NOTES ON Y.C., ON SOME THEORETICAL ISSUE, AND ON THE HIGHWAY SECTOR

"People of the same trade seldom meet together, even from merriment or diversion, but the conversation ends in a conspirancy against the public, or in some contrivance to raise prices".
Adam Smith, the father of free markets, but also of regulation.

1. BENCHMARKING

Perhaps "benchmarking" could be a better, more general title than YC, since it is a kind of "informative prerequisite" for all types of regulatory tools.
As a regulatory tool, YC may also have some drawback: it doesn't really cut the "capture links".

Many examples of failures due to this fact, that maybe have to be studied, as well as the success cases (see in particular the case of local public transport for Italy: "standard costs", minimum cost/revenue ratio, etc.).

2. ECONOMIES OF SCALE

One of the main issues of benchmarking is the measurement of economies of scale, scope etc. .

It has to be remembered that their (independently-proven) existence, is not per se a sufficient argument.
It has to be made sure that these economies are transferred to the users or to the taxpayers.

Furthermore, also the "<u>minimum</u> efficient dimension" issue remains on the table, in order to avoid excessive "clout", a.k.a. "capture power", of the regulated company

This is by far the main regulatory and policy issue in this moment in Italy

3. INFRASTRUCTURE PRICING

This the second main issue in Italy. Today it is utterly inconsistent among modes.

Infrastructure pricing strictly depends on the "willingness to pay" of the State in relation of that of the users. If the state pays for 100% of the investment costs, pricing will be driven toward SRMC (i.e., very low), and vice versa.

This "public WtP" seems to be high for railways, and very limited for other modes, independently from the MCP-ACP issue.

If regulation have to deal with efficiency, but never interfering with strictly political choices, nothing can be said (i.e. if we assume an "all-knowing, benevolent prince").

But if we assume a "captured" (or "possibly captured") decision maker, this picture must change.

In turn, this assumption seems mandatory, due to strictly logical reasons: if there is no capture, there is no need for <u>independent</u> regulatory bodies.

The assumption of "capture" means a rather different sets of theoretical tools (manly deriving from the "public choice" literature). Here, I am outside the "mainstream" theory, but this is the proof of an important and free debate within the Advisory Board.

On top of this, an inefficient infrastructure pricing system will alter the transport market, at least for some component: if regulation has to be based on efficiency, every regulatory tool will suffer.
Traffic allocation among modes will become inefficient.

Finally, will the incentives for efficiency of an infrastructure company that has to pay for its investment be the same as one that has not to care for it?

Most likely, the incentives will be distorted, and naturally aimed at maximizing public transfers.

4. HIGHWAYS

For highways, a recent and still unpublished research (that I have coordinated) based on comparative ex-post CBAs of 6 large investments, suggests that there are both overinvestment and underinvestment cases.

This research has also dealt with the overall concession system. It is well-known that it is both not very transparent (the contracts are classified, being between two formally private subjects, i.e. shareholding companies, or SpA), and not very strict toward the concessionaires

The research shows also a large variance of exogenous conditions which influences both unit costs (that vary in a range between 1 and 10, mainly because of the diversity of geographical features) and demand (traffic levels vary in range between to 1 and 7).

Also for this reason, probably competitive tendering for limited periods is the more effective regulatory tool.

Moreover, the research shows that the environmental aspects are largely irrelevant in terms of costs and benefits.

7. INCENTIVE REGULATION

Incentives are effective if consistent with the objective of the regulated company. For private companies this is in general straightforward: profits.

Far less so for companies totally or partially owned by public actors, even if "formally" private (SpA).

Profit for these companies for sure is not an objective.
Therefore the traditional regulatory tools, even Y.C,, have probably to be adjusted, even radically.