transport	3- 31
3.5.3 Management Form in the Future	3- 34
3.6 INFRASTRUCTURE	3- 35
3.6.1 Subjects for Infrastructure	3- 35
3.6.2 Optimum Railway Network to be Preserved in the Future	3- 39
3.6.3 Rail Access Charges	3- 40

4. PRIVATIZATION SCENARIOS	4- 1
4.1 TRANSITION PERIOD TO PRIVATIZATION	4- 1
4.2 SELECTION OF PRIVATIZATION SCENARIOS	4- 1
4.3 SCENARIO 1	4- 1
4.3.1 Executive Policy	4- 1
4.3.2 Basic Means	4- 2
4.3.3 Privatization Phases (see Fig. 4.3.2)	4- 9
4.4 SCENARIO 2	4-13
4.4.1 Executive Policy	4-13
4.4.2 Basic MeansStreamline organization	4-13
4.4.3 Privatization Phases (see Fig. 4.4.1)	4-15
4.5 EVALUATION AND CALCULATION OF SCENARIOS	4-18
4.5.1 Qualitative Evaluation	4-18
4.5.2 Calculation Examples	4-22
5. PROPOSALS FOR EXECUTING THE SELECTED SCENARIO	5- 1
5.1 MANAGEMENT FORM	5- 1
5.1.1 Infrastructure Sector	5- 1
5.1.2 Holding Company (HC)	5- 1
5.2 PRIVATIZATION PHASES AND EFFECT OF PRIVATIZATION	5- 2
5.2.1 Privatization Phases (see 4.3.3, Fig. 4.3.2)	5- 2
5.2.2 Effects of Privatization	5- 4
5.3 SEPARATION AND DISPOSAL OF ASSETS	5- 6
5.3.1 Desirable separations and their methodology	5- 6
5.3.2 Recommendations for organization units and “organized portions of assets”	5- 7
5.3.3 Recommendation for Individual classes of assets	5- 9
5.3.4 Staff Investment Fund	5- 9
5.3.5 Separation & disposals by phases	5-10
5.4 MANAGEMENT OF LIGHT DENSITY LINE	5-10
5.4.1 Criteria of Line Liquidation	5-10
5.4.2 Lines to be liquidated	5-12
5.4.3 Procedure for Liquidation of Light Density Line	5-15
5.4.4 Alternative Transport System	5-16

5.4.5	Phased Executive Guideline for Line Liquidation	5- 18
5.4.6	Costs of Line Liquidation	5- 19
5.5	TARGET STAFFING LEVELS AT PKP	5- 19
5.5.1	Factors determining Target Staffing Levels	5- 19
5.5.2	Key Labor Challenges	5- 20
5.5.3	Target Staff numbers	5- 20
5.5.4	Analysis of Labor Surplus and Shortages by region and function	5- 22
5.5.5	Evaluation of Overtime Hours by Function	5- 24
5.5.6	Buy-Out Strategy	5- 26
5.5.7	Scheduled staffing by phases	5- 27
5.6	POSSIBILITY OF RAILWAY-RELATED BUSINESSES	5- 28
5.6.1	Types of Railway-Related Businesses and the Experience of Japanese Railways	5- 28
5.6.2	Experience of Hokkaido Japan Railway Company (JRH)	5- 28
5.6.3	Telecommunication Business	5- 31
5.6.4	Recommendations for promotion of RRB	5- 32
5.6.5	Implementation Schedule for Development of RRB (cf. 4.3.3, 5.2.1)	5- 34
5.7	INVESTMENT IN EQUIPMENT AND FACILITIES	5- 34
5.7.1	Policies on Investment	5- 34
5.7.2	Investment Plan for Equipment and Facilities	5- 36
5.7.3	Investment Amounts	5- 37
5.7.4	(Methods of) Financing Investments	5- 38
5.7.5	Implementation Schedule of Investment Plans	5- 41
5.8	GOVERNMENT SUBSIDY	5- 41
5.8.1	Government Policy for Subsidy	5- 41
5.8.2	Desirable Government Subsidy	5- 43
5.8.3	Analysis of Efficiency of Subsidy	5- 46
5.8.4	Government subsidies by phases	5- 47
5.9	HUMAN RESOURCE DEVELOPMENT	5- 48
5.9.1	Training System	5- 48
5.9.2	Personnel Management System	5- 50
5.9.3	Human resource development by phases	5- 53
5.10	MANAGEMENT OF PASSENGER TRANSPORT	5- 54

5.10.1	Basic Concept	5- 54
5.10.2	Inter-city Transport Company	5- 55
5.10.3	Urban Transport Companies	5- 58
5.10.4	Local Transport Companies	5- 59
5.10.5	Schedule to Improve Passenger Services	5- 60
5.11	MANAGEMENT OF FREIGHT TRANSPORT	5- 61
5.11.1	Basic Concept	5- 61
5.11.2	Freight Transport Railway Company	5- 62
5.11.3	Complex Freight Transport Company	5- 66
5.11.4	Schedule of Freight Transport Improvement Measures	5- 68
6.	COMPREHENSIVE PROPOSAL	6- 1
6.1	PROPOSAL FOR THE PLAN OF PRIVATIZATION	6- 1
6.2	ORGANIZATION TO PROMOTE PRIVATIZATION	6- 7
6.3	RESPONSIBILITY OF THE GOVERNMENT	6- 8
6.4	RESPONSIBILITY OF PKP	6- 9
6.5	CORRESPONDENCE TO EU POLICIES	6- 10
6.6	CONTINUATION OF SURVEY AND IMPLEMENTATION OF TECHNICAL COOPERATION	6- 11

1. INTRODUCTION

1.1 BACKGROUND OF THE STUDY AND DEVELOPMENT IN THE PAST

While transforming its economy to a market-oriented one since 1989, Poland has been discussing the possibility of privatizing its state-owned railways (PKP) since 1991.

To support this movement, the Japanese Government conducted "The Study on the National Transport Plan in the Republic of Poland (1991 - 1992)", and proposed an early implementation of PKP reformation.

After the survey, Poland organized the Interministerial Commission for Restructuring Polish State Railways to start reforming PKP toward privatization.

In the way toward recovery of sound financial status and organizational innovation of PKP, however, there are a number of difficult problems including those between labor and management.

Under the circumstances, Poland, who took note of the successful privatization of Japanese National Railways, approached the government of Japan to obtain technical cooperation, in order to prepare an optimum plan for the privatization of PKP, and requested in 1995 September to conduct this survey.

In response to this request, a preliminary study team was sent to Poland in 1996 March. The team concluded an agreement on the scope of work with the government of Poland in 1996 April. Based on this agreement, Japan International Cooperation Agency (JICA) organized a study team and set up an advisory committee to implement this study.

The JICA team started a survey in 1996 October, collected relevant data and information during a site survey from 1996 November, reviewed reports in the past and submitted a progress report to the government of Poland in 1997 January.

Based on the site survey results and in response to the opinions on the progress report, the team prepared an interim report, in which the team explained the role of railways in Poland, results of demand forecast, problems for PKP privatization and alternative measures.

In 1997 June, the team explained the interim report to the government of Poland and obtained approval for its essential part. By reflecting the comments on the interim report offered by the government of Poland, the team prepared a draft final report.

In 1997 December, the team explained the draft final report and have discussions with the

government of Poland. By taking into consideration comments on the draft final report by the government of Poland, the team made the Final Report of the Study on Privatization of Poland.

1.2 OBJECTIVE OF THE STUDY

The objective of the study is to implement a survey related to the master plan to support the privatization of PKP under the above-mentioned circumstances, based on the scope of work agreed upon between the government of Poland and JICA on April 11, 1996.

In this study, the study team reviewed the PKP privatization program, which is a means of shifting to a market economy promoted by the government of Poland, overviewed comprehensive transport networks encompassing conjunction with neighboring countries, implemented a survey to establish an optimum PKP privatization plan and transferred technologies to counterparts in Poland.

1.3 SCHEDULE OF THE STUDY

Table 1.3.1 shows the schedule of the study.

1.4 ORGANIZATION OF THE STUDY

This study was performed by a team organized by JICA with experts in railway operation, management analysis and other fields. Counterparts in Poland were members of Ministry of Transport and Maritime Economy (MTME).

To smoothly perform the study, a Steering Committee was organized with members of governmental organizations in Poland including the Ministry of Transport and Maritime Economy (MTME) and state-owned railways (PKP). For the convenience of site surveys and collection of information, a counterpart team was organized with members of PKP.

To lead the study team and facilitate smooth implementation of survey, JICA organized a Supervisory Committee.

Fig. 1.4.1 shows the organization of the study.

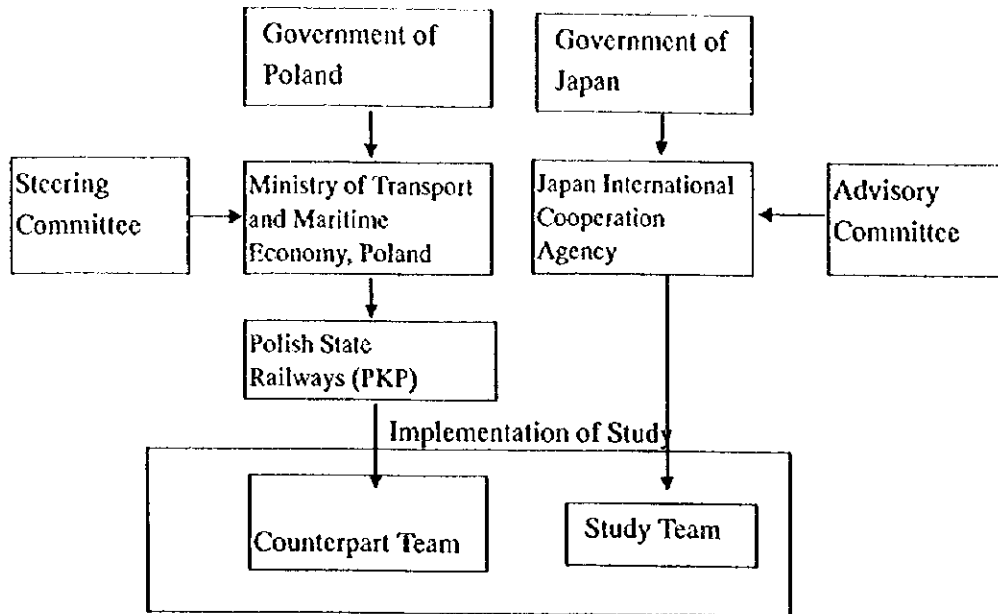


Fig. 1.4.1 Organization of the Study

1.5 MEMBERS OF THE ORGANIZATION OF THE STUDY

The following table summarizes members of the organization of the study

(1) ADVISORY COMMITTEE (FIVE PERSONS)

Name	Assignment	Present position
Tatsuhiko SUGA	Chairman, Organization and Management of PKP	Executive Director, East Japan Railway Culture Foundation
Osamu HASEGAWA	Railway Management	Manager, Administration Division, Railway Development Department, Corporation for Advanced Transport & Technology
Daisaku MURAKAMI	Railway Facilities and Operation	Deputy Director, Technology Development Office, Engineering Planning Division, Ministry of Transport
Tsutomu SHIBATA	Management Analysis	Director General, International Cooperation Department, The Japan Development Bank
Nobuhiro KOYAMA	Transport and Economic Development	Development Specialist, Institute for International Cooperation, Japan International Cooperation Agency (JICA)

(2) JICA (ONE PERSON)

Name	Assignment	Present position
Koichi KITO (1996 October - 1997 March)	Study Planning	Staff, First Development Study Division, Social Development Study Development, Japan International Cooperation Agency (JICA)
Shoichi TSUGANE (1997 April - 1998 January)	Study Planning	Staff, First Development Study Division, Social Development Study Development, Japan International Cooperation Agency (JICA)

(3) STUDY TEAM (14 PERSONS)

Name	Assignment
Naofumi TAKASHIGE	Team Leader, Organization Analysis
Ken MACHIDA	Acting Leader, Management Analysis
Pawel TOMCZYK	Public Investment Policy
Naoki TAKANASHI	Transport Demand Forecast
Seiichiro YAMAZAKI	Analysis of Fare Structures and Transport Economics
Michio FUJHASHI	Business Enterprise Strategy
Daniel B. MESNICK	Personnel Management and Productivity
Charles WATSON	Financial Analysis
Nobutaka TATEMATSU	Passenger Transport Planning
Takashi JORAKU	Freight Transport Planning
Yoshihiro AKIYAMA	Railway Facilities Planning
Koji SAGAWA	Rolling Stock Planning
Masaaki MORITA	Environmental Analysis
Toshiyasu OHASHI	Coordinator

(4) Polish Steering Committee

Ministry of Transport and Maritime Economy	
Mr. Krzysztof CELINSKI	Director of Railway Department
Mrs. Ewa SZCZEPANSKA	Director of Economics and Finance Department
Mrs. Danuta TYSKIEWICZ	Director of Legal Department
Mr. Zdzislaw URBANIAK	Director of Transport Policy Department
Mrs. Ewa SPYCHAJ	Director of Ownership Transformation Department
Polish State Railways (PKP).	
Mr. Albin SPYCHALSKI	Deputy Director of PKP, Member of the Supervisory Board of PKP.
Mr. Marian LUKASLAK	Director of Strategy Office
Mr. Gerard ROGOWSKI	Deputy Director of Strategy Office

(5) Polish Counterparts

No.	Name of Task	Department	Name	Position
1	Organizational Analysis	KWE	A. Spychalski	The Member of the Board
		KSR	M. Lukasiak	Director
		KBS	E. Kubik	Director
2	Management Analysis	MTiGM		
		KFK	W. Woroniecki	Director
		KEK	G. Piekarzewicz	Council of the PKP
3	Public Investment Policy	MTiGM		
4	Transport Demand Forecast	MTiGM		
		KSR	M. Lukasiak	Director
		KI	K. Kozuchowski	The Head
		KSR	T. Szemplinski	The Head
		KSR	T. Trojanowska	The General
		KSR	G. Stachura	Higher Specialist
		KI	K. Kozuchowski	The Head
5	Fare Structure and Transport Economy	MTiGM		
		KD	M. Musial	The Head
		KSR	L. Rudzinski	The Head
			T. Szemplinski	The Head
			T. Trojanowski	General Specialist
		KIIP	G. Uklejewski	Director
			T. Werner	Higher Specialist
			K. Peryt	Higher Specialist
		KHT	J. Tymoszek	Director
			S. Trzaskowski	The Head
			W. Czemiawski	The Head
6	Business Enterprise Strategy	KSB	St. Klubinski	General Specialist
		KSR	M. Lukasiak	Director
		KSR	G. Rogowski	Deputy Director

7	Personal Management and Productivity	KOS	T. Krajewski	The Head
		KSR	J. Blaszczyk	General Specialist
			B. Huczko	General Specialist
8	Financial Analysis	KF	A. Jarcewska	The Head
			H. Blaszczyk	The Specialist
		KFK	W. Woroniecki	Director
		KSR	G. Rogowski	Deputy Director
		KEK	M. Kryszkiewicz	Council
		KN	R. Olejniczak	Director
		KI	K. Kozuchowski	The Head
9	Passenger Transportation	KHP	G. Uklejewski	Director
10	Freight Transport Planning	KHT	J. Tymoszek	Director
			S. Wojtowicz	The Head
			S. Trzaskowski	The Head
11	Railway Facilities Planning	KD	M. Musial	The Head
		KSR	L. Rudzinski	The Head
		KI	K. Kozuchowski	The Head
		KE	A. Wach	The Head
		KA	M. Radziukiewicz	The Head
		KDK	M. Kopczynski	The Head
12	Rolling Stock Planning	KME	A. Skrodzki	The Head
			K. Kolodziejki	The Head
		KMU	W. Cywinski	The Head
			A. Kluczyk	The Head
13	Environmental Analysis	KSR	A. Wroblewski	General Specialist
14	Coordinator	MTiGM		

2. CURRENT SITUATION AND FUTURE DIRECTION OF THE PKP

2.1 CURRENT SITUATION OF RAILWAY TRANSPORTATION

2.1.1 Railway Network

The Polish railway network have an extensive network which covers whole nation; railways with a route length of 22,285km standard gauge (gauge: 1,435mm) including broad gauge (gauge: 1,520mm), and length of 1,3888km of narrow gauge (gauge: 600mm, 750mm, 785mm and 1,000mm)

At present 8,906km, 39.4% of standard gauge tracks is double tracked and 11,625km, 52.2% is electrified.

According to the present statutory definition and PKP technical regulation, PKP railway network is classified into following 3 types.

Table 2.1.1 Classification of lines

Classification	Length (km)	Remarks
Lines of National Importance	13,880(62%)	A ministerial ordinance of September 3 1996
Lines of Regional Importance	6,000(27%)	-
Non-profitable Lines	2,400(11%)	income/cost=0.1~0.2

Source : PKP annual report 96

2.1.2 Passenger Transportation

(1) Trends in customer preferences regarding types of tickets and train services

The number of passengers in rapid and express train of PKP has gone down from 66 million and 18,000 million passenger-km to 50 million and 12,300 million passenger-km in the same period. Within general fall in railway passenger traffic the conventional speed trains suffered the most significant decrease-from 722 million passengers and 32,300 million passenger-km in 1990 to 415 million passengers and 14,300 million passenger-km in 1995. (Table 2.1.2, Figure 2.1.2 and Figure 2.1.3)

Table 2.1.2 Changes of passengers transport volume by types and classes of train

(Unit : million passengers)

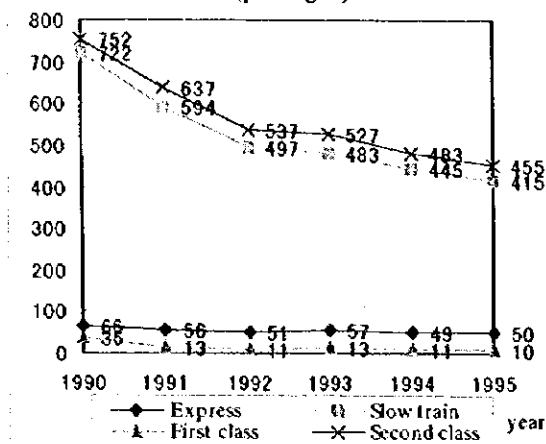
Year	1990	1991	1992	1993	1994	1995
Express	66	56	51	57	49	50
Slow train	722	594	497	483	445	415
First class	36	13	11	13	11	10
Second class	752	637	537	527	483	455

(Unit : hundred million passenger-km)

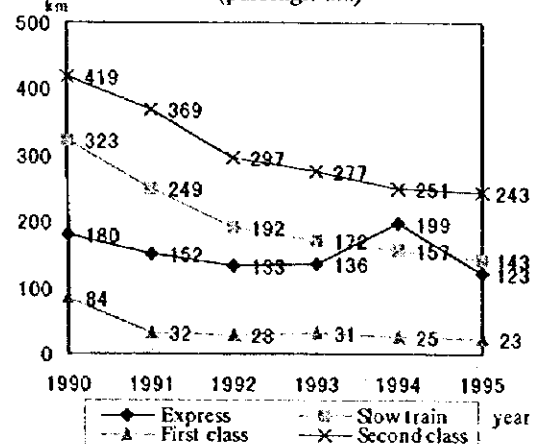
Year	1990	1991	1992	1993	1994	1995
Express	180	152	133	136	199	123
Slow train	323	249	192	172	157	143
First class	84	32	28	31	25	23
Second class	419	369	297	277	251	243

Source : Statistical yearbook PKP

million people Figure 2.1.2 Changes of passengers transport volume by types and classes of train (passengers)



hundred million passenger-km Figure 2.1.3 Changes of passengers transport volume types and classes of train (passenger-km)



Season tickets have become less popular. In 1990 the sales of such tickets amounted to 304 million passengers and 6,100million passenger-km while in 1995 there were 175 million passengers and 3,700 million passenger-km respectively. However in 1995 the number of suburban commuters season tickets has grown by 18.7% compared to 1994. On the other hand a number of full fare ticket holders on conventional speed trains has significantly decreased and this trend still continues. (Table 2.1.3, Figure 2.1.4 and Figure 2.1.5)

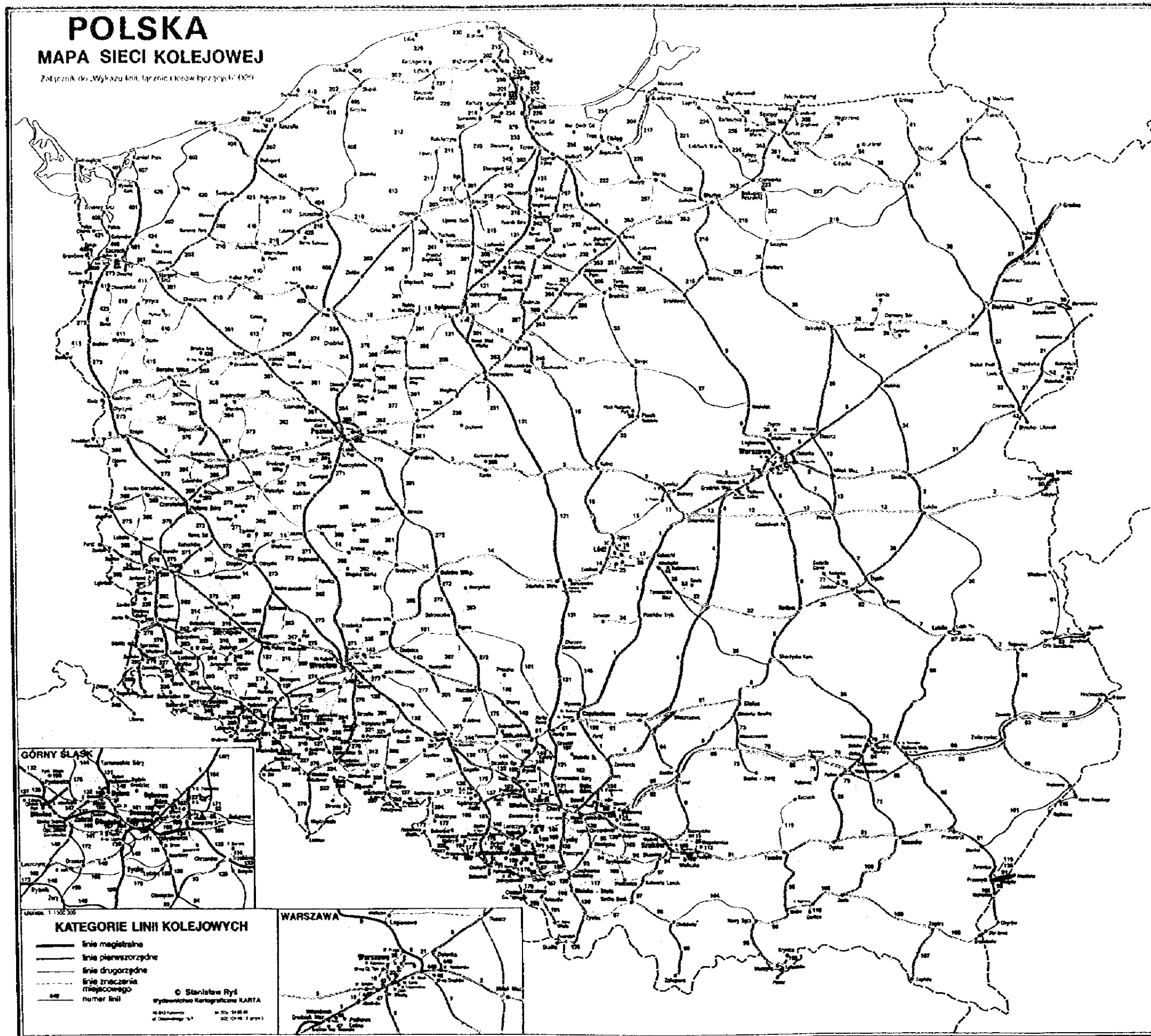


Fig 2.1.1 Lines of National Importance

Table 2.1.3 Changes of passengers transport volume by types of ticket

(Unit: million passengers)

	1990	1991	1992	1993	1994	1995
Normal ticket	484	449	408	421	346	290
Season ticket	304	201	140	119	148	175
Total	788	650	548	540	494	465

(Unit: hundred million passenger-km)

	1990	1991	1992	1993	1994	1995
Normal ticket	442	364	299	286	247	229
Season ticket	61	37	26	22	29	37
Total	503	401	325	308	276	266

Source : Statistical yearbook PKP

Figure 2.1.4 Changes of passengers transport volume by types of ticket (passenger)

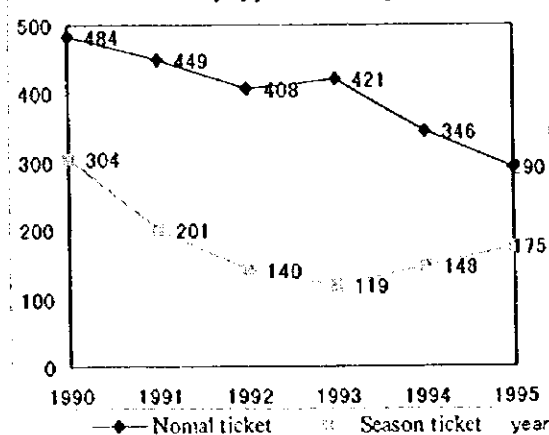
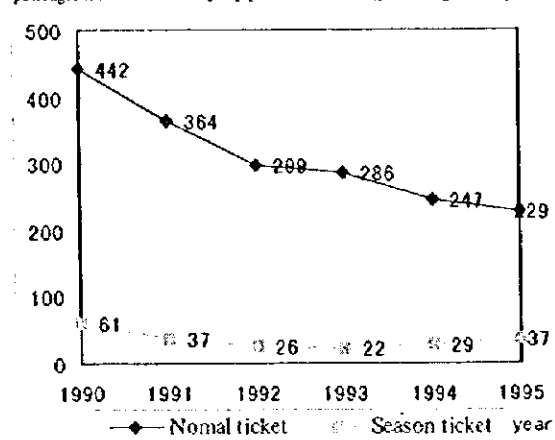


Figure 2.1.5 Changes of passengers transport volume by types of ticket (passenger-km)



(2) Situation in inter-city transport

1) International transport

The volume of international transport has decreased from 5,755 thousand passengers and 1,005 million passenger-km in 1994 to 5,049 thousand passengers and 857 million passenger-km in 1995. (Table 2.1.4)

Table 2.1.4 Comparison of transport volume in 1994 and 1995

Quality of :	thousand passenger		million pass-km		average pass-km	
	1994	1995	1994	1995	1994	1995
Internation. Transp.	5,755	5,049	1,005	857	175	170
Interregion. Transp.	65,068	64,266	15,830	15,617	243	243
Agglomer. Transp.	277,934	262,969	6,687	6,425	24	24
Provincial transp.	144,917	132,775	4,073	3,723	28	28

Source : Statistical yearbook PKP

The volume of international transport by countries includes the following:

Belarus - 1,324,000 passengers, Ukraine - 1,236,000, Germany - 950,000, Russia 916,000, Czech Republic - 156,000, Austria - 85,000.

2) Domestic inter-city transport

The number of EC, IC, EX and other express trains and rapid trains operating in inter-city transport on major routes exceeds 10 and passenger traffic one way varies from 700 to 2,900 passengers per day.

Table 2.1.5 Inter-city trains on major lines (1997)

Section	Distance (km)	Travel time (fastest train) (h-m)	Max Speed (km/h)	Scheduled speed (km/h)	No. of Trains, One way (trains/day)	Transport Volume, one way (passenger/day)
Warsaw-Krakow	287	2-35	160	111	12	2,980
Warsaw-Katowice	293	2-35	160	113	10	2,266
Warsaw-Gdansk	329	3-21	120	98	10	2,848
Warsaw-Poznan	306	3-04	130	100	8	2,154
Warsaw-Lublin	175	2-06	120	83	8	1,388
Warsaw-Wroclaw	385	4-35	120	84	5	1,248
Poznan-Szczecin	214	2-26	120	88	8	756
Poznan-Wroclaw	165	1-42	120	97	9	965
Katowice-Wroclaw	180	2-28	120	73	10	776

Source : Time-table PKP 1996, Data of actual passenger flow (7.1996)

Note : The one-way transport volume shows daily average in July 1997.

The total number of passengers in above trains in 1995 was 64,266 thousand (98.8% of previous year) and 15,617 million passenger-km (98.7% of previous year).

(3) Situation in commuter transport

There are a number of cities in Poland which are surrounded by densely populated metropolitan areas. Warsaw metropolitan area has the population of 1.8 million people. The passenger transport volume in its city zone amounts to 82,412 thousand passengers being the highest in the country. Next come Gdansk (62,517 thousand) and Katowice (31,577 thousand). These three city zones represent 67% of total commuter railway transportation in Poland. (Table 2.1.6)

Table 2.1.6 Transport volume in major city areas (1995)

(Unit ; thousand persons, %)

Major city area	Transport volume	Share of commuter	City population
Warsaw	82,412	58.7	1,632
Gdansk	62,517	50.1	463
Katowice	31,577	45.4	351
Bialystok	16,079	53.3	279
Wroclaw	14,278	45.9	642
Poznan	13,528	50.7	581
Bydgoszcz	11,956	49.4	386
Krakow	11,313	47.0	745
Lodz	9,335	42.8	820
Szczecin	9,138	49.6	419

Source : Statistical yearbook PKP

The volume of commuter transport shows also the decreasing trend 262,969 thousand passengers (94.6% of the previous year) and 6,425 million passenger-km (91.1% respectively). Above figures represent respectively 57% and 25% of total passenger transport volume and prove the importance of commuter transport in overall passenger railway traffic of the country. (Table 2.1.4)

(4) Local traffic lines

Conventional speed train passenger volume shows continuous tendency to decrease 132,775 thousand passengers (91.6% of the previous year) and 3,723 million passenger-km (91.4% of the previous year). As there is a tendency of migration to big cities and decrease of population number in rural areas, railways cannot expect any growth of local passenger traffic. (Table 2.1.4)

Along with the decrease of the passenger transport volume the number of has also decreased. On some local lines service has cut following respective agreements with local government authorities. Passenger on local lines encounter deterioration of services of to reduced number of trains and poor quality of cars. There is a continuous shift to automobile transportation.

2.1.3 Freight Transportation**(1) Trends in freight traffic volume**

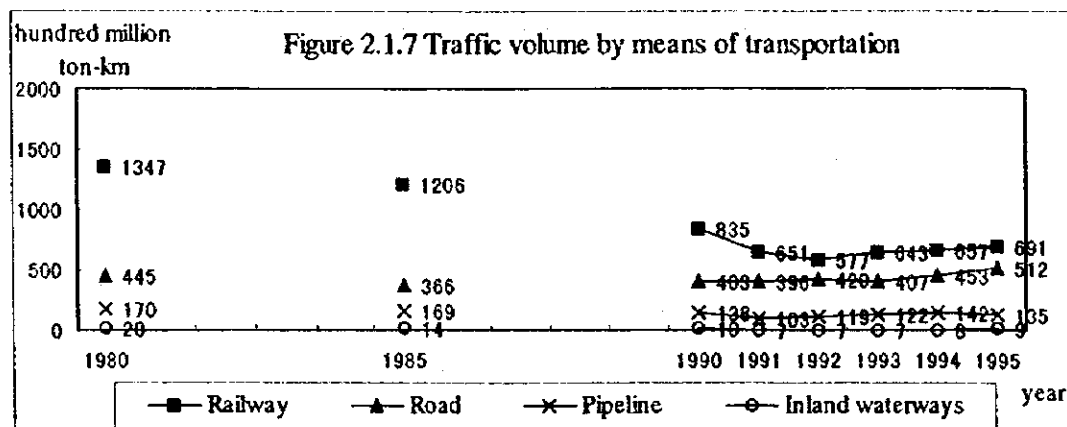
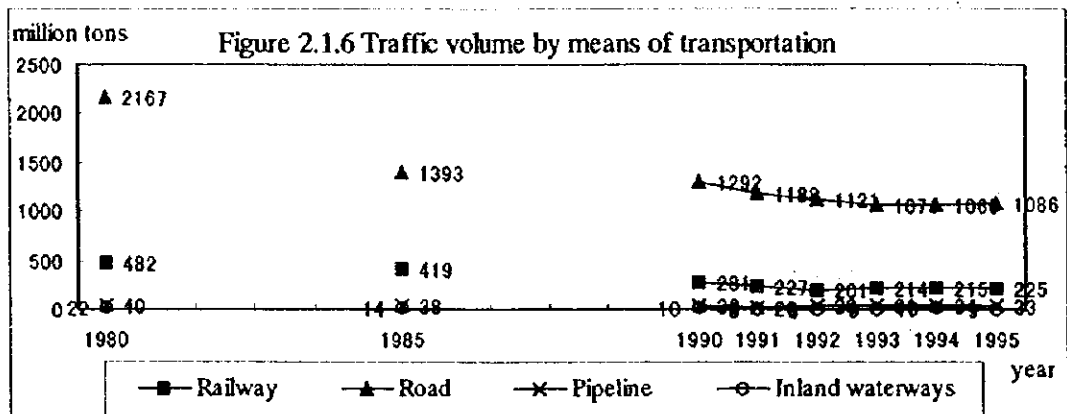
In 1980 when the planned economy was carried out, freight traffic volume amounted to

482 million tons and 134.7 billion ton-km. By 1990, however, plummeted 282 million tons and 83.5 billion ton-km due to the change of the economic system, and decreased further in 1992 to 202 million tons and 57.8 billion ton-km. In the following years, freight volume followed an increasing trend while fluctuating in the process, reaching 225 million tons and 69.1 billion ton-km in 1995.

Table 2.1.7 Traffic volume by means of transportation

Year	1980	1985	1990	1991	1992	1993	1994	1995
Freight tonnage (unit : million tons)	2711	1864	1617	1449	1360	1325	1319	1353
Railway	482	419	282	227	201	214	215	225
Road	2167	1393	1292	1188	1121	1071	1060	1086
Pipeline	40	38	33	26	30	31	34	33
Inland waterways	22	14	10	8	8	9	10	9
Freight tonnage (unit : hundred million ton-km)	1982	1755	1386	1157	1123	1179	1260	1347
Railway	1347	1206	835	651	577	643	657	691
Road	445	366	403	396	420	407	453	512
Pipeline	170	169	138	103	119	122	142	135
Inland waterways	20	14	10	7	7	7	8	9

Note : Poland national statistics annual report and PKP annual report



(2) Trends in Freight Transportation Items

In Poland which had performed the role of the energy supply base in the old economic system, coal occupies a large proportion of the gross national production, and coal transportation by the national railway stood at 62 million tons in 1980, which accounted for 34% of the freight traffic volume. During the shift of the economic system, the gross national production suffered a substantial decrease, and therefore the railway transport volume sharply dropped from 482 million tons in 1980 to 225 million tons in 1995, a marked 47% decline. Nonetheless, coal being most suited to railway transportation, coal transportation on railway suffered a relatively small decrease, registering 60% of the total volume transported by rail in 1992.

The transport volume of the items other than coal is the way to gradual recovery after falls in transport volume up until 1992. A general look at performance from 1990 to 1995 reveals that large-volume primary products, such as coal, ore, and stone, occupy a substantial proportion of the total transport volume, whereas agricultural products and agriculture-related goods, including fertilizer do not amount to much, nor do secondary products a sizable proportion of the transport volume.

Table 2.1.8 Trends in freight transportation items

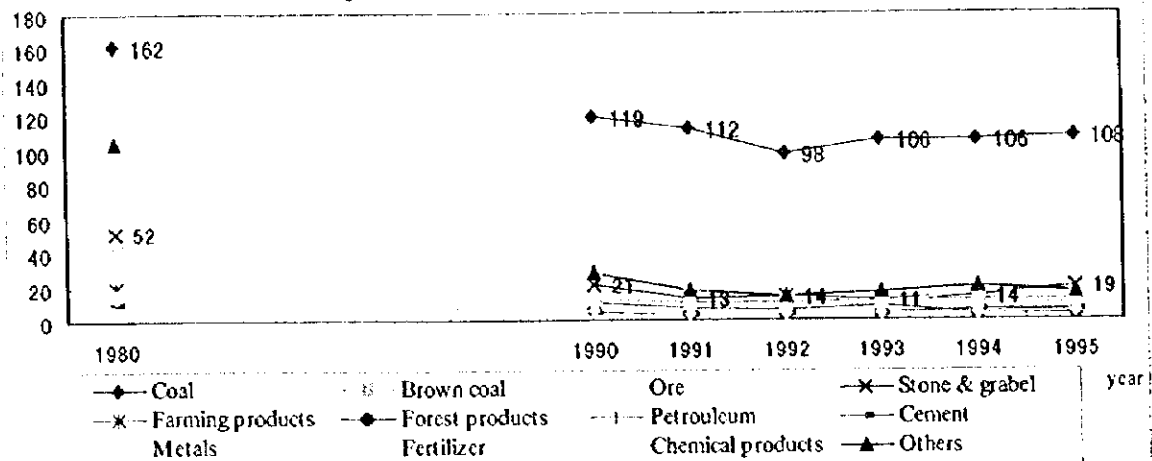
(Unit : million tons)

Year	1980	1990	1991	1992	1993	1994	1995
Coal	162 (34)	119 (43)	112 (50)	98 (49)	106 (49)	106 (50)	108 (48)
Brown coal	18	11	10	10	9	9	9
Ore	27	14	11	9	9	8	14
Stone & gravel	52	21	13	14	11	14	19
Farming products	20	10	7	6	8	4	6
Forest products	13	6	4	3	3	3	3
Petroleum	17	12	10	10	11	11	12
Cement	10	5	3	3	4	6	6
Metals	44	26	18	14	10	15	17
Fertilizer	14	6	4	4	4	4	5
Chemical products	15	11	9	8	9	9	10
Others	104	28	17	14	16	19	16
Total	482	281	225	200	213	213	224

Source : PKP annual report (The figures in parentheses are percentages to totals.)

million tons

Figure 2.1.8 Trends in freight transportation items



(3) International Transportation

In 1995, international freight transportation by PKP amounted to 82.8 million tons and 34.3 billion ton-km, which account for 37% in tonnage and 50% in ton-km in PKP's total freight transportation. From this, it is presumed that PKP's international freight transportation is on the track to recovery while the Polish economy is moving from the chaotic period to stability.

International transportation consists of export, import and transit. Among these three, exports represent the largest share in international transportation, accounting for 66% in tonnage and 67% in ton-km.

Table 2.1.9 PKP's international freight traffic volume

Year	1990	1991	1992	1993	1994	1995
Traffic (million tons)	278	225	200	212	213	224
Domestic	198(72)	166(74)	143(73)	149(71)	72(66)	141(63)
International	79(28)	59(26)	55(27)	64(29)	72(34)	83(37)
Export	49	41	39	41	51	55
Import	23	13	13	17	16	22
Transit	8	4	4	5	6	6
Traffic (100 million ton-km)	835	651	577	643	657	691
Domestic	485(68)	418(64)	359(62)	372(68)	345(53)	347(50)
International	349(42)	233(36)	217(42)	271(42)	311(48)	343(50)
Export	215	154	183	183	227	233
Import	89	55	65	65	56	78
Transit	45	24	23	23	28	32

Source: PKP annual report (The figures in parentheses are percentages to totals.)

Among the items associated with international transportation, coal accounts for a large share in exports while ore represents by far the greater share in imports. The recent trend is an increase in products transportation by containers, etc.

Table 2.1.10 Railway transportation of imported goods

(Unit : thousand tons)

Item	1980	1985	1990	1995	Remark
Coal	1073	1071	574	1131	
Brown coal	4	97	7	45	
Ore	20161	12111	8506	6215	Due to change of economic system
Stone, etc.	60	65	45	63	
Petroleum	2284	2015	1496	1538	
Metals	3709	2871	2144	1352	Due to change of economic system
Cement	97	10	30	2	
Fertilizer	3423	4035	915	935	Increase in domestic production
Chemicals	1249	1026	1064	1759	
Cereals	7035	1866	1360	1655	Due to change of economic system
Other farming products	2224	1451	642	811	
Lumber	533	459	172	303	
Others	3761	3304	1791	1420	
Total	45613	35638	22709	22015	

Table 2.1.11 Railway transportation of export goods

(Unit : thousand tons)

Item	1980	1985	1990	1995	Remark
Coal	30727	34088	26102	31790	
Brown coal	1702	1666	3346	3928	
Ore	18	185	84	191	
Stone, etc.	155	68	76	3154	Construction boom in Germany
Petroleum	831	481	1032	762	
Metals	3000	2756	5497	3808	
Cement	1233	1152	712	3113	Construction boom in Germany
Fertilizer	297	210	1456	1570	
Chemicals	3694	3193	3116	3676	
Farming products	524	1580	2278	1724	
Lumber	1553	2126	742	315	
Others	2725	2403	2481	2116	
Total	46459	52645	49146	55256	

Figure 2.1.9 Railway transportation of imported goods

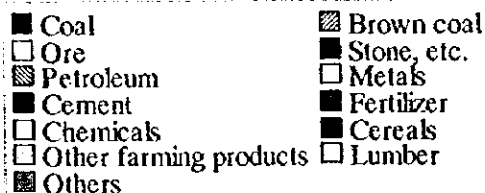
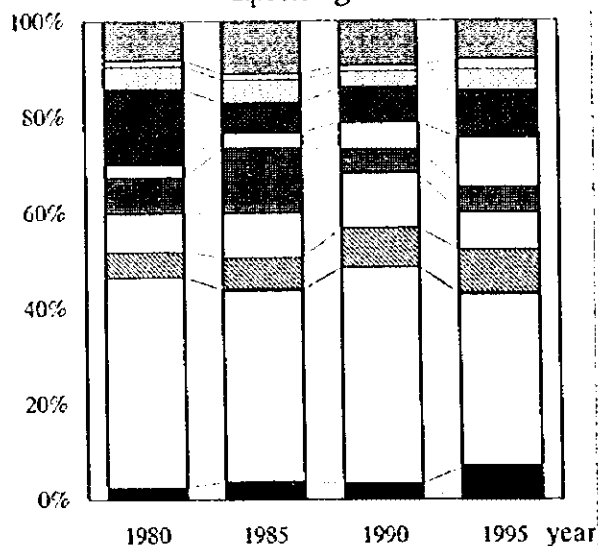
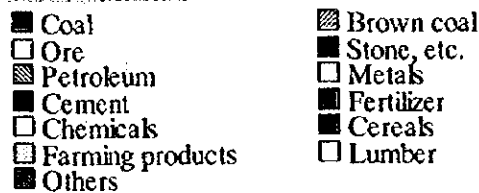
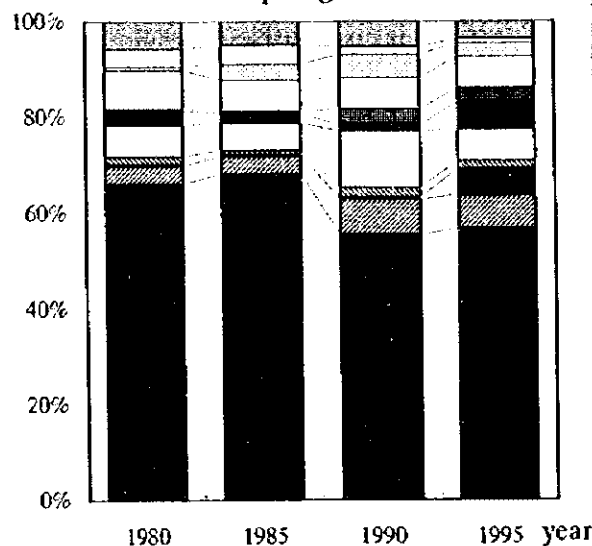


Figure 2.1.10 Railway transportation of export goods



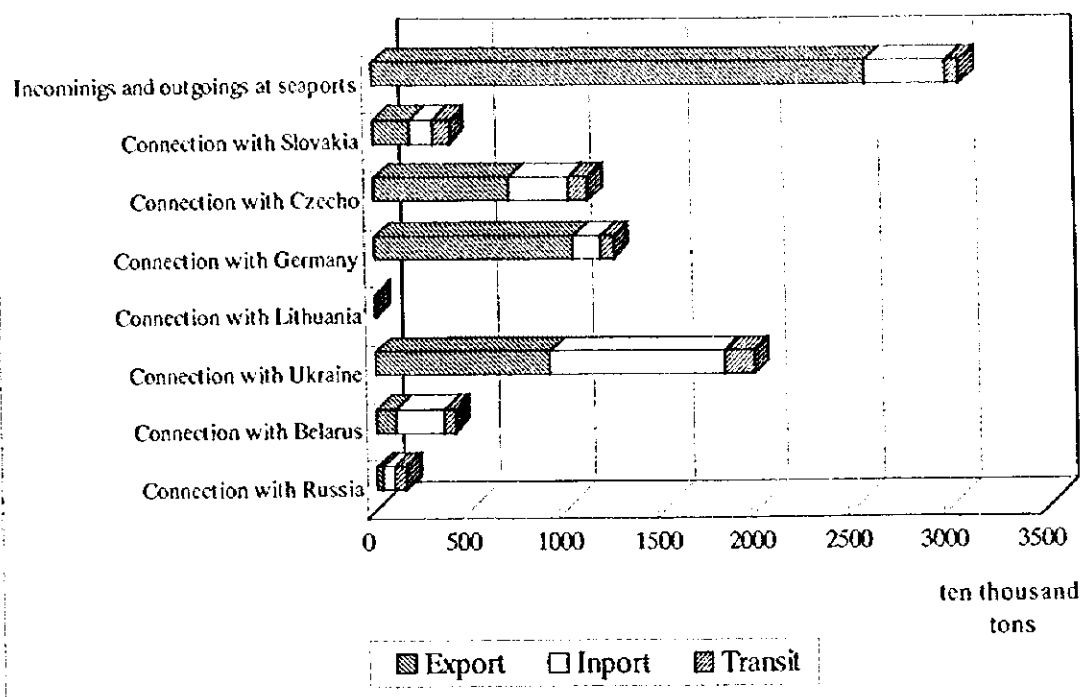
As junction station for international freight transportation, there are 36 stations (31 inland stations; 5 seaport stations). The traffic volume of international cargoes in those stations in 1995 is shown below.

Table 2.1.12 International freight volume by rail

(Unit : ten thousand tons)

	Export	Import	Transit	Total
Connection with Russia	32	55	62	94
Connection with Belarus	102	252	56	411
Connection with Ukraine	903	903	161	1967
Connection with Lithuania	1	2	3	6
Connection with Germany	1034	140	66	1239
Connection with Czecho	695	312	105	1115
Connection with Slovakia	190	118	91	399
Incomings and outgoings at seaports	2569	418	71	3059
Total	5525	2201	564	8291

Figure 2.1.11 International freight volume by rail



As the track gauge differs in Russia, Lithuania, Belarus and Ukraine, goods for these states are transshipped at the junction stations near the national border.

On international transportation, bilateral agreements have been concluded with the trading partner countries, while the transportation plan was formulated to facilitate the traffic such that 60 international preferential freight trains (TEA,TEC,TED,TET) have been designated and given top priority and differentiated from some 480 international general trains (TGL,TGR,TGZ,TGT) in transportation operations.

2.2 MANAGEMENT AND FINANCIAL SITUATION

Methods for determining a company's share price depend heavily on the Balance Sheet (e.g. Net Asset Value method) or the Profit & Loss Statement (e.g. Earnings Per Share method).

The accounts of the PKP are not the consolidated (acquisition method) results of the PKP and its subsidiaries.

2.2.1 Analysis of the 1996 financial statements

(1) The Balance Sheet

The Balance Sheet shows assets/liabilities of 21,956,543,600 PLN, up 763,462,200 PLN.

- Tangible fixed assets

	PLN 000's	1996	PLN 000's	1995
Land	5,519	0.03%	4,968	0.03%
buildings & constructions	13,746,263	69.8%	13,825,033	72.2%
technical equipment and machines	919,465	4.7%	835,659	4.4%
means of transport	3,962,825	20.1%	3,792,532	19.8%
other	1,067,390	5.4%	681,707	3.6%
Total	19,701,462		19,139,899	

- The value of land shown in the Balance Sheet is 5,519,317 PLN (about US\$1.9 million @ \$1 = 2.8755). 97% of the land utilized by the PKP is not owned and thus not included.

- Investments of 1,798,888,500 PLN during 1996 were financed by:

International Bank for Reconstruction and Development (IBRD)	94,942,600
European Investment Bank (EIB)	122,426,500
Polish Government subsidy	385,430,200
PHARE and the PKP	1,122,168,000
Other foreign credits	73,921,200

- The long-term liabilities of 762,28,400 PLN (1995 – 507,137,751) are owed to:

	1996	1995
IBRD	367,245,044	303,654,489
EIB	321,503,585	203,483,262
Bank Kreditanstalt	73,479,780	

The long-term liabilities account for just 3.5% (1995 - 2.4%) of total assets ¹.

(2) The Profit & Loss Account

The P&L shows a loss of 260,997,600 PLN (1995 a loss of 106,221,531 PLN). If we exclude depreciation but include state subsidies, then there is an operating profit i.e. positive cashflow from operations of 871,978,563 PLN (1995 – 745,163,473 PLN).

¹ Annex I/2 of the EU White Paper "A Strategy for Revitalising the Community's Railways" shows that the EU average was 54% in 1994 (highest 89% and lowest 14%). Thus the PKP at 3.5% has a smaller proportion of debt than any EU country.

- Revenues

The total revenue of 8.4 bn PLN was from freight (5.0 bn PLN), passengers (1.2 bn PLN) other sources (1.2 bn PLN) and government subsidies (1.0 bn PLN). Revenues increased by less than the rate of inflation. Freight handled was 222.6 m tons (down 0.8%) and was carried 68306 m ton-km (down 1.1%). Passengers carried totaled 433.5 m persons (down 6.8%) over a distance of 26,558 m passenger-km (down 0.2%).

Freight tariffs rose on average by 18.3% whilst passenger tariffs rose by an average of 14.5%. These increases can be compared to consumer price inflation (19.9%).

- The depreciation expense for 1996 of 1,132,008,041 PLN (1995 – 851,385,004 PLN) is a 33% increase. Otherwise the PKP would have made a profit.

- PKP's operating ratios are ²:

	1996	1995
with subsidies	102.9	101.3
without subsidies	116.2	117.5

(3) The Cashflow Statement

The Cashflow Statement for the year to 31 December 1996 shows a net decrease in cash of 92,990,155 PLN (1995 -- increase of 202,797,027 PLN) to 366,013,537 PLN (1995 – 459,003,692 PLN).

2.2.2 Analysis of PKP's 20-year forecasts

The analysis of PKP's 20-year forecasts dated 24 June 1996 (in 1995 prices) shows :

(1) Optimistic scenario results

- Freight and Passenger revenues increase by 11% and 44% respectively
- Other income increases by 637m PLN
- Losses peak at 776m PLN in 1998 and improve to a profit of 38m PLN in 2005
- Investment of 16,737m PLN (1997 to 2005)
- Total borrowing in 2005 of 2.5bn PLN (1996 – 2.5 bn PLN)

(2) Pessimistic scenario results

² The PKP has contracted to control these ratios as part of their debt agreement with the IBRD.

- Freight and Passenger revenues decrease by 9% and 7% respectively
- Other income increases by 313m PLN
- Losses peak at 1,067m PLN in 1998 and improve to a loss of 935m PLN in 2005
- Investment of 11,875m PLN (1997 to 2005)
- Total borrowing in 2005 of 2.2bn PLN (1996 – 2.5 bn PLN)

2.2.3 Requirements for PKP restructuring / privatization

Requirements (for improvements) for privatization that have been identified are :

(1) Disclosure requirements

In order to attract investors to any separated part of the PKP or to the Holding Company, increased financial information is essential.

- 1) The Annual Report PKP 1995 (in English) certainly does not meet the disclosure requirements as required by 'Western' countries. And International Stock Exchanges
- 2) The PKP should also provide "current cost" financial statements (per IAS 29).

(2) Briefings for analysts

In addition to the Annual Report, the PKP will need to make private presentations several times a year to representatives of financial institutions (Analysts, Stockbrokers etc.) Detailed information needs to be presented and all questions answered.

(3) Financial Management Skills

1) The current finance function can be characterized as being concerned mainly with :

- external reporting/accounting
- technical compliance with Polish accounting law;
- concentration by staff on book-keeper/administrator/custodian roles.

2) Requirements for the future :

- business leadership in terms of the advice given to management and meeting agreed service levels to the business;
- "value-added" advice and improvement of the business;
- professional financial managers to manage the business and provide a professional service.

(4) Auditors role in cost allocations

It is recommended that the PKP & MTME should use the services of auditors to check the cost allocations.

(5) Use of auditors for subsidy determination

The amount of subsidy that should be paid by the State to the PKP (by line / service) is difficult for the State to verify as many costs have been apportioned. The PKP and the State could similarly agree that auditors would verify the amounts to be reimbursed for uneconomic services that the PKP is obliged to provide.

2.3 RESTRUCTURING PLAN PKP ITSELF

2.3.1 Main Objectives

The main objectives of the PKP restructuring plan are:

- market oriented modern company as a part of the European railway system
- financial equilibrium in the first stage and generation of profits in the further stages
- strong competitive position both for other transport branches and other railway operators

In order to achieve these objectives, the following strategic goals are postulated:

- a) adaptation to the market economy
- b) harmonization of PKP standards to the European Union
- c) internal rationalization of PKP operations

2.3.2 Actual Progress made to date

The PKP will be composed of:

- four sectors - passenger transport, freight transport, infrastructure and traction with workshop βαγκων and twelve verticals of service functions, i.e. real estate, housing, welfare, pensions, railway health care, data processing, telecommunication, power engineering, training, procurement, railway security service and units subordinated to the Management Board of PKP.

In addition, two new legal acts have been elaborated:

- Railway Transport Act, approved by the Parliament in July 1997
- Draft of PKP Restructuring Law, submitted to the Parliament in April 1997

The Railway Transport Law, following the EU directives, introduces:

- open access to infrastructure for operators outside PKP
- infrastructure charges and their determination
- concession rules for operators
- rules of technical control for railway operations and safety

The draft of the PKP Restructuring Law proposes

- an establishment of the Agency of Railway Property (ARP) outside PKP and its subordination to the Ministry of Transport
- rules of ARP operations for property, transferred from PKP as surplus assets, housing, land and real estate, both with solved and unsolved legal ownership or documentation, liquidated unprofitable lines with infrastructure and other assets
- scope of allowances for employees during the PKP restructuring.

2.3.3 Evaluation of the Pilot Program in the Eastern DOKP

On 1st January 1997 the implementation of the pilot restructuring program began in the Eastern DOKP with the organizational restructuring into sectors and verticals. The most important part of the pilot experiment is the economic-financial restructuring. This process covers the introduction of management accounting, new financial system, new principles of bonus motivation and systems of mutual settlements. The new financial system allows for settlement of costs in their place of origin for all units in sectors and verticals, cost allocation to freight and passenger transportation, calculation of maintenance costs for lines and objects and determination of unit costs. The assets have been specified and allocated to infrastructure, traction with workshop backup and to newly established real estate vertical. The surplus assets, estimated at 30%, have been already reduced by 10% and transferred to the real estate vertical. It is planned to transfer them later to the Agency of Railway Property. The Lublin experiment is also being conducted in an intensive cooperation with employees and trade unions („mentality restructuring“) and under assumption of no layouts outside the company, but with necessary transfers within DOKP.

It is difficult to evaluate the experiment in a comprehensive way due to its short time of operation and lack of many important indicators and data. However an attempt of rough evaluation has been conducted using two simple criteria - financial-economic effects and social impact. The presented evaluation is based on available documents and the meeting with the Director of the Eastern DOKP Mr. Augustowski, on 10th July 1997 in Lublin.

Evaluation of the Eastern DOKP experiment

Financial - Economic Effects	
Advantages	Disadvantages
<ul style="list-style-type: none"> • Increase of revenues (not disclosed) • Decrease of total costs (not disclosed) • Increase of efficiency (not disclosed) • Increase of nominal wages by 28% and its direct link to efficiency • Decrease of unit costs • New realistic cost allocation • Clear determination of costs for each enterprise (including assets) • Determination of infrastructure charges • Identification of surplus assets • Projected balanced final result (no loss / no profit) for 1997 • Possible decrease of government subsidies • New organizational and business culture structures • Improvement of management • Improvement of services • Improvement of motivation system • Testing and improvement possibility before implementation to the entire PKP 	<ul style="list-style-type: none"> • Lack of internal settlements for sectors (introduction planned on 1 January 1998) • Time consuming process for identification of surplus assets • Lack of legal status for ownership (90% of real estate) • Lack of plans for separation of company units outside or with PKP shareholding and their privatization • Surplus employment allocated only within PKP („social peace“)
Social Impact	
Advantages	Disadvantages
<ul style="list-style-type: none"> • Maintenance of „social peace“ (no strikes) • “Mentality” restructuring of employees <ul style="list-style-type: none"> a) active participation in the restructuring process b) identification with the company aims c) creation of positive attitude towards restructuring and future privatization 	<ul style="list-style-type: none"> • Possible too high allowances for the maintenance of „social

Generally, the experiment seems to be a success story. The restructuring is being realized gradually and without any significant disturbances. It is interesting to notice that the careful surplus employment policy can be evaluated simultaneously as an advantage from the social point of view and disadvantage if a pure economic criterion only is applied.

2.3.4 Timetable for the Future

PKP has elaborated its own program of transformation and privatization. The program distinguishes four stages of transformation into a commercially oriented company until 2015, independent on the state administration and running business on the criterion of profit maximization. The realization of public service shall be based on negotiated contracts with the government or local governments.

- The first stage („centralized structure“), until the end of 1998, aims at creating of sector and vertical structure with full internal settlements. An eventual privatization shall be limited only to some selected activities, e.g., social activities, and will not cover the core operations. The integration processes with the EU programs will be conducted as well. There is also assumed to terminate and implement the Eastern DOKP experiment to the entire company. The PKP intends to issue bonds to finance the infrastructure, rolling stock and backup. The legal ownership of land, real estate and apartments shall be also gradually clarified and allocated. This transformation stage shall result in a minimization of the financial loss.
- The second phase („integrated structure“), from 1999 to 2002, shall create an organizational independence for all four sectors. The infrastructure sector will be organizationally *σεπαρατεδ* (inside PKP) according to the Railway Transport Law and EU Directive 440/91. The activities of verticals will be expanded through services outside PKP. It is planned to establish the Agency of the Railway Property (ARP) outside the company and transfer the surplus assets there. The full integration with the EU regulations is assumed as well. The company should reach the financial equilibrium.
- The third stage („integrated structure“ - Joint Stock Company of the State Treasury PKP SA), will cover the transformation of PKP into a Joint Stock Company of the State Treasury PKP S.A. in the period from 2003 to 2005. The sectors will be fully independent with settlements on the principle of „internal customer“. The transfer of surplus assets to the Agency of Railway Property will be terminated. The PKP SA

οηαλλ be fully integrated with the Western European railways (membership of the European Union is expected in 2003). The company should also generate profits.

- In the fourth stage („holding structure“) after 2005, the privatization through IPO (Initial Public Offering) will be performed. The new capital flow will accelerate the further development of the company. It shall influence on new competitive offer through modernization of infrastructure, rolling stock, backup and information system. The Polskie Koleje S.A. shall reach a significant financial surplus.

General remarks

The PKP transformation program is an interesting and coherent document reflecting a picture for modern railway company, integrated with the European system. Its scope covers the most important aspects of restructuring, simultaneously taking into account the Polish circumstances.

Let us concentrate our comments and remarks on some selected problems:

Impact of social factors

- The PKP restructuring program indicates a strong influence of social factors on the employment ρεστρυχτηρινη. The plan does not assume any massive layoffs and aims at performing of smooth path for gradual employment adjustment. This solution is a result of present employment policy, strongly affected by trade unions. There is no social compliance for a massive PKP employment reduction, observed in the years 1990 - 1992. The „social peace“ approach dominates over the economic and financial restructuring criteria. It is expressed by a careful determination of size and structure of employment, taking into account specific Polish features, e.g., very low mobility of labor force, lack of housing, still high unemployment rate etc. The rationalization of employment is conducted in cooperation with the trade unions through social agreements and supported by the government and EU funds. This policy will finally result in an employment reduction by 53 thousand (23%) in 2005 and by 76 thousand (33%) in 2015 as compared with 1996.

Limited separation of PKP units

- The restructuring program limits the separation of PKP units to some non-core social activities in the first stages. A creation of new companies is projected in the third stage after 2002. It seems to be too hard constraint. There are legal possibilities for a separation of other units with or without shareholding of PKP (Art. 22 and Art. 44 of the PKP Law) and τηρειν further privatization. These processes could be performed

only on the „initiative basis“ of management and employees with positive statement from the trade unions and PKP management. For example, these processes could encompass some traction and workshop backup enterprises or other enterprises with potentially existing demand for their services also from outside PKP. Such bottom up procedures would enable to rationalize employment and assets in a smooth way. Also an establishment of joint venture companies with PKP as shareholder in some freight market segments, not necessarily the most attractive ones, could enable an improvement in financial results. A new joint company could execute transportation payments in more efficient manner („first payment and then service“ following the passenger transportation pattern). It would also improve the cash liquidity and eliminate a creation of „bad loans“.

Marketing approach

- Financial and organizational restructuring introduces new corporate culture structures into PKP. The main aim is to reduce costs and increase revenues through a comprehensive improvement of all activities at the presence of other operators and competitors. PKP should develop many new products, supported by aggressive marketing activities, so called „new offer approach“ (not only market driven one) to attract new customers, e.g. annual railway card (very successful product in Germany), special weekend family tariffs, etc. A special role should be played by strong marketing for qualified passenger transportation as a potential source for increase of revenues. This approach should be additionally expanded through active participation in railway related businesses generating profits already in the years 1998 - 2002.

Sources of investments

- One of the most important problems for the PKP future is its investment strategy. PKP own financial possibilities do not cover the growing investment needs, especially after deep investment shortfalls in the last few years. The planned issue of bonds in 1998 (no amount disclosed yet) seems to be a proper step. The policy towards new financial sources shall be expanded earlier, i.e. in the second stage of transformation. A promoting role of the government should be also continued. The consolidation processes of banking system in Poland and growing participation of foreign banks shall create a good offer of banking products. The market will offer a choice from traditional loans in different currencies and different commercial banks or international financial institutions to issues of bonds and leasing.

Split of passenger and freight units

- The restructuring program does not propose a split of passenger and freight

transportation into smaller units of highly specialized profile. These solutions exist in other countries and seem to be a natural way towards an increase of efficiency and effectiveness. The passenger transportation could be divided in accordance with types of services into inter-city, agglomeration and local (regional) companies. The freight transportation could be reshaped into 3-4 units accordingly to homogeneity of commodity groups. Such a split would create impetus to improve management, employment rationalization and financial results.

2.4 RESTRUCTURING PLAN SUPPORTED BY THE WORLD BANK

2.4.1 Basic Concepts

The restructuring plan for PKP, prepared by the Mercer Management Consulting and financially supported by the World Bank, postulates two main objectives of the restructuring and reorganization of the PKP

1. creation of a market oriented commercial railway that applies the best world models in reference to quality standard of service and costs, facilitating an effective competition with road and air transport
2. minimization of the railway transport costs for the Government.

The study discusses five approaches to the PKP restructuring:

- Continuation of current strategy (state before the beginning of PKP own restructuring program).
- Acceleration of improvement actions within current structure.
- Creation of Restructuring Agency within PKP and restructuring.
- Splitting into New PKP and a separate Restructuring Agency and restructuring.
- Privatization the enterprise either in whole or in parts.

2.4.2 Role and Functions of the Restructuring Agency

The PKP restructuring with a separate Restructuring Agency has been proposed as the most desirable variant. Its evaluation is presented in the table below.

Selected Option	
Split into New PKP and a Restructuring Agency and Restructure	
<ul style="list-style-type: none"> - Creation of a separate Restructuring Agency - Identification of surplus assets and non-core lines and transfer their management to the Restructuring Agency - Creation of commercially oriented „New PKP“ with cost-competitive level of assets and staff 	
Advantages <ul style="list-style-type: none"> - Breaking of previous organizational and cultural structures - Clear separation of activities - Irreversible change - Management can focus on providing high quality, low cost rail service - Reduction in cost to the Government 	Disadvantages <ul style="list-style-type: none"> - Possible disruption in short term with impact on service quality - Takes time and effort to get prepared for the change (e.g. separation of assets, employees) - Risk of Restructuring Agency continuing for a long time

The proposed variant of the PKP restructuring includes an establishment of the separate Restructuring Agency on the basis of the following principles:

- Transfer of all surplus labor, real estate, rolling stock and non-operating services (except health) and light density lines
- Setting a limited period of operation of the Restructuring Agency
- Determination of funds for Agency in the fixed required time
- Identification of the status of Restructuring Agency as a Government Agency (probably under the responsibility of the Ministry of Transport)
- Establishment of a Board of Directors and designing a management structure similar to those of commercial companies
- Appointment of Chief Executive and members of top management with commercial experience
- Setting of time limits for implementation of tasks and introduction of a system of incentives to management to stimulate tasks within agreed time limits
- Identification of an obligation to proceed with retraining, early retirement or severance payment

The Restructuring Agency will be separated into four divisions covering assets, employees, non core lines and administration:

- The Asset Management Division, divided into four departments - Real Estate, Apartments, Business Activities and Equipment
- The Employee Management Division, composed of two departments - Severance and Early Retirement and Outplacement
- The Non Core Lines, divided into three departments - Operations and Economic

Analysis, Line Transfers and Line Closures

- The Support and Administration, composed of three departments - Finance and Accounting, Legal and Human Resources

The total staff of the Restructuring Agency will oscillate between 50 - 62 persons between 1997 and 2001 and after this year a decrease in staff is assumed to 12 persons until 2005. The projected revenues will exceed costs after two years of Agency's existence and should result in an increase in profit until 2005.

Comment:

The proposed employment for the Restructuring Agency seems to be underestimated in order to match its scope of tasks and division into twelve departments. The assumption of 60 persons, including regional branches, is not realistic. In addition it would be difficult to separate the competencies of the Agency, e.g. for the non-core lines department from the competencies of railway operator.

2.4.3 Treatment of Employees and Assets

The employment restructuring is based on analysis of different European railways and assumes that PKP would need 20% more employees to compensate the technological gap. After this adjustment the targeted PKP employment should be 180 thousand in 1998 and about 110-120 thousand in 2005.

The Mercer Management Consulting has attempted to estimate revenue from sale of non rail, non core and surplus assets (presented below).

Revenue from Sale of Assets

Assets / activities	Revenue Potential (PLN million)	Comments
Surplus land	700 - 2 800	Assuming 10-40% range of surplus and minimum scenario. value calculated for land in Warsaw agglomeration only
Apartments	700 - 1 700	Assuming 20-50% of market value
Surplus buildings	140 - 270	Assuming 25-50% range of surplus (only central buildings in 9 major agglomerations)
Surplus rolling stock	140 - 270 50 - 60	Estimated value according to efficiencies of Western railway Assuming net book value (underestimated)
Social assets	10 - 20	Assuming 3-5 years of capitalized revenue
PKL	< 10	No data received
POLRES		

Source: Mercer Management Consulting

Comment:

The table indicates that the main source for revenue is sale of surplus land. It can not be accepted in the situation of 10% legally proved land ownership and long lasting legislative procedures. In addition, the total PKP legally proved land amounts only for 5.5 million PLN, an equivalent of 0.03% total its assets in 1996.

2.4.4 Financial Evaluation of the Selected Restructuring Variant

The proposed restructuring option has been analyzed in the context of total financial aspect, including all potential costs and benefits and involvement of all organizations to the restructuring process. The calculations have been conducted under the following definitions and foundations:

- The benefits of the restructuring is the sum of wage savings and revenue from sale of assets (see comment above)

The costs of the restructuring is the sum of severance payments, cost of retraining, outplacement, performance bonuses for the New PKP employees and costs related to the sale of assets. The total net benefits of the PKP restructuring exceed PLN 10 bn.

Total Financial Results of the PKP Restructuring (constant 1996 PLN million)

Restructuring Agency	Labor Fund	New PKP	Total
Redundancy payment	Unemployment benefit payments	Performance bonuses	
1 071	321	2 015	
Costs related to labor reduction			
21			
Administrative costs			
75			
Costs related to asset sale			
48			
Total costs	321	2 015	3 552
Revenue from sale of assets		Wage savings	
2 400		11 547	13 947
Cost / benefit	321	9 531	10 395

Source: Mercer Management Consulting

2.5 REQUIREMENT FOR PKP PRIVATIZATION

2.5.1 History of Polish Privatization

The legislative framework for a comprehensive privatization program of the State Owned Enterprises (or SOEs) was initiated by the Law on the Privatization of State Owned Enterprises passed on July 13, 1990 and followed by other laws. The modified new Law on the Commercialization and Privatization of State Owned Enterprises was passed on April 8, 1997.

The government philosophy to the privatization processes in Poland, implementing a variety of privatization methods (multi-track), can be characterized by two decision elements - individually formulated general privatization program by the government for particular enterprises (case by case approach) and a relatively high degree of freedom given to the privatized enterprises concerning the detailed privatization program and choice of the privatization method. The reliance placed on voluntary participation by so called "insiders" represented by managers, employees and trade unions aimed at the acceleration of privatization processes by avoiding the unexpected conflicts which would result by the centralization of these processes.

2.5.2 Various Methods of Privatization

The conducted privatization programs include the following methods:

- (1) Indirect privatization (capital privatization) is intended for large and medium sized, relatively prosperous SOEs. First a SOE is transformed into a joint stock company with all shares owned by the State Treasury. A new company operates according to the Commercial Code. The State Treasury shares can be sold to the third parties through the Initial Public Offering (IPO), tender or by invitation to negotiations.
- (2) Direct privatization
The direct privatization through liquidation according is applied for relatively prosperous small and medium sized enterprises (less than 500 employees with revenues not exceeding ECU 6 million). This method can be executed through asset sale, contribution into a company or lease to a company created by a majority of the employees. The asset sale of the company can be realized through tender or invitation to negotiations.
- (3) Stabilization, Restructuring and Privatization Program is aimed at companies in critical financial condition by providing appropriate management expertise, cash injections, and other tools.

- (4) Privatization through Restructuring is applied for enterprises which require restructuring prior to privatization
- (5) Bank Debt Agreement Procedure is intended for enterprises in poor financial conditions. SOEs are commercialized and a part of their shares is transferred to their creditors.
- (6) The Mass Privatization Program (MPP), created as a key element of the restructuring and acceleration of privatization processes through the 15 National Investment Funds (NIF) and was established in December 1994, encompassing 512 companies.

2.5.3 Relationship with EU Directives

The EU directions of railway transformation are presented in the following documents:

- Decree 1893/91
- Directive 91/440
- Directive 95/18
- Directive 95/19

The present state and directions of development for railway transport were analyzed in the EU „White Paper. A strategy for revitalizing the Community’s railways“ in 1996. The document critically evaluates the railway insulation from market forces and stresses a certain government responsibility for imposed obligations without compensating fully for the costs. The proposed railway development should be determined by:

- creation of a new railway based on business orientation with independent management
- government aid intended to relieve the railways of debt and improve their finances and its linkage to restructuring program
- adoption of market forces by
 - a) open access for all freight and for all international passenger services, supported by the separation of infrastructure management and railway operations
 - b) open access for domestic passenger transport in respect to network benefits and public services
- generalization of public service contracts (PSC) between the government and railway operators
- full financial compensation of public services and exceptional social costs by the government

- integration of national railway systems
- establishment of government and EU programs for the redundant employment

The processes of PKP harmonization and adjustment to the EU standards are expressed by two legal acts:

- PKP Law of 6 July 1995
- Railway Transportation Law, approved by the Parliament in July 1997

The PKP Law postulates a decisive autonomy of the company, however not changing PKP into a company operating according to the Commercial Code. The competencies of the PKP Council are similar to a supervisory board and the PKP Management to a board management in a joint stock company.

The separation of infrastructure sector is postulated by the PKP Law. This process, planned to be terminated by the end of 1998, has been already advanced in the Lublin experiment. PKP restructuring plan assumes that the infrastructure sector will remain in the company structure. The Railway Transport Law determines the rules for infrastructure charges, following the EU directions. The EU rule of an open access to the infrastructure is also included in the Railway Transport Law. This liberalization factor enables the open access to other operators, domestic and international, if they possess a proper concession. In the case of foreign operators the permission is issued by international (bilateral) agreements, in which Poland is one of the parties.

The principles of public service contracts are included in the PKP Law and executed by the annual agreement between PKP and the government (see section 5.8). The subsidy targeted to domestic passenger transportation covers agglomeration, urban and regional transportation. The agreement also determines government subsidy for investments on railway lines of national importance, implementing the AGC and AGTC agreements. The subsidy is not transferable (no cross subsidy), following the EU directives.

2.5.4 Requirement for the PKP Privatization

The PKP privatization should create a business oriented company with independent management operating according to market rules. The privatized PKP shall improve the enterprise performance in the following, widely accepted, scope (see also discussion in section 5.3):

- effective company management

- increase of efficiency
- development of competitive market position
- increase of quality for services
- satisfaction of customers
- access to capital and know-how
- cost rationalization
- maximization of profits

Let us consider the requirements of the PKP privatization for two possible kinds of the PKP transformation processes:

- privatization of PKP parts, called further small scale PKP privatization
- privatization of the entire PKP, called further large scale PKP privatization

The foundations for small scale PKP privatization are included in the PKP Law:

1. Article 44 - until December 31, 1998, the Minister of Transport may (after consultation with the Council of PKP) separate from the PKP organization units or organized portions of assets in order to further privatization
2. Article 22 - PKP may create business entities anticipated in the provisions of law
The privatization of the PKP parts, after separation from the company, can be further performed according to the Law on the Commercialization and Privatization. The privatization methods should be recommended in regard to employees' proposal, business activity and actual market situation.

It is proposed to use two methods for small scale PKP privatization (see section 5.2.2):

- indirect (capital) method
- direct method

additionally completed in exceptional cases by

- bank debt agreement procedure

The indirect method is especially recommended as ensuring capital inflows. The direct method with its different paths can be applied only for PKP parts, which have less than 500 employees. The bank debt agreement procedure can be used in exceptional cases to cover possible PKP debtors.

The small scale PKP privatization path could be an effective instrument in the PKP restructuring process. It would create new economic units from the PKP assets, both with and without PKP shareholding. However this form of privatization has not been used for the last two years 1995 - 1997. In addition, the PKP restructuring plan limits separation

and further privatization to the PKP social activities until the end of 1998.

The foundations for large scale PKP privatization are different due to the fact that the company acts according to its own PKP Law. The Commercialization and Privatization Law from April 8 1997 does not cover PKP according to:

- Article 3 pos. 7 as an SOE „acting under acts other than law on state owned enterprises

It means that the large scale PKP privatization requires a new PKP Privatization Law. Taking into account the size of PKP (over 500 employees) and the Polish Privatization Law, the indirect (capital) method can be only proposed (see discussion in section 2.5.2). The future PKP Privatization Law can be elaborated on the basis of the Commercialization and Privatization Law for indirect privatization method (see Fig. 1 presenting the privatization through transformation) combined with the existing PKP Law.

In the first stage of transformation the PKP must be corporatized into a joint stock company owned in 100% by the State Treasury and governed by the Commercial Code. Some elements of corporation procedure have been already included in the PKP structure (PKP Law). For example, the functions of the PKP Council are similar to a supervisory boards (including its composition needed to commercialization processes in Poland). Also the competencies of the PKP Management have many common features with management boards in joint stock companies.

The final goal of the large scale PKP privatization is the Initial Public Offering (IPO) and a successful listing on the Warsaw Stock Exchange (WSE). It means that the PKP should match all conditions of the WSE. The most significant conditions concern its financial results. According to the present state of WSE regulations, PKP S.A. must have registered a pre-tax combined profits for the past three financial years of at least PLN 5 million and a pre-tax profit for the last financial year (present state of the WSE rules). The future PKP S.A. must also have publicly disclosed audited annual financial reports for the last three financial years.

3. ISSUES TO BE SOLVED TOWARDS PRIVATIZATION

3.1 ROLES OF RAILWAY TRANSPORT

3.1.1 Railways Position in Transport System

(1) Commercial profitability of railway business

From eras in which railways play the leading role in the land transport, today's transport policy has been changed to focusing on the competition of different transport means, assuming the development of airplane and automobile traffic. It has been anticipated that the railway business also in Poland will face at competition among traffic means in the future, and the traffic system reorganization will advance on the basis of the commercial profitability through the competition between transport means under the common rules.

On the one hand, however, because of external effects, etc. in the traffic market, considerable cases, in which market mechanism does not work satisfactorily, are expected, for that necessary public regulations are required from the point of view of social benefit preservation.

1) Inter regional passenger transport

Focusing at characteristics of the railway system as a cost decreasing industry, in Poland, like Warszawa-Katowice and Warszawa-Gdansk, there are corridors to connect areas of high density distant from a few hundred kilometers. It is considered that such corridors create a prominent market to railway systems.

It is said that the railway can compete predominantly against the aviation in a range of less than 300 km of the transport distance. The above-mentioned corridors have satisfied this criteria.

2) Intra regional passenger transport

The railway can be said as the most suitable transport means to the public need in view of its mass transport capacity and being harmonious to the environment, and it is considered that in the big city area like Warszawa, the establishment of the municipal public transport system, incorporating the railway as a core system, is desirable. However, it is expected that the railway profitability is hardly maintained in the urban public transport similarly to the Western countries, it will be necessary that the urban transport is maintained by public financial assistance.

As for local transport, it does not meet the conditions for the railway business in view

of the profitability because the demand characteristics are of short-distance and low-density transport,. However, taking into consideration of such railway users without the transport means except the railway, it is necessary that the government should take initiative to provide alternative transport means when the local railway has to be liquidated.

3) Freight transport

As clarified by the present transport results, the main transport items of PKP are of bulk transport for coal, ores, oil, etc. It is expected that these key items will reinforce the importance of railway freight in the Polish industries in the future. Therefore, it is assumed that the bulk freight stands at the comparative predominance also in the railway industry. However, accompanied by the economic growth , main cargo item will shift from raw materials to the industrial product , it is considered that railway freight should maintain its position by developing the combined transport services in which railway freight has a close connection with road transport.

(2) Perspective of car traffic

It is expected that the development trend of road traffic affects considerably to activities of the railway as a significant competitor against the railway transport. First, the car ownership has grown rapidly at present , and considering an increase in economic growth and average income in the future, it is supposed that much more cars will be owned in households in the future.

On the one hand, with regard to the progress to the road provision , it is pointed out that situation is not necessarily optimistic . Regarding the present domestic trunk line network of approximately 367,000 kilometers (national roads to streets), after 1986 the finance of road maintenance has been reduced, and as the results servicing level of roads has been considerably lowered. Meanwhile ,with regard to the provision of expressway network, the construction plan extending over 2,600 km has been publicly noticed and it assumes to finish the construction of the road network within 20 years with total amount cost reaching to 100 billion US \$. However even apart from cost issue , it is considered that the plan target , which is to provide road network in use at a base of 160 km of annual average, is remarkably difficult to be realized , when considering the necessary term for design and assessment process carried out before.

In particular since the toll road provision has depended on employment of private sector as the BOT, etc. the business profitability becomes a crucial factor, and it is remained uncertain whether the construction plan will develop or not according to the initial target plan . Assuming the above-mentioned, concerning the car transport in the

future it is supposed that diffusion of automobiles themselves is progressed and the social and economic conditions act as a plus factor for the car use , however the perspective is not necessarily clear and lucid in the future because it has been unknown whether the road provisioning program favorably progresses or not .

(3) Role of railway from viewpoints of social economics

Rapid increase in car ownership has been progressed accompanied with the economic growth as seen clear in the present car registration state in Poland. It is foreseen that the present number of 7,000,000 units of cars more or less will reach to the level exceeding 12,000,000 units in the 21st century . If this increase continues in metropolitan areas like Warszawa, etc. the road congestion will be deteriorated more, and the lack of traffic capacity will become more serious. Apparently this trend gives undesirable effect to the environment and the living, and it is clear that the relatively moderate road improvement scale , that has progressed in the present urban area , does not meet a rapid increase of road traffic demand, and it is considered that the effective utilization of the mass public transport ,including the railway network , should be taken as the standard of urban transport policy rather than the increase of road capacity , as suggested from the Western experience .

3.1.2 Traffic Demand Outlook

(1) Traffic Demand Forecast

The demand forecast of railway passenger for this study was conducted by using the following "four-step method."

- First Step : Trip generation/attraction forecast
- Second Step : Trip distribution forecast
- Third Step : Modal choice
- Fourth Step : Traffic assignment

The potential number of the railway passengers was calculated by using the average number of trip for railway passenger over past 5 years of 0.0385 trip/day/person as a control total value. The number of the passengers who will transfer from the railway to automobile was assumed to be 130 million trips. Trip generation/attraction model were forecasted by using the multi-regression model assuming the population, the working population and GDP of each voivodship (prefecture) as independent valuables.

The trip distribution model followed the present pattern method by OD table among main stations based on the PKP statistics for ticket sales. In the modal choice model, the improvement of the speed and the effects on the rise of the fare were investigated by making the multinomial logit model from SP (stated preference) survey. The traffic assignment was distributed on the link based on the PKP railway network by all-or-nothing assignment method.

On the other hand, the demand forecast of railway freight employed "growth factor method" by the steps shown below:

- First Step : Forecast on production volume by commodity
- Second Step : Trip distribution forecast by commodity
- Third Step : Traffic assignment by commodity

The production volume by main 17 commodities were used as a control total value. The production volume was revised by the GDP future forecast and several statistics of the newest GUS (Central Statistical Office) based on the numerical value which was forecast in "PKP Restructuring Project" in 1993 and in 1995 through the World Bank. The trip distribution model was based on the OD table among the main stations by the statistics on the PKP rail freight transport. The traffic assignment was distributed by main commodities on the link based on the PKP railway network through the all-or-nothing assignment method.

The results for the demand forecast on the railway passenger and the railway freight are shown in table 3.1.1. The number of passengers in 2005 will decrease by 8% over that in 1995 and passenger-kms in 2005 will increase of about 7% over that in 1995. Meanwhile, though there will be many fluctuations of freight ton and ton-kms by each commodity, the total freight ton and ton-kms in 2005 will stay on the same level as those in 1995, respectively.

Table 3.1.1 Summary of Projected Railway Transport

Year	1995		2005	
	No. of Passengers in thousand	Passenger-kms in million	Freight Tons in thousand	Ton-kms in million
1995	465,059	26,622	224,345	69,094
2005	427,000	28,442	223,711	69,123

(2) Modal Choice

The curve on the railway utilization rate was made by using Railway OD forecasted in this survey and the Road OD Table forecasted in PHARE Programme of EC (Dec. 1996). The result is shown in Fig. 3.1.1-2.

The share held by the railway system for passenger transport in 1995 is exceeding 50 % with trip length of more than 300 km. Likewise, the share held by the railway system for freight transport is 70 % with trip length of more than 200 km. The long distance transport by railway system is advantageous for passenger transport and freight transport.

In the passenger transport in 2005, the share held by the railway system is more than 40 % with trip length of 300 km. For the long distance transport, the share held by passenger transport will lose about 10 % against 1995. The share held by the railway system for freight transport is about 10 % decrease. The share held by the railway system for freight transport is 60 % with trip length of 200 km.

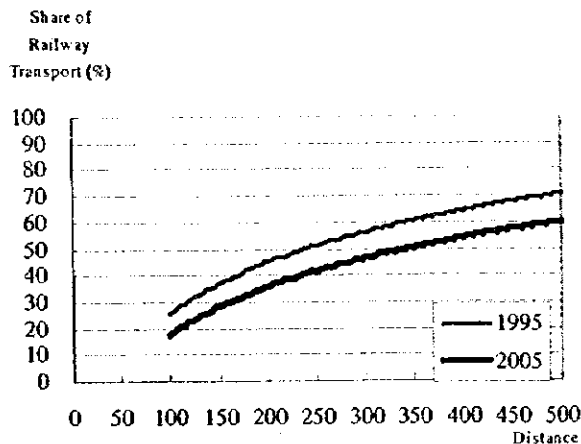


Fig 3.1.1 Railway Utilization Rate of Passenger Transport

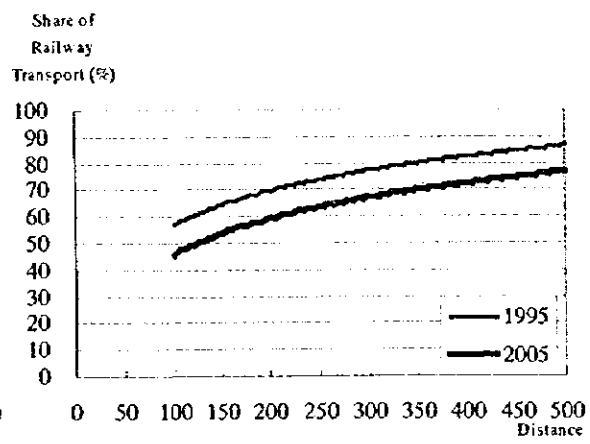


Fig 3.1.2 Railway Utilization Rate of Freight Transport

(3) Investigation of Main Cause for Demand Fluctuation

As the main cause for the demand fluctuation of the railway system, the population, GDP, fare (tariff), traveling time (transporting time), the number of registered cars, the road development (motorway extension) are considered. In these causes, the fare (tariff) and the travelling time (the transporting time) are most influential in the railway demand.

The recent rise in the railway fare has deteriorated the consumers' purchasing power. It is known that it is greatly related with the decrease of the railway passenger. It is understood from the SP survey that the passengers are sensitive to the railway fare. The freight tariff in Poland is politically decided upon the coal freight which amounts to 50 % of the railway freight transport and the relationship between the tariff and the freight demand is not clear. The detailed information will be referred in § 3.3.

It is very important to shorten the travelling time for the railway passenger, specially for the passenger on business. However, the shortening of the running time gives little effect on the freight transport. The reason is that in the freight transport, it takes much more time to handle the cargo in the railway yard. If the total transporting time is decreased, it will give the effect on the demand of the freight transport.

3.1.3 Direction of Transport Market Policy

(1) Direction of market liberalization

According to the Polish traffic policy, it has been suggested that as a target the policy aims at, comes to reorganize the transport business, which is exposed to strict competition in intra-regional, inter-regional and international level, being adjusted to commercial rules at present and from now.

As the basic principle related to the integration of competitive conditions among transport means proposed by the EC, it has been pointed out that each transport system should bear its cost accompanied with using the infrastructure as the absolute conditions in order to make the equilibrium market. In case it is limited to the land transport, a considerable difference has been observed in the infrastructure cost between the railway transport and the road transport in Poland, and the equilibrium of infrastructure cost borne between both parties will be required.

- ① The infrastructure cost has been constituted by two: fixed cost, including the sunk cost, and variable charge, which is accompanied with the utilization of vehicles. According to the basic concept of the EC, from a long-term viewpoint it shall be reasonable that all of this fixed cost + variable cost is borne by the utilizer. On the one hand, the marginal cost principle to bear only variable cost by the utilizer from the viewpoint in terms of effective utilization of the traffic system is made important, and in this case it does not agree with the above-mentioned full cost principle. To cover the full infrastructure cost only by charging the marginal

cost, the subsidy from the general source by the fee collection separately charged is made necessary and indispensable.

- ② For the equilibrium of costs , there is two typical approach , the first way is that the expenses at the railway side , which is supposed as much borne , are reduced , or the second way is that the extra cost at the road side is collected in form of duties or surcharges . According to the Polish transport policy the increase in charge to the road side may be of influences of inflation, etc., and it may be desirable to alleviate the infrastructure cost at the railway side. For this reason it has been pointed out that the infra cost is reduced through abolishing local routes with low demand density or the access right to PKP line is given to operators other than PKP.

(2) Open access of railway infrastructure

Poland has declared as one of policy targets matching with the EU standard in the face of transport policy aiming at the future affiliation with the EU. Among directives up to now as a directive to determine the proper way of the railway network in the future Europe, there is an EC's directive (91/440/EEC) (adopted in 1991 and proposed for revision in 1995).

The said directive is composed of the following:

- ① Granting the administrative independence right to the railway management
- ② Separation the operation sector from the infrastructure on accounting (vertical separation)
- ③ Finance stabilization of railway business
- ④ Guaranteeing the open access to the railway network of each country

As a movement of servicing the Polish domestic laws, there is the establishment of the Railway Business Law, intending the legalization bearing in mind the vertical separation of railway, establishment of license system on railway business and realization of open access to the infrastructure on the basis of the EC's directive. Concerning the article of open access in it, what is intended on the liberalization equal or of more than it to the EC's member country is noted.

(3) Pan-European international rapid transport network

Pan-European international rapid transport network is a concept that foresees the EC's

integration, and supports the increase of high speed transport demand in EC's countries after integration, aiming at connecting each country in Europe by the rapid railway network . The EC's committee announced the study report on the construction of European rapid railway network in 1990, and proposed was the rapid transport railway network composed of 9,000 km of new lines, 15,000 km of improvement for conventional lines and 1,200 km of connection lines by 2010 as the master plan in it. For this reason, indicated was the guideline of (interoperability) to make the mutual service of rapid railway system possible in the EC's Directive No. 96/48. According to this the level that shall provide the vehicle equipment and infrastructure of Pan-Europe rapid transport railway network and the function for the mutual service the rapid transport railway network connecting plural countries (operability), and the requisite, etc. to function these effectively have been prescribed, and the interested countries shall be required to make efforts toward the servicing. Poland , being located in the center of traffic corridor connecting the West Europe to the East Europe, has some international important routes in the territory as a concept route, and there is a possibility to become issues of domestic railway network servicing in the future in shape of the international pledge toward the formation of international rapid railway network. In particular, it is supposed that the installation of interoperability being necessary to form high speed railway network comes to be important, and as to routes corresponding to international important routes, the technical conditions in accordance with the international standards will be needed .

3.1.4 Consideration of Environment

(1) Preliminary Environmental Survey

According to PES (Preliminary Environmental Survey), the purpose of the survey is to size the essence of the negative impact to the environment, by the privatization of PKP and, in the same time, to make some preparation to decide a necessary clause by IEE (Initial Environment Examination) and EIA (Environmental Impact Assessments).

Therefore, in this section, necessary items are provided for the environmental screening and scoping of the options taken in PKP privatization plan, taking account of the JICA environmental guideline which is to foresee environmental problems and provide the environmental protection scheme.

At this stage of the privatization planning, neither IEE nor EIA are required because no direct impact can be investigation for the environment. Furthermore the matter of

privatization has few relation with environment. However, it is easily supposed that some rationalization will take place when assuming a concrete plan of privatization. Namely it is considered that the people, who are living along non-profitable lines to be liquidated, receive undesirable effect for their economic activity and the impact by noise and vibration might increase along some profitable lines where train frequencies are increasing and train speed gets higher. On the other hand, though it is "unknown" as influential items for environment at present, in a reference of past examples, there are "waste, topography and soil condition, landscape, water pollution, and land subsidence". Consequently, at the execution stage of privatization, IEE or EIA being based on regulation are necessary.

(2) The tendency of the environmental countermeasures related to transport field in countries of EU and others

At present in EU, according to the pollution gases (as a carbon dioxide and nitrogen compounds) coming from the transport, the European Community settled the base level for common exhaust-gas, and is carrying this regulation into effect. Also, EU is of great concern about the environmental problem, so adjust successive progress of the technology, is beefing up the regulations.

As well in Poland, when is going to gain the membership in EU, the same kind of measure is undertaken, and it is evident, that the restriction about the automobiles would be also strict. In following, the strict roles would be put on vehicles used before the project had been introduced. To make public transport facilities, such as railway transport and its service, better for the environment, comes to be essential condition.

3.1.5 Maintaining of Railway Transport

(1) Role of government, etc. on the preservation of the railway transport

A railway enterprise shall be administered, by the principle applied to a civil enterprise in the EC's Directive No. 91/440, it is prescribed that the said principle should be respected also in the category of public service obligation forced by the nation, etc. (Art. 5)

By the establishment of the Railway Business Law, it is supposed that the railway transport business from now on will become a license undertaking, if it is a business entity satisfying the conditions, it can freely enter into the market, and for the service to render and the tariff setting an enterprise freely carry out as a basic style. For this

reason, it is considered that the unprofitable transport field in the railway sector, for example, the preservation of the railway traffic in the local transport, etc. that a large expectation cannot taken in the quantity of demand will come to a issue .

Concerning public traffic service liabilities in local governments, through the Law on Local Self-governing Body established in 1990, the local public transport (mainly aiming at the bus transport) was included in liabilities of municipality self-government bodies, that is to say, under this law frames , the organizers of local transport and the offer itself were institutionally separated concerning the transport service quantity and quality necessary , the former assumes a role to determine the frame as to the quantity and quality of service necessary as the municipal public transportation from viewpoints of the social benefit, and the latter was specialized to be a business activity as the main supplier of public transport services. Concerning the preservation of railway routes, the system similar to this is possible, and it is desirable to start the examination of a contract as to the transport service rendering among the government, local governments and railway business entity in the future.

(2) Transport market segmentation

In the passenger transport of the present PKP, little concern is given to the differences of transport market characteristics between the inter regional transport and intra regional transport. For these two transport markets, it is not adequate to apply the same principle of business administration because of differences, etc. in the social meaning directed to the transport business. Also regarding the preservation of the railway transport, in the domain of interurban services covering the whole country, for the PKP that fostered the administration, technology and transport know-how as the leading role of unique domestic railway transport up to now , its participation to the business is justifiable also from now on, however for the municipal zone transport service that should examine the quality and quantity of the transport service in accordance with the transport need limited in a specific region , there is few reason for the PKP to take part such transport services directly also in the future , and rather it is desirable to assume the liabilities in the transport business at local level and/or at local self-governing organizations.

3.2 EXPERIENCE OF PRIVATIZATION OF RAILWAYS IN JAPAN AND WEST EUROPEAN COUNTRIES AND SUGGESTION TO PKP REFORM

3.2.1 Reform of Japanese National Railways

(1) The basic reason of the management failure of the Japanese National Railways (JNR) is that JNR was unable to cope with the changes in circumstances around the railway, such as the development of automobiles and airplanes and the changes in industrial structure. The main causes of this are: the loss of management autonomy; abnormal management-labor relations; fare revisions which were not realized adequately and at proper occasions; a large amount of investment which depends on loans; and gigantic size of JNR organization which exceeded the limit of management administration. This led to the accumulation of huge long-term debts and occurrence of many surplus employees, and financial burdens of the government reached their limit as well. Under these circumstances, the reform of JNR was drastically implemented in the following ways.

- ① In order to ensure railway operation which can meet actual situations of the regions concerned, and also to realize railways which act with sense of competition, JNR was privatized and divided into six passenger railway companies and one freight railway company in April 1987.
- ② Of the long-term debts of 37.2 trillion yen of JNR including the accumulated debts and the burdens on pensions, 14.5 trillion yen was taken over by the new railway companies (JR companies), and the remaining debts were transferred to newly-established JNR Settlement Corporation (JNRSC).
- ③ As of April 1986, the number of surplus employees of JNR was 77,000. JNR thereafter encouraged 39,000 employees to retire by providing a special payment equivalent to the amount which is 10 times their monthly salary, in addition to the ordinary retirement allowance. Furthermore, the government promoted re-employment by enacting a special law. Thanks to these measures, the surplus employee problem was solved by April 1990.
- ④ Of the passenger railway companies created by the division of JNR, three companies with low transport density and weak basis of management were exempted from taking over JNR's long-term debts. At the same time, management stabilizing funds, 1.278 trillion yen in total, were established for the three companies, so that these companies can secure profits by adding the interest of the funds to revenues.

(2) The main characteristics of the JNR reform are as follows.

- ① A settlement corporation was established to perform the settlement of accumulated debts of JNR, sales of assets and so forth.
- ② The government took the initiative for reducing the number of surplus employees

of JNR.

- ③ The JR companies created by the JNR reform made efforts to enhance productivity by management-labor cooperation.
- ④ Traffic volume increased due to the improvement of national economy and an adequate fare policy.

Owing to the above factors, JR companies are achieving better operational results than originally expected.

3.2.2 Reform of British Rail

- (1) In 1992, the government published a white paper on the privatization of British Rail (BR), and decided to separate infrastructure-management and train-operation companies and to adopt a "franchise system".
- (2) In 1993, the Railway Reform Law was enacted on the basis of the reform plan described in the above white paper. Starting from April 1994, BR was divided into enterprises more than 90 and was privatized.
- (3) The passenger service sector was divided into 25 companies. The right of operation was granted to a bidder who required the minimum amount of subsidies among bidders. After the BR privatization, however, subsidies from the government have substantially increased.
- (4) The freight service sector was divided into three companies: a train-load freight company, a complex transport company, and a channel tunnel transport company. The financial results of these companies are different one another, and two companies are in the red.
- (5) In 1995, the Rail Track Company in the infrastructure sector earned 2.3 billion pounds in total including track use fees from passenger and freight companies, and spent 2 billion pounds for track maintenance and investment, and so forth.

3.2.3 Reform of Swedish State Railways

- (1) In 1988, the government amended the Transport Policy Law, and decided to separate the operation and infrastructure sectors of the Swedish State Railways (SJ) into two different organizations. Thus, SJ was entrusted with train operation, and the newly-organized Swedish Railway Board (BV) with infrastructure management.
- (2) SJ pays rail access charges to the national exchequer, and BV receives compensations for the costs of track maintenance, investment and so forth, from the

general account of the national budget. In 1995, the amount of rail access charges paid by SJ accounts for only 8% of the annual budget of BV.

- (3) The revenue and expense of SJ are balanced, for such reasons as that the rail access charges are inexpensive and that the transport on local lines is conducted in accordance with a transport contract with local governments.

3.2.4 Reform of German National Railway

- (1) The government enacted a railway reform law in 1993 and established German Railway Co., Ltd. (DBAG) in January 1994, in order to cope with the increase of long-term debts of the German National Railway and to carry out the integration of railways necessitated by the unification of East and West Germany.
- (2) In establishing DBAG, the government took measures for a large amount of financial assistance, regarding long-term debts, pension funds, and so forth. Furthermore, the government provided DBAG with subsidies for short-distance passenger transport, assistance for track construction investment, and so forth. The revenue and expense of DBAG in 1995 was balanced by adding the subsidies from the government.
- (3) The organization of DBAG consists of three internal independent divisions: "passenger, freight, and infrastructure" divisions. In the future, DBAG will be reorganized into a holding company and the three divisions will be instituted as independent stock companies.

3.2.5 Reform of French National Railway

- (1) The financial results of the French National Railway (SNCF) worsened due to the increase of capital costs entailed by the construction of TGV and also to the stagnation of traffic volume. To cope with this situation, the government submitted to the National Diet in 1996 a plan of reforming SNCF.
- (2) In the above reform plan, SNCF is to be in charge of transport, and a newly-established railway public corporation is to undertake infrastructure management. The railway public corporation is also to take over two-thirds of the debts of SNCF (175 billion franc, as of the end of 1995).
- (3) The above reform plan was authorized by the Diet in February 1997. The railway public corporation took over infrastructures, surplus assets, and the two-thirds of debts of SNCF.

- (4) It is estimated that, by this reform, SNCF which suffered a loss of 15.2 billion franc in 1996 will recover the balance between revenue and expense in 1998. On the other hand, the railway public corporation will receive assistance of 25 billion franc per year from the government.

3.2.6 Suggestion to PKP Reform

- (1) In Japan and West European countries, the governments are providing some financial assistance to railways with low transport density. For instance, management stabilizing funds have been established in Japan, and subsidies are provided in Western Europe to passenger transport and infrastructure sectors. In view of the low transport density of PKP, it is necessary for the Polish government as well to extend subsidies to passenger service businesses and promote investment in infrastructures in the future.
- (2) In various countries, large financial burdens have been borne by the governments in realizing reforms of respective national railways. The main purpose of the financial burdens is the disposal of long-term debts of national railways, and investment in infrastructures is also made sometimes in order to ensure self-support operation of the railways after their reforms. Fortunately, PKP does not have long-term debts. However, since the investment in facilities has been insufficient in Poland, it is necessary to increase the amount of investment to modernize facilities and rolling stock before the PKP privatization.
- (3) To enhance the efficiency and productivity of railways, individual countries are taking measures for promoting competition in railway enterprises and for clarifying the responsibility of railway management. The concrete methods applied for this include: division of national railways; approval of the entry of new railway operations; and railway privatization. In Poland as well, it is necessary to implement such measures as: separation of infrastructure and transport sectors; division of the transport sector; and privatization of PKP.
- (4) Public organizations have been set up in some countries to support reforms of national railways. Such organizations include: "control agencies" which supervise enterprises; "infrastructure administration agencies" which maintain tracks; and "settlement corporations" which deal with long-term debts, surplus assets and so forth. In Poland, it is necessary to judge the necessity of these organizations, taking into consideration such facts as that a chief inspector system is to be established and that PKP does not have long-term debts.
- (5) Among different countries, a common factor which has worsened the financial

performance of railways is the existence of surplus employees. In Japan, the government took the initiative in promoting such measures as mediation of re-employment and vocational training. In Poland, since the solution of the surplus employee problem is an important key to the reform of PKP, it is essential for the government to take positive steps.

- (6) Some countries have clarified the principles of handling local lines where advantageous railway characteristics cannot be displayed. In this case, although unprofitable local lines should be abolished in principle, some of them are entrusted to the finance and management responsibility of local governments when their continued operation is necessary for the regions concerned. In Poland as well, it is necessary to clarify the responsibilities and burdens of local governments for the operation of local lines.

Table 3.2.1 Reforms of National Railways in Japan and Western Europe

	km of Line	Transport Volume (TV)		No. of Staff	TV per Line km (thousand)	TV per Staff (thousand)	Reform of National Railways
		P·kms (million)	T·kms (million)				
Poland	24,313	21,762	64,719	248,761	3,557	348	In 1997, Railway Transport Law was enacted.
Japan	20,255	244,375	24,000	193,145	13,255	1,390	In 1987, JNR was divided and privatized. (6 passenger companies and 1 freight company) A settlement corporation was established to deal with long-term debts, etc.
United Kingdom	16,536	28,656	12,292	106,347	2,476	384	In 1993, BR was divided and privatized. (25 passenger companies, 3 freight companies, and 1 infrastructure company) Franchise Agency and Railway Control Agency were established.
Sweden	9,661	5,906	18,523	21,856	2,529	1,118	In 1988, infrastructure and transport sectors were separated. The infrastructure sector and transport sector belong to Railway Agency and National Railway, respectively. Local lines were transferred to local governments.
Germany	41,718	60,514	69,483	327,076	3,116	397	In 1994, DB and DR were integrated into DBAG. Railway Agency and Railway Assets Organization were established. Local lines were transferred to local governments.
France	32,275	58,675	47,953	185,690	3,304	574	In 1997, infrastructure and transport sectors were separated. The infrastructure sector and transport sector belongs to Railway Public Corporation and National Railway, respectively. Local lines were transferred to local governments.

(Note)

1. Data Year – 1994
2. Source: “Rail Business Report 1997” (exclude of “Reform of National Railways”)