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Report No. 22466

PERFORMANCE AUDIT REPORT

BULGARIA

TELECOMMUNICATIONS PROJECT

(LOAN 3592–BU)

June 27, 2001

Sector and Thematic Evaluation Group
Operations Evaluation Department

Currency Equivalents (annual averages)

Currency Unit: Bulgarian Leva
(Period average)

1 Leva =0.47586 US$
US$ 1 = 2.10146 Leva

Abbreviations and Acronyms

BTC	Bulgarian Telecommunications Company
CPT	Committee for Posts and Telecommunications
DON	Digital Overlay Network
EBRD	European Bank for Reconstruction and Development
EIB	European Investment Bank
GOB	Government of Bulgaria
ICT	Information and Communication Technology
OED	Operations Evaluation Department
OSS/MIS	Operational Support System/Management Information System
PSD	Private Sector Development
STC	State Telecommunications Commission
WTO	World Trade Organization

Fiscal Year

Government of Bulgaria: January 1 to December 31

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The World Bank
Washington, D.C. 20433
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Office of the Director-General
Operations Evaluation

June 27, 2001

MEMORANDUM TO THE EXECUTIVE DIRECTORS AND THE PRESIDENT

SUBJECT: Performance Audit Report on Bulgaria Telecommunications Project (Loan 3592-BU)

This is the Performance Audit Report for the Bulgarian Telecommunication Project for which an IBRD loan of US$30 million equivalent was approved in April 1993. The project closed on June 30, 1999, six months behind schedule, total disbursed US$28.1 million. The EIB and EBRD provided cofinancing.

The project aimed to address major deficiencies in the sector by improving the quality of service, introducing new services, corporatizing and improving the financial position and management of the Bulgarian Telecommunication Company, and encouraging private sector involvement in the sector. The main components included investment in a digital network and computer-based support systems, and technical assistance for corporate development of the BTC. Later in project implementation, the government decided to go beyond the original ambitious objectives and privatize the BTC. The Bank agreed to finance advisory assistance for privatization under an ongoing Technical Assistance Loan.

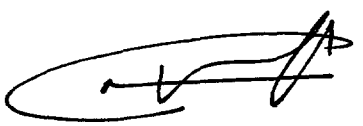
OED rates the project's the overall outcome satisfactory (highly satisfactory in the ICR), its sustainability as likely, and its institutional development impact as high (as in the ICR). Project objectives were comprehensive and demanding, but highly relevant to the sector and implementation exceeded the original objectives. Project costs were significantly lower than estimated, and savings were effectively used to expand the project's scope. Every parameter and capacity envisaged in the SAR was exceeded and the project led to significant improvements in the physical access and service quality, BTC's corporate management, and financial performance. All envisioned policy and regulatory reforms were implemented, albeit with some delays.

The project's overall outcome rating was graded as satisfactory rather than highly satisfactory because the major objective of partial privatization was not achieved, even though this objective was not part of the original project (and there was no formal restructuring), and first-attempted sales of major infrastructures are often unpredictable. Although the audit rates BTC's performance highly satisfactory, it notes that the performance of the telecommunications commission and privatization agency were mixed and that mistakes were made that may have reduced the chance of successful sale of the BTC. OED rates the Bank's overall performance satisfactory, including its effective coordination with cofinanciers, although it notes that the Bank was perceived by BTC as slow and bureaucratic at times when speed was necessary and by some senior officials as taking a cautious approach when timely advice would have been more helpful during a complex privatization process.

Experience with this project confirms a number of OED lessons (including those mentioned in OED/OEG's recent review of the Bank Group's experience in Information Infrastructure):

- Privatization of major infrastructure such as telecommunications is technically and politically complex and the process can be unpredictable. Hence, privatization transactions should be designed for maximum flexibility (options) to respond to market shifts and unanticipated events, which needs to be balanced with specificity that is required for ensuring transparency in evaluation.
- There is a need for clearer and more specific guidance to Bank staff --in the form of Bank-wide guidelines and/or operational policies-- to enable them to respond flexibly, yet consistently across sectors and countries, to governments' requests for advice during the structuring and negotiation of complex infrastructure privatizations.
- An appropriately prepared investment loan, combined with technical assistance, can be an effective vehicle for broad sector policy and institutional reforms, as well as targeted investments and capacity building.
- A strong local champion and project design that matches local implementation proved to be key success factors in this project.
- Establishing effective regulatory policies and institutions in the infrastructure sectors (network utilities) is a long-term process that requires continuous improvement and sustained support. The Bank should take a long-term view in supporting this process.

Attachment



Contents

This report was prepared by Nagy K. Hanna, who audited the project in January 2001. William Hurlbut edited the report, and Soon-Won Pak and Pilar Barquero provided administrative support.

Principal Ratings

	ICR	*PAR*
Outcome	Highly satisfactory	Satisfactory
Sustainability	Likely	Likely
Institutional Development Impact	High	High
Borrower Performance	Satisfactory	Satisfactory
Bank Performance	Satisfactory	Satisfactory

Key Staff Responsible

	Task Manager	*Division Chief*	*Department Director*
Appraisal	R. Sharma	F. Batzella	M. Wiehen
Completion	V. Atur	H. Busz	A. Vorkink

Preface

This is a Performance Audit Report (PAR) for the Bulgarian Telecommunication Project (Ln. 3592–BU) for which a Bank loan in the amount of US$30 million equivalent was approved on April 13, 1993. The project closed on June 30, 1999, six months behind schedule. The final total disbursed was US$28.1. An Implementation Completion Report (ICR) was submitted on May 5, 2000.

This PAR was prepared by the Operations Evaluation Department (OED) based on the ICR, the Staff Appraisal Report, a review of Bank files, and extensive discussions with Bulgarian policymakers and implementing agencies, Bank staff, consultants, and cofinanciers. The cooperation and assistance of all stakeholders and government officials is gratefully acknowledged, as is the support of the staff of the World Bank Country Office in Bulgaria.

This PAR complements and builds on an excellent ICR. It focuses on lessons and future direction, since the project presents rich lessons of critical relevance to country assistance strategy and for Bank involvement in privatization and regulation of infrastructure activities, particularly in transition economies. At the time the ICR was prepared, negotiations for the sale of the Bulgarian Telecommunications Company were underway, and successful privatization was anticipated, hence, the privatization was not covered in the ICR. The PAR therefore gives special attention to this experience, as lessons are likely to be critical to the Bank's assistance to privatization of Bulgaria's infrastructure and utilities.

Following standard OED procedures, the draft PAR was sent to the borrower for comments before being finalized. Borrower comments have been received and are included in Annex B.

1. Background

1.1 In 1993, the post and telecommunications sector in Bulgaria consisted of three public organizations – the Committee for Posts and Telecommunications (CPT), the Bulgarian Post Company, and the Bulgarian Telecommunications Company (BTC). CPT was responsible for developing and implementing posts and telecommunications policy and held delegated responsibility for the shareholder functions of Bulgarian Post Company and BTC. BTC's services included domestic and international telephony, fixed telephone network and leased lines, telex, telegraphy, radio and television transmission, and data transmission.

1.2 With a population of 9.0 million and 2.6 million telephones, Bulgaria had the highest telephone density in Eastern Europe with nearly 29 telephones per 100 population in 1990. However, there were 612,000 applications on the waiting list with an average waiting time of 10 years. Business, industry, and government administrations were underserved, with only 36 percent of the lines. Service quality was poor, with call completion rate at less than 35 percent compared to world standard of 60 to 70 percent, and as low as 9 percent for international calls. Automatic direct dialing was limited in most areas due to obsolete equipment and inadequate network capacity, and international calls were handled by operators due to the scarcity of international circuits. Advanced services such as facsimile and packet-switched data communications were limited due to poor circuit quality and reliability. The telecommunications network infrastructure consisted largely of obsolete equipment that required replacement, involving an investment of US$340 million over the medium term. At the same time, BTC's financial condition was poor with operating losses and the added burden of bearing postal subsidies.

1.3 To address these deficiencies and modernize the telecommunications sector, CPT, assisted by technical, policy, and financial assistance from the Bank and by consultants funded by EC-PHARE, developed a strategy that the Government of Bulgaria (GOB) adopted in 1992. The strategy aimed at *improving the quality of service* overall, especially to business customers, and expanding access with a modern digital infrastructure; *improving BTC's financial performance* by adopting tariff policies to support the financing of infrastructure modernization and expansion, and by separating telecommunications and postal operations, and eliminating postal subsidies; *developing BTC* by corporatizing it, introducing modern management practices and assisting it to attract investment; and *introducing new services and encouraging private sector involvement* in the sector. The strategy also identified the need to *separate and strengthen policy-making and regulatory functions*, and establish a legal framework for expanding private sector involvement. The strategy envisioned a multi-phase effort to modernize Bulgaria's telecommunications sector, of which the Telecommunications Project is the first element.

1.4 **Telecommunications Project**: To implement the strategy, the Bulgarian authorities arranged for support and financial assistance from the European Investment Bank (EIB), the European Bank for Reconstruction and Development (EBRD) and the World Bank. EIB and EBRD focused on financing BTC's infrastructure modernization. The Bank, in addition to providing support to BTC's infrastructure modernization and corporate development, provided technical assistance to CPT to strengthen policy-making and regulatory functions financed from the Technical Assistance Loan (TAL, Loan 3384-BU; 1991). The project initiated urgent actions required to build a foundation for sustained longer-term sector development.

1.5 The three major components of the project were:

- Implementation of a Digital Overlay Network of BTC for the period 1993–97, including digitalization of the trunk routes and expansion of the network

- Design and implementation of a computer-based Operational Support System/Management Information System (OSS/MIS) for BTC
- Technical assistance for the corporate development of BTC, including establishment of managerial functions such as accounting, auditing, financial management, and planning.

1.6 During project implementation, GOB decided to go beyond the original objectives and privatize BTC, and requested the Bank's assistance. The Bank agreed to finance advisory services for sector policy, legal, and privatization under the TAL. The Telecommunications Project was not formally restructured to reflect this added objective.

1.7 The objectives of the project were clear, important for sector development, and responded to the needs of the borrower. While the investment and corporate development parts were not risky, the policy and institutional reform parts were moderately risky, both because of the lack of understanding of these by policymakers and because the necessary involvement of political authorities introduced additional uncertainties. Further, the achievement of these policy objectives from a separate loan (TAL) posed coordination challenges for the Bank.

1.8 The project was implemented during a period of political uncertainty resulting from six governments in five years and severe economic crisis and collapse of the banking system at the peak of implementation. Through concerted efforts of the donors, BTC emerged in 1998/99 as a strong and profitable company with modern technologies in its network, ready for privatization. BTC's quality of service over its digital network exceeds that of its peers in Central and Eastern Europe and compares fairly well with Western European utilities. The waiting list was reduced by over one-third and the waiting time fell to about one month in most cities and large towns with digital exchanges. All advanced telecommunications services are available in Bulgaria, with premium services to business customers. With support from the TAL, Bulgaria enacted a Telecommunications Law that met EU harmonization requirements and World Trade Organization (WTO) commitments, and the institutional structure for policymaking and regulation were separated to enhance investor confidence and promote fair competition.

1.9 The project did not include privatization of the BTC but aimed at preparing BTC for privatization and at providing key policy frameworks and negotiating tools for the transaction, while the TAL was used for financing the services of the financial advisory consortium to advise the government on the sale of BTC. The bidding process took more than a year and involved substantial resources and political attention, but the sale was not successfully concluded (paras 2.4-2.6).

2. Project Design and Implementation

2.1 The project design was kept simple, consistent with experience in the region. Ownership of the project by the GOB was considerable. Most assumptions utilized in the development of the project were reasonable, with the exception of those concerning Bulgaria's macroeconomic performance, which turned out to be overly optimistic. This caused BTC's financial performance — while substantially improved and profitable — to fall short of the profit target expected at the outset of the project.

2.2 The components of the project were not revised, but the scope was expanded following significant savings from prices that were lower than estimated on almost all infrastructure contracts. BTC expanded the access network (under EBRD and EIB loans) to resort areas and central parts of cities and towns to serve additional business subscribers by installing additional

switching and transmission as well as multiplex systems in the national transit level and junction networks in Sofia and seven other large cities. BTC also used the savings in the Bank loan for a second satellite earth station to provide capacity for handling increasing traffic with Asian countries. These components were consistent with the original project description and did not require restructuring of the project. As a result, the project was able to implement a substantially greater new capacity at a lower price than envisioned.

2.3 *Project implementation* went exceedingly well (with the exception of the attempted privatization, see below) and was completed by June 1999, six months behind the original schedule of December 31, 1998. Implementation of network components was highly satisfactory, with substantially greater capabilities than envisioned. This enabled the more rapid growth of traffic and revenues, thus enhancing BTC's profit. As shown in the table below, every parameter of system performance and capacity envisioned in the SAR was exceeded. The expansion of the scope increased the benefits derived from the project. The increased quantities effectively advanced the long-term BTC network development program by about one year and BTC consequently derived greater revenues from the resulting growth in subscribers and traffic for an investment lower than forecast.

Description	*Appraisal*	*Actual*
Long-distance fiber optic cable network;	1,700 km;	1,803 km;
Transmission bit rate	155 Mbps[a]	2,488 Mbps
Digital microwave network	1,100 km	1,300 km
Intelsat Standard A earth station	1	2
International digital trunks	3,000	8,310
Long-distance digital trunks	70,000	71,350
Subscriber digital lines	123,500	216,688 plus 2,986 ISDN[b] and 980 DECT[c] lines
Metropolitan junction network expansion	Sofia	Sofia plus 7 other cities

a. Megabits per second

b. Integrated services digital network

c. Digital enhanced cordless telecommunications

BTC Privatization

2.4 The attempt to sell BTC was the most complex and largest privatization attempt to date in Bulgaria, and it followed international best practice. It was the first time for Bulgaria to negotiate a large contract for advisory work on privatization. A separate set of consultants was involved in preparing the regulatory framework. The bidding process was based on a sale strategy formulated by the Financial Advisory Consortium and approved by the Council of Ministers and the BTC steering committee. An information memorandum provided potential investors with a detailed overview of the company. A pre-marketing campaign was launched, including the preparation of a marketing document and the presentation of information on BTC to interested companies, and feedback was included in the sale strategy. For example, the participation in a GSM license was viewed as essential to attract wide interest from potential investors. The sale process was officially launched by an announcement on August 12, 1998, inviting interested parties to submit a letter of interest. Clear pre-qualifications were set, and that stage was considered a success, as eight companies were able to demonstrate that they met the pre-qualification criteria, and five ultimately registered with the Privatization Agency.

2.5 The drafting of a new license for BTC and for a 2nd GSM were done by the CPT, with input from preparation consultants. These draft licenses, together with the transaction documents, were issued on October 26, 1998, following the adoption of a new Telecommunications Law. The

text of the licenses has been a source of dissatisfaction for the bidders. These documents were first released in draft form and the registered bidders were invited to submit their comments for improvements, and after discussions and revisions, bidders were invited to submit comments on a second draft by the end of January 1999. It became apparent the three remaining bidders held completely different position on certain issues, which made producing a consensus on final transaction documents impossible. Final documents were released on February 28 and bid date was set for March 18, 1999. By that time, the market shift toward mobile telephony had become clearer. With the Kosovo crisis also looming, another bidder pulled out, and the two remaining bidders joined forces to bid together. The bid received was not technically compliant and was inconsistent with the preceding five months of negotiations on the documents.

2.6 The negotiation process with the only bidding consortium dragged out for several months. The financial advisor advised the government to abandon the documents and to stick to negotiating agreement on principles. Although this was done, changes in the Bulgarian negotiating team, constant leaks to the press and uninformed public, and involvement of new ministries and less experienced actors led to new positions and demands for concessions from both sides. Lacking expertise, the Privatization Agency was unable to lead the process effectively, and the sharing of objectives of privatization among key participants from the government side became diffused. The bidder ultimately made what may be considered an attractive price offer, but insisted on unacceptable changes in the regulatory framework. The negotiation collapsed by the July 2000 deadline. However, since then, the Government has moved forward with further expansion of competition and private sector participation in mobile telephony services by issuing a 2nd GSM license through another competitive bidding (para 6.1).

3. Outcomes

3.1 The project led to significant improvements in physical access and service quality, BTC's corporate management, financial performance, and policy and regulatory frameworks. All envisioned policy and regulatory reforms were implemented, albeit with significant delays. The system installed was much more robust and capable than the one originally envisioned; the cost of the project was about 12 percent less than estimated; and during implementation, a new and significant sector development objective was added (though it is not yet achieved, see lessons and future directions).

3.2 Improvement in access included a reduction in the subscriber waiting list from 612,000 in 1992 to 416,000 in 1998, and currently estimated at 250,000. The average waiting time in 1992 for all applications for service was more than 10 years. In 1998 this was reduced for applicants in the larger cities covered by the Digital Overlay Network (DON) to less than 1 month for 62 percent of applications and less than 25 weeks for 99 percent of applications. Long distance and international direct dialing was accessible by 93 percent of subscribers at the end of 1998, compared to 74 percent in 1992. Quality of service also improved. The average call completion rate for all classes of calls improved from 35 percent in 1992 to 49 percent in 1998 for local calls, 44 percent for long-distance calls and 42 percent for international calls (compared to SAR targets for 1998 of 73 percent, 60 percent and 50 percent). The number of fault reports per 100 lines decreased from over 100 in 1992 to 50 in 1998 (compared to a SAR target for 1998 of 47). The percentage of faults cleared within 48 hours improved from near zero in 1992 to 82 percent within 24 hours and 99 percent within 1 week in 1998 (compared to SAR targets for 1998 of 87 percent within 48 hours and 100 percent within 1 week). This was due both to the DON additions and to the performance incentives/penalties adopted in June 1998 tariffs.

3.3 Teledensity (lines per 100 population) increased from 27 in 1992 to 33 (forecast 30 at appraisal) in 1998. Average residential traffic increased by 12 percent and business traffic 56 percent from 1993 through 1998, indicative of BTC's emphasis on improving service to business customers. BTC now offers customers connected to the DON features including conference calls, call forwarding, abbreviated dialing, incoming and outgoing call barring, alarm call, and detailed billing. Integrated Services Digital Network services are now available in Sofia and locations with digital exchanges and nationwide Internet access is available. BTC has also established a transparent policy of equal network access and tariffs to licensed network operators and value-added service operators.

3.4 Total project costs, excluding interest during construction, were about US$265 million equivalent, or 88 percent of the appraisal estimate of US$301 million equivalent. The reduction of US$36 million equivalent in project costs is attributed to lower costs of local access network compared with appraisal estimates, which used conservative and international benchmarks, and to reduction in contingencies and changes in the exchange rate.

BTC Financial Performance

3.5 BTC's financial performance improved substantially through the implementation period, as did its profitability, and BTC was able to finance the local costs of the investment program. Revenues increased from US$105 million equivalent in 1992 to US$303 million equivalent in 1998 (compared to US$363 million estimated at appraisal), and net income after taxes, which was US$ –9.4 million in 1992, turned positive beginning in 1993 and reached US$29.4 million in 1997 and US$53.4 million in 1998. BTC's performance is attributed to tariff adjustment, cessation of payment of postal subsidies, greater than anticipated increases in other revenues (for example, an interconnection fee resulting from expanding value-added services), and reduction in payments to international telecommunications utilities. Revenue per line increased from US$53 in 1993 to US$108 in 1998, but lower than the SAR estimate of US$158. However, BTC's revenues and profits in 1998 fell about 25 percent short of the appraisal estimates, which is attributable to economic growth that was slower than assumed. But BTC's revenues and profits remain relatively healthy and capital expenditures continue to grow. For example, BTC's investment program for year 2001 includes the launching of 300,000 new trunk and subscriber lines, which will lead to 19 percent digitalization on installed subscriber lines, and 100 percent on trunk switching.

New Services and Private Sector Development

3.6 Following liberalization of all non-basic telecommunications services by GOB in 1992, the private sector gradually expanded its role and activities. BTC participated in several of these services through joint ventures. These included an analog mobile cellular service started in 1993 by Cable & Wireless in joint venture with BTC (39 percent owned by BTC); a digital GSM mobile cellular service (100 percent private, Mobitel/Citron) that grew faster than the analog service and had about 147,000 subscribers with 83 percent coverage of the population by mid-1999; paging services; and a recently issued 2nd GSM license. BTC also started two payphone joint ventures and nationwide data communications and Internet access services. In addition, there are many Internet service providers (ISPs) and cable TV operators. The project helped make this possible with the build-up of the digital BTC network and the strengthening of BTC's operations and financial performance, which reduced the risk to private operators.

3.7 The building up of the digital network also created opportunities for BTC participation in a range of international and regional projects: Trans European Line, Trans European Network,

Trans Balkan Line, and submarine optical cable linking Turkey, Bulgaria and Romania. The digital network thus leveraged the strategic geographic location of Bulgaria.

BTC's Corporate Development

3.8 BTC's standing as an independent corporation was well established at the start of the project by CPT's issuance of an operator license. A board and management structure in accordance with commercial codes were established. The organization structure, including marketing, strategic planning, human resources, and finance, were substantially upgraded to reflect the model in advanced countries. The technical assistance stimulated improvements in BTC, which were evident in the improvement in its reporting quality, timeliness, ability to deal with private operators in the country and abroad, and the financial turnaround with an unqualified financial audit by 1998. Also as a result of the project, a corporate Intranet network and MIS were deployed by 1999. BTC continues to deploy additional functions to its management and operating systems, but its human resource policies are likely to remain a binding constraint to realizing the full benefits of such investments. Skill obsolescence is on the rise and human resource renewal remains a major challenge.

Policy and Regulatory Reforms

3.9 All sector policy, regulatory, and institutional reforms contemplated under the project were achieved, albeit with delays. These are: adoption of sector development policy, a telecommunications tariff policy, an appropriate regulatory framework and separation of policy making from regulation under the Telecommunications Act, all during 1998.

3.10 CPT adopted an interim tariff policy in 1994 that (a) indexed international service tariffs to the U.S. dollar exchange rate and domestic service tariffs to the domestic producer price index; and (b) allowed automatic adjustments by BTC, in consultation with CPT, and not more than once per quarter. The periodic adjustments of tariffs were satisfactory, which enabled implementation of the project and gradually reduced cross-subsidies between business and residential subscribers and domestic long distance and international calls through rebalancing, which is still underway (in 1995, under the BSP government, CPT and BTC did not implement the tariff adjustments as per the formulas, but allowed tariff adjustment in July 1996 (58 percent) under pressure from donors). Following passage of the Telecommunications Act of 1998, GOB approved a policy that allows BTC to adjust tariffs in accordance with economic factors and policy formulas without prior approval from the State Telecommunications Commission (STC), the regulatory body for the sector.

3.11 The establishment of STC enabled also the separation of policymaking from regulations, and the establishment of the National Radio Frequency Spectrum Council to deal with all aspects related to radio spectrum policies has enabled CPT to focus on sector development policymaking overall. The achievement of policy and institutional reforms is thus satisfactory.

Economic and Financial Rates of Return

3.12 The NPV for the project was estimated at BGL 16.1 billion at appraisal with an ERR of 33 percent. The NPV for the project re-estimated by the ICR at completion is BGL 4.6 billion with an ERR of 26.4 percent. The actual IERR would have been higher if the economy had not suffered as it did during the period, and also if the tariff adjustments in 1995 were made as warranted. The financial rate of return for the completed project was calculated to be 24 percent compared to 31.6 percent (and 19 percent for the original scope) at project appraisal.

4. Ratings

Outcome: Relevance, Efficacy, and Efficiency

4.1 Project objectives were relatively comprehensive and remained highly relevant to overall sector objectives. The project also exceeded its original objectives. Also, project costs were significantly lower than estimated, due to effective procurement management, and the savings were used to expand the project's scope in ways consistent with the original objectives. However, the audit rates the project outcome as satisfactory rather than highly satisfactory . This is because of the uncertainty over the further development of BTC arising from the recent termination of negotiations to privatize. The whole process of relaunching BTC privatization, the goals, and the strategic options, have to be well thought through, together with the political and social consensus to support the process. The project outcomes remain satisfactory, particularly in light of the Government's continued commitment to sector reform.

Sustainability

4.2 The notable improvement in the financial performance of BTC and GOB's renewed commitment to continued development of the telecommunications sector indicates that the benefits of the project are sustainable. GOB and BTC are satisfied with the results achieved under the project, as are the business customers whose demand for services is growing. Tariff policy and tariff increases and rebalancing has enabled BTC to meet financial targets and the OSS/MIS completed in 1999 will continue to provide improved financial and operational management support. The policy and regulatory framework for managing the sector represents international good practice and it is contemplated that full competition will be introduced no later than January 1, 2003, in accordance with Bulgaria's WTO commitment. The GOB has remained committed to reform and liberalization of the telecommunications sector, and the results of the project evidence the signs of good transitional arrangements.

4.3 However, as the sale of BTC's shares to strategic investors was not concluded, there is some risk that BTC's progress and project benefits could unravel. Hence, this audit downgrades the ICR rating from highly likely to ***likely***. Vigilance of policymakers and of BTC management is critical during this transition period and the next steps to secure private participation in BTC are likely to determine whether the project's outcomes will last.

Institutional Development Impact

4.4 The project's institutional development impact was ***high***. BTC's development as a financially viable and strong telecommunications operator with corresponding improvements in its organization, profitability, and operational performance is remarkable. BTC has gained experience in Bank procedures, including international competitive bidding and technical standards, and has continued using these procedures in its investment program. The project has also heightened BTC awareness of the marketing function and of new services, and is currently considering the creation of a unit that would focus on the Internet business.

4.5 The changes achieved in the policy and regulatory framework are also significant, both because of the strategic nature of the changes and because of the long-term sustainability brought about by them. These developments were outward looking, embracing international best practices and aimed at achieving harmonization with EU requirements and fulfilling Bulgaria's WTO telecommunications commitment. The specific institutional development with impact on the

entire telecommunications sector are establishment of the *State Telecommunications Council* as an independent regulatory body and the *National Radio Frequency Spectrum Council*, an inter-ministerial body, for providing policy advice to the Council of Ministers on spectrum allocation. This investment project provided a vehicle for engaging in dialogue and advice on these broad policy issues, even though the funding for studies and institutional development came from the TAL.

Bank Performance

4.6 This audit agrees with the ICR rating that the Bank's overall performance was ***satisfactory***. During the lending phase, the Bank, in cooperation with the EU, EBRD, and EIB, provided comprehensive assistance to GOB, CPT, and BTC to develop an appropriate sector development strategy and to identify priority areas for short- to medium-term support. In addition to sector specialists in technical and financial areas, the Bank deployed policy and institutional specialists who complemented the mainly technical and financial expertise of the cofinanciers, particularly through the TAL. The Bank thus helped initiate a sustainable, long-term development strategy for the sector. The Bank also ensured a high degree of participation of the government, CPT, and BTC in the design and appraisal of the project. The small number of procurement packages with turnkey contracting and advance procurement in key areas helped reduce delays.

4.7 On the policy and institutional development aspects, the design and supervision could have been more emphasized. Notwithstanding staffing changes in CPT and BTC following changes in government, the design could have addressed the risks of delay for these actions. The targets for implementing the tariff policy and regulatory framework (January 1, 1994) were overoptimistic considering the needed consulting studies, which had to be managed under another loan (the TAL). Some of the broader reform objectives (such as "functional regulatory framework") could have been defined more clearly. Similarly, better monitoring and evaluation indicators for technical assistance for BTC's corporate development (such as number of trained staff, turnover of skilled staff, improvement in working capital, and rebalancing) would have been helpful during supervision.

4.8 The Bank's supervision was carried out in collaboration with the cofinanciers, including joint supervision missions throughout the project cycle, with participation from the Country Office. The coordination with cofinanciers enhanced the effectiveness of the dialogue with the government and BTC. A key accomplishment was the adoption of an interim tariff policy in 1994/95 which ensured the financial viability of BTC throughout project implementation. The supervision included appropriate skill mix and ensured the quality of advice provided. Country Office support helped the continuity of dialogue.

4.9 The QAG review in 1997 noted the supervision as marginally satisfactory based on the view that the risks due to the macro conditions were not adequately reflected in reports. But the project was less vulnerable than the other projects in the Bank's portfolio for Bulgaria. The performance of BTC management and the in-depth supervision may have further reduced BTC vulnerability to economic conditions during this period.

4.10 The Bank is perceived by BTC to have been slow and bureaucratic, for example, in taking three months for a formal agreement to a clearly needed amendment. BTC officials commented that the rigidity of the Bank sometimes constrained BTC from exploiting unused funds, and led to high transaction costs, even when requests were ultimately approved. The Bank was thus compared unfavorably with other sources of finance with less stringent requirements. This is clearly a challenge for the Bank, as it balances the demands of due process and fiduciary

responsibility with the speed required in dealing with commercial entities and fast-changing technologies.

4.11 Due to sensitivities and perceived reputational risks, the Bank took a cautious posture during the negotiations for the sale of the BTC (see para 5.3 and footnote 2). According to some officials of the Government, this was a responsible stance to take so as not to be perceived as interfering in commercial negotiations. Other officials interviewed by the audit mission viewed this posture as excessively cautious suggesting that the Bank could have played a more proactive role. In the latter view, this need was reinforced by the lack of trust between the government and the privatization advisor.

Borrower Performance

4.12 The audit agrees with the ICR in rating borrower performance ***satisfactory***. BTC's overall performance has been highly satisfactory in both the physical and technical assistance components. Some commercial aspects were unfamiliar to BTC, with the added strain of dealing with divergent requirements of the three lenders. However, BTC's ownership and commitment were high, and senior managers were continually involved. BTC undertook advance procurement in parallel with loan processing for the main packages and was quick to take advantage of lower-than-estimated prices and use the savings from all multilateral lenders to bolster system capabilities. BTC coped with technical aspects more easily than with financial, commercial, and institutional aspects.

4.13 At the time the loan was negotiated and approved in 1993, Bulgaria had begun the difficult transition from a central planning to a market economy. There have been four elected governments since 1991, three caretaker governments, and one "experts" government, which hindered decision-making. The presidents of CPT and BTC were also replaced. These frequent changes adversely affected the ability of CPT and BTC to implement policies and development activities on schedule in accordance with project commitments. Focus and attention was also diverted by the severe economic crisis and collapse of the banking system in late 1996-early 1997. Despite these obstacles, in due course, all policy actions were completed to the satisfaction of the Bank, EIB, and EBRD.

4.14 The CPT's (and the government's) performance, which was unsatisfactory through mid-term, was upgraded to satisfactory for having established suitable sector policy and regulatory frameworks and initiated an open tender for partial privatization of BTC. Despite the changes in government during project implementation and substantial delays, the GOB fulfilled the covenants of the guarantee agreement to the satisfaction of the Bank, EBRD, and EIB. High-level officials of the CPT were heavily involved in the preparation of the project. The transfer of staff between CPT and BTC at high levels helped coordination and understanding of their different roles.

4.15 Although mistakes were made that may have reduced the chance of successful privatization of the BTC, these were due to inexperience in using their financial advisor and navigating through a messy political process, but mostly, due to unanticipated market shift. It should be also acknowledged that privatization of major infrastructure remains an unpredictable process. It is to government's credit that it did not err on the side of reducing competition or violating EU policies in order to accommodate the demands of a potential buyer, and remains committed to seeking a transparent privatization of the BTC.

5. Findings and Lessons

Lesson 1: Privatization of major infrastructure such as telecommunications is a highly technically and politically complex and unpredictable process. Hence, privatization transactions should be designed for maximum flexibility, to respond to market shifts and unanticipated events.

5.1 Many factors have contributed to failing to conclude the privatization of BTC:

- Recent shifts in the telecommunications market, including shift of interest away from acquisition of fixed-line companies toward more advanced technologies such as mobile telephony and the Internet; consolidation and large mergers; and increasing liberalization in Europe which were forcing the incumbents to focus on their large domestic markets.
- The focus on a single formula for privatization, combined with unclear goals about privatization of the BTC, lead to a set of transaction documents that were never fully accepted by potential bidders . As a result, the government was left with one joint bidder to negotiate with.
- Timing, particularly the eruption of the Kosovo crisis at the time of the bidding, and a recent economic crisis and subsequent reforms that had yet to bear fruit
- Strong but unanticipated vested interests, frequent changes of officials and government positions, constant leaks of the government's negotiating positions to the press, lack of a national consensus, and diffused decision making process within government
- Poor consultations with the bidders during the critical period between pre-qualification and final bid submission.[1]
- The protracted (almost 15 months) negotiation process and the excessive demands of the only remaining bidder, particularly regarding exclusivity and indemnities for changes in the regulatory framework
- Reduced fiscal pressures (signaled by the IMF) as a basis for BTC privatization
- Inexperienced and weak Privatization Agency
- Failure of the privatization advisor to gain the trust of the Privatization Agency/GOB
- According to some borrower officials, the Bank's excessive reluctance to provide the government with advice when critically needed during the negotiations, for fear of being perceived to interfere (see footnote 2).

5.2 The first four factors are most critical and point to the need to be agile in market timing and retain flexibility about the means and options, given market and political uncertainties surrounding the privatization of large infrastructures. At the same time, clarity and specificity in bidding is required to ensure transparent evaluation and hence seeking a right balance between flexibility and bid clarity is a challenge.

- **Lesson 2: There is a need for clearer and more specific guidance to Bank staff –in the form of Bank-wide guidelines and/or operational policies– to enable them to respond flexibly, yet consistently across sectors and countries, to governments' requests for advice during the structuring and negotiation of complex infrastructure privatizations. OED may examine this critical issue in its forthcoming PSD evaluations.**

5.3 Because of the broad developmental impact of infrastructure privatizations, the Bank and the borrower have major stakes in their outcome, suggesting the importance of timely and expert advice. However, it is often difficult for Bank staff to distinguish between advising the

[1] The region disagrees with this statement.

government on the developmental impact of a proposed transaction structure--which is within the Bank's mandate and responsibility—and providing transaction-level advice—which is not. For example, should the Bank provide advice to a client country in cases where negotiations evolve in a direction which might obviate a central element of the regulatory framework promoted by the Bank and supported by best practice (e.g., inappropriate terms of exclusivity)? The absence of Bank-wide guidelines and the lack of specificity of current operational policies make it difficult for staff to respond flexibly, yet consistently across countries and sectors, to possible government's requests for assistance on these matters. OED may examine this critical issue in its forthcoming PSD evaluations, covering Bank-wide experience.[2]

Lesson 3: Adequate capacity and coordination among the key parts of the Government should be developed to handle the challenges of complex transactions and political consensus building.

5.4 The new privatization agencies are unlikely to have the capacity to deal with complex privatization deals, or the experience and confidence to use their financial advisors as effectively as needed to compensate for their capacity. The GOB has sought private strategic investors for the BTC, to bring new investment and technology as well as reduce the fiscal deficit. There was also a consensus within the sector that the BTC and the enabling regulatory framework, which were prepared under the project, were ready for a clear move toward privatization and competition. But such consensus was not sustained and coupled with the inability to exploit the financial advisors' expertise to the fullest, dealing with the various issues in the complex transaction became politically difficult challenges as the process subsequently revealed. This represents a major challenge to Governments in identifying appropriate supervisory and decisions making support structures for complex privatization transactions. Also, whenever issues with financial advisors arise, they should be dealt with immediately and resolved without delay.

Lesson 4: An investment loan, combined with technical assistance, can be an effective vehicle for broad policy and institutional reforms, as well as targeted investments and capacity building in a key infrastructure sector.

5.3 Project outcome is rated satisfactory, even though it was carried out mainly during a period when the performance of the Bank's portfolio and the country's macroeconomic management were poor. The Bank's primary value-added remains in the provision of quality advice, but this is often possible only when coupled with resource mobilization. As an investment loan, the operation enabled the Bank to build long-term relationships with the BTC and policy and regulatory institutions, and in-depth knowledge of the sector in Bulgaria. It provided a more appropriate time horizon than a typical adjustment loan, and a more in-depth sectoral expertise and relationship with key stakeholders than a multi-sectoral, technical assistance, or

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[2] The legal department commented that " OP7.40 [on disputes over defaults on external debt, expropriation, and breach of contract] , in so far as it deals with breach of contract, describes principles for Bank engagement that are equally applicable to the pre-contractual stage of negotiation". And " [legal is] not aware of any specific guidelines for staff in drawing the distinction between the developmental impacts of a transaction and transaction-level advice, though [legal does] not believe that it is a difficult distinction to draw in any specific case." The region commented that : "the policy of the Bank is very clear that the Bank is **not** to pro-actively involve itself in contract formulation for contracts it is not financing. OMS 1.28 [subsequently converted to OP 7.40], paragraph 11 reflects this sentiment in the case of actual disputes but this principle has been widely stated in the Bank as equally applicable for contract formulation (which of course could then lead to a contract dispute). In recent years, several prominent cases have occurred in the telecommunications sector which led to high level delegations of telecommunications representatives and their lawyers calling on the Bank's president to protest, and threaten legal action against the Bank, if the Bank did not maintain strict neutrality in the relations between a government and a private telecommunication investor. The result of these contacts was the repeated issuance of written confirmation to staff and managers from the president's office that the Bank is not to be involved in advising governments about their contractual relations with private investors and suppliers when the Bank is not financing the contract."

programmatic loan. The flexible use of the TAL also helped reinforce and complement the primary focus of the project on the investment and institutional aspects of the BTC.

Lesson 5: A strong local champion and project design that matches local implementation capacity are key success factors.

5.4 Key factors for success were a) local ownership, particularly a local champion with a clear vision of the sector and the need for reform; b) simple project design, taking into account the unproven capacity of BTC in implementing large projects with external financing, and the Bank's lack of experience in the country; c) in-depth involvement of a seasoned Bank professional, who had extensive experience in a large telecommunication company, and who engendered BTC confidence during project preparation; and d) good economic and sector work prior to Bank lending. BTC was viewed as a major foreign exchange earner, and the telecommunications infrastructure as the nervous system for a modern economy and a benchmark for accession to the EU. The local champion (former chairman of CPT) convinced the Bank to be involved, even though the GOB had other sources of financing, and Bank management was not as keen in getting involved in a free-standing telecommunications project. He was convinced of the value of superior and sustained advice from the Bank, complemented by other co-financiers. A quick and timely preparation helped in having the project ultimately considered in the lending program. The Bank's involvement in strengthening BTC gave it credibility in the sector, which permitted the Bank to pursue additional sectoral objectives such as privatization.

Lesson 6: Coordination with development partners is critical, particularly when dealing with large infrastructure investments and sensitive policy reforms.

5.5 The project showed how strong synergy among a country's development partners is key to helping borrowers and governments achieve reform objectives through a coordinated and consultative approach. Success in persuading the Bulgarian authorities to conform to the agreed tariff formula was achieved mainly because of effective coordination and combined influence for reform. The EU accession standards were a motivating factor. Although the procedures of EU, EIB, EBRD, and the Bank differed at times, these provided financing flexibility to BTC and more comprehensive assistance than would otherwise have been possible with Bank involvement alone. Conducting joint missions with other cofinanciers also reduced the burden on BTC.

Lesson 7: Establishing effective regulatory policies and institutions in the infrastructure sectors (network utilities) is a long-term process that requires continuous improvement and sustained support.

5.6 All sector policy, regulatory, and institutional reforms set under the project were implemented, albeit with delays. The intent to privatize BTC provided significant political momentum for these reforms. But the changes in government delayed important actions. Targets for achieving broader reform objectives also should be set with realistic timetables, taking into account the political risks and implementation challenges. Moreover, the emerging institutions are still in a fragile state, and yet to be tested, and the Telecommunication Law has been revised in light of deficiencies highlighted by the recent failed attempt to privatize the BTC. Passing the Telecommunication Law and establishing the State Telecommunications Council are only first steps. Currently, the regulator is overloaded by the demands to issue licenses, and is less able to be proactive and to monitor or anticipate the fast-changing telecommunications market.

5.7 The task of restructuring the network utilities and of establishing appropriate regulatory frameworks to attract large-scale private investment and ensure competitive markets poses major challenges for developing countries and transition economies. This task is likely to require

successive improvements in the frameworks and long-term capacity building of the policy and regulatory bodies. Currently, there is very limited regulatory expertise in Bulgaria, as this is a recent development. Moreover, policymakers will very rapidly be confronted with second-generation issues that arise when privatization is combined with unbundling (for example, the United States had considerable expertise with first-generation problems with regulated monopolies). Rapid technological change adds to the exceedingly complex challenges of establishing and maintaining effective regulation. The Bank should therefore take a longer-term view in supporting this process, drawing on its diverse instruments, and may even consider strengthening the expertise of the Country Office in privatization and regulation. The Bank should also encourage the Government to get broader ownership for such reforms.

6. Future Directions

6.1 The Bank responded to Bulgaria's need to modernize its telecommunications infrastructure with a timely investment loan, and a companion technical assistance, but this was then viewed as a one-shot involvement. This may be too narrow and short-term a view of the information and communication sector and of the critical role of this sector in supporting Bulgaria's accession to the EU and in creating a competitive, knowledge-based economy. The achievements of this project need to be consolidated and the challenges of an information society need to be addressed. The following are some pointers for consideration by both the Bank and the country:

- **Instruments for supporting privatization and regulation of infrastructure:** Although this investment loan (and associated TAL) did not guarantee a successful sale of BTC, this experience suggest that in-depth, specialized and timely advisory assistance, as well as continuity and long-term engagement are needed for concluding complex privatization deals in the infrastructure sectors, and perhaps more important, for ensuring successful development impact from privatization. Further privatization and regulation challenges of infrastructures and utilities, particularly where sectoral relationships are not yet developed, need to be met through development assistance instruments that emphasize the long-term developmental impacts. . A one-tranche programmatic adjustment loan, with its broad coverage, short time horizon, and emphasis on conditionality, is unlikely to be a sufficient vehicle for supporting programs involving complex infrastructure privatization and regulatory capacity development. The Bank needs to assess and select the appropriate instruments for the tasks at hand. The Bank may also give more attention to capacity building for privatization by assisting the Privatization Agency to systematically assess local experience and that of similar countries with complex privatization, particularly in infrastructure, and to incorporate these lessons into its future efforts to design and implement privatization strategies.

- **Options for BTC privatization:** Bulgaria needs to clarify its objectives and strategy for privatization of major infrastructures or utilities. It is timely to examine the recent experience with BTC's privatization process and to develop consensus on a new privatization strategy that builds on this experience. The GOB may want to seek independent advice from the Bank and other sources, including international professional advisors. Quality investors are likely to take comfort from the fact that the GOB had quality advisors who would be better able to market the transaction. Quality and transparency of privatization of such a strategic asset should be given higher priority over speed. The GOB should clarify its policy objectives for the development of information and communication sector, including the timing and modality of privatizing BTC. The GOB has already taken some steps in this direction, including the issuing of a 2nd GSM

license, rebalancing the tariff structure, and amending the Telecommunication Law. But more homework is needed and clear decision-making power must be vested in a competent negotiating team.

- **Preparing BTC for competition:** Strategic planning is needed to prepare BTC for competition. Telecommunications services are fast-changing and increasingly globalized, and the BTC must face competition by the end of 2002, as its exclusivity expires. BTC expects to be bound by Universal Service Obligation in 2004 and the compensation mechanism for the USO will be determined in an ordinance that would be part of the Telecommunications Act. BTC has to compensate for time lost since the completion of the project, and for uncertainties arising from the protracted negotiations for the sale. Continued corporate development is urgent. But pending its privatization, BTC is unable to make significant human resource adjustments, to reduce its staffing to international standards, or to attract staff with the new skills needed for this dynamic business. It also needs an infusion of major investments, continued rebalancing of its tariffs, and re-organizing and partnering to serve the fast-growing Internet business. Perhaps the most urgent role for the strategic investor or contract manager is to address the human resource challenge. BTC cannot afford to lose much more time.

- **Information and communication technology (ICT) strategy for a knowledge-based economy**: The recent termination of negotiations to privatize BTC, and the growing awareness of the unique strengths of Bulgaria in the ICT sector and of the importance of knowledge in development all call for a fresh look at the sector. The EU has set clear standards for accession in the telecommunications services, and for promoting ICT and information society among EU members. Bulgaria has several strengths in this area, including high teledensity relative to its per capita income, high ICT-skilled human resources, a strategic position between East and West, and significant science and technology institutions. But it is losing many of its young, skilled workers, its R & D institutions are not oriented to a market economy, it lacks venture capital, and its Internet use is not focused on local development needs and lacks local content.

- To fully leverage its window of opportunity, Bulgaria must assess its strengths and weaknesses for building a knowledge-based economy, and examine its options for the ICT sector, the related education and innovation sectors, and overall investment and regulatory environments. Among the various objectives that may be considered are: reducing the digital and knowledge divide, making Bulgaria an Internet hub, diffusing ICT among local SMEs, promoting the export of ICT services, and using ICT to facilitate public-private transactions and to promote transparency and good governance. Options for BTC development and privatization (including using BTC to create an Internet backbone and/or enhanced information access to rural and underserved areas), further development of the wireless and cable markets, and promoting various public-private initiatives should be examined within this broader knowledge-based economy framework. In a sense, the Telecommunications Project should be viewed as a first step in modernizing the ICT sector and developing a knowledge-based economy. Bulgaria should also seek to leverage the "*E*urope Initiative", recently launched by the EU, to establish cheaper, faster and secure internet; invest in skills for knowledge-based economy; and stimulate the use of internet through e-commerce, e-government, e-health, intelligent transport services, and digital content development.

A. Basic Data

Bulgaria—Telecommunications Project (Loan 3592–BU)

Key Project Data

	Appraisal Estimate	*Actual or current estimate*	*Actual as % of Appraisal estimate*
Total project costs (US$)	301.4	265.1	88
Loan amount (US$)	30		
Cancellations		1.4	
Date physical components completed: June 30, 1999			

Project Dates

Steps in project cycle	*Original*	*Actual*
Identification/Preparation		
Appraisal		December 7, 1992
Approval		April 13, 1993
Negotiations		
Board presentation		
Signing		August 5, 1993
Effectiveness		December 3, 1993
Project Completion	December 31, 1998	June 30, 1999
Loan closing	December 31, 1998	June 30, 1999

Staff Inputs (staff weeks)

Stage of project cycle	*Actual/Latest Estimate*	
	Number of Staff Weeks	*US$*
Preparation to Appraisal	16.9	52.6
Appraisal	28.1	81.0
Negotiations through Board approval	14.6	44.9
Supervision	132.6	383.8
Completion	10.6	33.8
Total	202.8	596.1

Mission Data

Stage of project cycle	Date (month/year)	No. of staff in field	Duration of mission (# of days)	Specializations represented[a]	Performance ratings[b]		Types of problems[c]
					Implement. Status	Develop. Objectives	
Through appraisal				F, E			
Appraisal through Board approval				F, E			
Supervision 1	10/93	3	2	F, E	S	S	
Supervision 2	12/93	1	7	E	S	S	
Supervision 3	06/94	4	5	F, E, O	S	S	P
Supervision 4	07/95	3	5	F, E, O	S	S	F
Supervision 5	12/95	4	3	F, E, P, O	S	S	F, P
Supervision 6	12/96	1	2	O	S	S	F
Supervision 7	04/97	3	5	F, L, O	S	S	
Supervision 8	01/98	3	8	F, L, O	S	S	
Supervision 9	05/98	3	10	F, L, O	HS	HS	
Supervision 10	02/99	3	5	F, O	HS	HS	
Supervision 11*	05/99	2	3	F, L	HS	HS	
Supervision 12*	06/99	2	10	E, O	HS	HS	

a. E = Engineer; F = Financial Analyst; L = Legal, O = Operations; P = Procurement.
b. HS = Highly Satisfactory; S = Satisfactory; U = Unsatisfactory.
c. F = Financial; P = Procurement
* Included discussion on implementation completion.

B. Comments from the Borrower

Draft Performance Audit Report

COMMENTS

by the Ministry of transport and communications - Bulgaria

There seem that a slight shift in the initially proclaimed goals and intentions in '92-'93 related to the DON loan appears, in the actual WB evaluation of the outcome.

During the preparatory work and the first implementation phase, privatization of the incumbent was considered as a long-term objective and the DON project finalization was not considered as an essential preparatory step for privatization (see Background).

Moreover, the collapse of the privatization negotiations was by no means influenced negatively by the DON project. Even a much better DON development (if possible) wouldn't have affected the privatization process in a material way.

The outcome of a small part of the Technical Assistance Loan (TAL), targeted at the privatization of BTC, should probably be evaluated separately from the DON.
Even in this case, the TAL privatization related spending could receive an overall positive evaluation:

1. A highly harmonized regulatory framework, facilitating EU accession negotiations and telecommunications market development.
2. Experts at the Ministry of Transport and communications (former CPT) and the State telecommunications commission (STC) with accrued during the negotiation process experience.
3. Improved accountancy, managerial attitude, customer care re-orientation as a follow-up to the multiple investigations in the Company.

Some details:

1. PREFACE - v

Paragraph three, the last two sentences
"At the time ICR was prepared, negotiations for the sale of the Bulgarian Telecommunications Company were underway, and successful privatization was anticipated, hence, the privatization was not covered by

ICR. The PAR therefore gives special attention to this experience, as lessons are likely to be critical to the Bank's assistance to privatization of Bulgaria's infrastructure and utilities."

Our comment:
The aforementioned loan of the World Bank was intended for the implementation of a specific project (DON) and a sequence of sub-projects incorporated by the main project. It is logical that ICR does not reflect the process of privatization since at the time of ICR preparation and adoption the negotiations have not been completed. The Bank's technical assistance can not be associated with the privatization issue since as discussed during the last auditing mission of OED, dated January 14, 2001 it was channeled to different aspects associated with the DON project implementation. During the mission it was pointed out by BTC management that the specific outcomes of the project supporting the preparation of the Company's privatization were: infrastructure modernization, corporate development of BTC Plc., introduction of new services, promotion of private sector investment, and separation of policy-making and regulatory functions.

Therefore, the privatization of BTC Plc. should not be regarded as a "critical lesson" to the Bank's experience in this field.

II. RATINGS - page 7

"Outcome Relevance, Efficacy and Efficiency
Paragraph 1, sentence 3, 4
4.1. "However, the audit rates the project outcome as satisfactory rather than highly satisfactory. This is because of the uncertainty over the further development of BTC arising from the recent termination of negotiations to privatize."

Our comment:
As it was stated by both policy-maker (The Ministry of Transport and Communications) and BTC Management during the Auditing Mission of OED of January 14, 2001, a Strategy for development of the telecommunications sector would be adopted envisaging re-launching the process of privatization of BTC. The Strategy is ready now and the Company has retained its leading position on the fixed-line telecommunications and wholesale ISP market. The financial status of the company is stable (see Annual and Quarterly Report) and an aggressive innovative marketing strategy has been launched for improvement of BTC's service-provision and customer care on the home market. Several

promotions (a Christmas and Easter promotion) were conducted successfully this year. Given the possibility for awarding BTC Plc. with a GSM license, the Company's future seems promising since the incumbent operator would find an additional opportunity for finding a position on the mobile market.
BTC recommends that the rating of the project outcome could remain "highly satisfactory" since the project's implementation contributed directly or indirectly for the achievements stated above.

"Sustainability - page 7
4., Sentence 1,2
" However, as the sale of BTC's shares to strategic investors was not concluded, there is some risk that BTC's progress and project benefits could unravel. Hence, the audit downgrades the ICR rating from highly likely to likely."

Our comment:
It is not secure to base the ratings of project's sustainability on insights of the future. The effort of the Bulgarian Government and policy-makers in terms of attraction of strategic or financial investors to BTC continues and the evidence for that is the aforementioned Strategy for development of the telecommunications sector. On the other hand, a project's sustainability is measured by the effect of the implementation process and its sustainable outcome. In this case, the implementation of the project resulted in a significant progress in the corporate development of BTC, which will consequentially have impact on BTC's successful performance in a liberalized environment.
Recommendation: The rating could remain unchanged.

III. Future Directions - page 13, 14

Bullet two - "Options for privatization" and bullet 3 "Preparing BTC for competition"

Our comment:
With regard to the options for BTC privatization the objectives and strategy have been already clarified by the policy-maker. High priority of the transparency of the process is given.
In the sphere of BTC's preparation for liberalization on December 31, 2002, a thorough and comprehensive program has been developed by the Company tuning up BTC's priorities with the future developments on the telecom market in Bulgaria (See the paragraphs above.)