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**HEARING ON THE USE OF TENDERS AND AUCTIONS**

-- Paper by Prof. Marco Ponti --

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## THE ITALIAN TRANSPORT CASE

*By Professor Marco Ponti\**

### 1. Transport is an extremely complex sector

1. There are several transport modes (rail, roads, air, sea...), services and infrastructure, natural and legal monopolies, various externalities, public and private actors at every level, social objectives. This makes it both difficult to summarize the issues at play, and interesting in order to compare different policy approaches and results. This note refers to the Italian case, but also relates to a world-wide survey that the author is carrying out as a responsible for economic regulation within the World Conference of Transport Research Society.

2. The Italian picture is undergoing a quite radical reform process, given the evident inefficiencies of the former regulatory system (a highly “captured” one).

### 2. Concessions for infrastructure

3. Concessions for toll infrastructures have gradually been introduced after a long period of direct management both by the central state and by local administrations. These concessions have been awarded to public companies for railways and ports, and to fully or partially private ones for airports and toll highways. No real competitive procedure has been used for these initial concessions.

4. A severe problem emerged for the main profit-generating one: “Autostrade SpA”, controlling the vast majority of toll highways in Italy. This concession has been awarded to an industrial group (Benetton), i.e. has been privatized, for a large sum (about EUR 7 billion), deemed nevertheless quite cheap standing the revenue perspectives and the political clout that a new dominant private company would have acquired. The regulation has been weak, with an ill-defined price-cap formula, and no independent regulatory body. The profits derived have been outstanding. Following the opinion of the majority of scholars, a trade-off has been made between immediate revenues for the State and the proper defence of users from future monopolistic rents.

5. The investments picture, for every infrastructure, has been dismal: railways and ports concessions have had large transfers from the State, without any control of their economic soundness (no comparative financial or Cost-Benefit analysis, spectacular cost overruns by the rail investments in High Speed Trains - HST). For airports and highways, the lack of control has generated identical consequences: investments paid by the user instead of the State, but with little control on cost efficiency and undue rents.

6. The present situations seem unchanged: there are still large railway investments, with 100% public funding and extremely doubtful economic sense (the European TEN-T – trans-European Transport Network – “rail-only” approach not helping), and political projects aimed at extending highway concessions after they expire, without any competitive procedure.

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7. A few relevant PPP projects (mainly subway lines) have seen risk-allocation approaches that actually leave almost all the commercial risk to the public actor, transforming PPPs in disguised public expenses, made just in order to circumvent budget constraints.

8. A special case is that of the unbundling of the rail infrastructure from the services: the recent shelving by the European Parliament of the “Fourth liberalization package” of the rail sector proposed by the Commission, means that this basic “conflict of interest” has not been eliminated (service operators have to pay for using an infrastructure owned by a competitor). This is definitely a severe blow to the entire liberalization process for the sector.

### **3. Concessions for services**

9. Setting apart a limited opening for competition in the HST sector (the small new-entrant is already facing severe losses), the concessions for services are mainly in local public transport, heavily subsidized and inefficient, with the largest share represented by public companies, owned by the local administrations that they serve.

10. Here several attempts have been made in order to promote a tendering system (“competition for the market”). But in absence of a strong regulator, and with a public “residual claimant” that up to now has footed any conceivable bill, no real progress has been made. Out of one hundred tenders, 99% have been awarded to the incumbent company, with little or no savings for the public purse.

11. The key issues here are the conflict of interest (the conceding body can own a contender), and the excessive dimension of the tendered lots (no economies of scale having been proved, this is a severe entry barrier). Also here the role of the European Commission resulted very conservative, especially for the rail local services (see above).

### **4. Past and present regulatory bodies**

12. The sector has not been actually “regulated” in technical terms, and the transport ministry has been directly in charge of everything since a long time. After the first changes in the administrative structure in the late '80 (formal concessions, formal shareholding companies even if entirely public, etc.), some new specialized bodies have been created in order to deal with the different transport modes. ENAC for the air sector, ANAS for the road sector, and other minor ones. Railways remained an all-too-relevant exception, perhaps the proof of its political power (the transport ministry itself was located in the same building of the FS SpA). After the setting up of independent authorities for energy, telecommunications, and competition, a special body (NARS) was created within the Ministry of Economy, in charge of dealing with the public services lacking an independent authority, but only with advisory tasks.

13. In year 2013, after almost twenty years of postponements, the independent authority of transport regulation (ART) has been created. Its powers are limited (only veto, but no economic sanction allowed). Its first decrees are indeed interesting, but are extremely recent.

### **5. Provisional recommendations**

14. Deriving conclusions out of such differentiated regulatory practices and experiences is far from easy, and would require an in depth, case-by-case analysis. Nevertheless, some broad indications can be suggested.

## 5.1 *General*

15. Let us assume that independent regulation is justified only in the presence of “capture”, and “capture” in turn explains the majority of inefficiencies in the provision of public services. So the real issue is “capture minimization”, and this have to be obtained mainly by unbundling strategies, both for services and infrastructure concessions, in order to reduce their political and economic clout (“too big to fail”, votes of exchange, asymmetry of information, etc.). This has to be accompanied, as a logical consequence, by the abolition of any “residual claimant”: bankruptcy for small companies can be allowed (and have to). The regulatory theory in particular sets the above-mentioned issue of political clout against economies of scale, in recommending “minimum efficient dimensions” for the regulated companies.

16. Obviously, a stronger regulator would be recommended. Also a stronger European political will in this direction looks necessary, but this dimension is outside the scope of this note (see Ponti (2001) on the European transport policy<sup>1</sup>).

## 5.2 *Specific*

17. Within the Italian transport sector, “capture” mechanisms of the political decision makers, and the resulting inefficiencies, are widespread, and this is a shared opinion. Following the theory, this implies small lots both in infrastructure (unbundling) and services, but also short concessions (less “clout building”, reduced space for renegotiation, less problems of amortization with proper takeover rules). Incentive for investing in new large infrastructure seem not much necessary, given the rather static demand, the widespread underutilization of the majority of the rail network, and the highway new links soon to be opened. (What is severely missing here are sound, comparative, independent benefit-cost and financial analysis). Given the nearly-absent private commercial (i.e. traffic) risks within the present PPP concessions, there is a solid doubt that it will be better to return to the “old” direct investment approach, if compared to fake PPP (here an example can be made on the new subways of Milan, that are jeopardizing the financial sustainability of this administration).

18. Toll highways are largely amortized, and the present system shows no logical nor functional relation with other similar non-toll highways, and generates large rents due to poor (better still: captured) previous concession rules. Here, a scenario where these are again brought back under state control, has to be considered, allowing for a far more comprehensive and sensible regulation of the entire road system, based for example on the wide use of “congestion charges”, instead of the inefficient “average cost” toll pricing at present in use (“per se” an inefficient pricing approach).

19. In this context, the modest technical content of the sector and the absolute predominance and urgency of the maintenance of non-toll roads have to be highlighted. At present, these roads are much used and congested, and severely underfunded notwithstanding the extremely high gasoline taxation, internalizing all the external cost (see the recent IMF research on this topic<sup>2</sup>). There is not enough space here to present a possible scheme of concessions of road maintenance, control, and investments based on traffic catchment areas, also studied by the World Bank, and proposed to the Lombardy region.

20. In contrast, for ports, airports and rail services a full privatization with solid independent regulation can be recommended. In particular, the privatization of rail services will obtain as a direct consequence the unbundling of the network, that may remain public, from the services.

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<sup>1</sup> Ponti M., Boitani, A. and F. Ramella (2013), “The European transport policy: its main issues”, in "Case studies on transport policy", Elsevier.

<sup>2</sup> Parry, I.; Heine, D.; Lis, E. and Shanjun Li (2014) “Getting energy prices right: From principle to practice”, IMF, July 2014.

21. For ports and airports investments, a good practice seems to be related with compulsory direct negotiation among the concessionaires and the companies that are served by these infrastructures, and especially so for those investments that they will have to pay for. The same will be also recommended in future for rail investments, when the pricing system will be homogenized for all modes (ACP or MCP, but more likely something in-between, depending on the marginal opportunity cost of the public funds involved).

22. The issue of incentives for improving the quality of transport services, with the related investment in rolling stocks etc., has to be based on leaving far more freedom in tariff level and structure (besides getting rid of the present conflict of interest). An important regulatory solution for local bus transport can be based on leaving part of the service in competition “in the market”, setting only some social standards (see the Swedish project), and/or limiting this full liberalization to specific areas. This in order to disclose a basic asymmetry of information on the possible efficient costs of production, that in Italy seem to be far lower than the present ones.

23. A well-known issue in local transport tenders is the alternative between “net” and “gross cost” concessions: the first system is incentivising the revenue side (since the concessionaire will be responsible both for cost and revenues), but is a severe entry barrier (the incumbent will have a very large “information rent”), while the “gross cost” system (the concessionaire bids only on the cost side; see the London case) is far more simple and open to competition, but has no incentive on the revenue side.

24. A compromise seems a possible solution, leaving for example to the concessionaire the revenues of the extra-traffic that it will be able to generate with the quality of the service.

## **6. Conclusions**

25. The range of possible “good practices” and incentives, in order to get efficient results from the concessionaires, is really widespread within the transport sector, both for services and infrastructure. Nevertheless the Italian experience suggests that by far the main issue to take preliminary into account is the “level of capture” of the decision maker, and its possible “hidden agenda”. The best technical solutions will be the ones able to reduce its “level of capture”, in addition to the direct effects that these solutions will have on the concessionaires.