"To Bid or Not to Bid, This is the Question: The Italian Experience in Competitive Tendering for Local Bus Services"

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To bid or not to bid, this is the question: the Italian experience in competitive tendering for local bus services

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Abstract

Competitive tendering is a popular mechanism for the provision of local bus services when a major objective is subsidy savings. Despite uncertainties in the legal framework some competitive tendering was implemented in Italy since 1998. The evidence so far is that participants were limited in number, the incumbents were almost everywhere able to gain the franchise, whilst subsidy savings were in many cases negligible. If some "political" conditions favouring more effective tendering procedures are not fulfilled, other regimes should be considered in order to obtain substantial subsidy savings.

Keywords: Local bus services; Tendering.

1. Introduction

In the last century many local bus companies in Italy (as in many European countries) enjoyed monopoly protection by means of non-tendered concessions or public ownership. The financial performance of these firms has deteriorated for more than thirty years. Financial distress is only partly explained by declining patronage (lower shares in the private – public transport split) and fares permanently lower than average costs. An important role is also played by low and stagnant productivity, due to weak incentives for efficiency. Weak incentives, in turn, are not surprisingly related to cost-plus contracts, based on individual negotiations between local governments and the (local) monopoly firm. Incentives are even weaker when the firm is publicly owned and the local government can not credibly commit to let the firm go bankrupt in the presence of high and/or increasing deficits (Boycko, Shleifer and Vishny, 1996).

Competitive tendering is held to be the most effective instrument to create competitive pressure in a market in which an open competition among firms is not

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feasible or uneconomic (Demsetz, 1968). In Europe competitive tendering of transport services has been implemented in France, in Great Britain and in the Scandinavian countries. As summarised by Hensher and Wallis (2005), in fifteen years competitive tendering brought about a 50-55% reduction in real unit costs in London, whilst in Scandinavia there were savings ranging from 5 to 34%, but most in the range of 20-30%[1].

The appraisal of the French experience casts some doubts on the efficiency enhancing properties of competitive tendering. It has been said that "competition has not been fostered and the performance indicators are still mediocre, not to mention the fact that collusion still exists" (Yvrande-Billon, 2005, p. 19). The French Competition Commission, in 2005 denounced the existence of a cartel between the three leading operators, who were alleged for explicit bidding coordination, leading to higher prices "than those that would have resulted from a competitive functioning of the market" (Yvrande-Billon, 2005, p. 15).

In order to improve the allocative and productive efficiency of the local bus industry, the Italian government introduced a reform (D.lgs. 422/97 and 400/99) whose main purpose was to create a more market-oriented industry, enhance competition and reduce the huge amount of subsidies to the unprofitable local bus companies. In particular, the bill stated that non-tendered concessions were to be banned as of January 2004. By that date all subsidised local transport services (rail services included) would have been tendered off. Later legislative interventions changed the institutional framework, introducing normative uncertainty and leaving discretion to local governments whether tendering out concessions or making use of *in house provision*. Despite all these fluctuations in the legal rules, in some regions tenders did actually take place.

The purpose of this paper is to assess the competitive tendering procedures in Italy and to point out the main difficulties that have so far hindered the process. The structure of the paper is as follows. In section 2 the most important issues that competitive tendering in the local bus industry rises are briefly examined. In section 3 a summary of the results of competitive tendering is presented - making use of the information we gathered and organised over the years – followed by a tentative assessment of those results. Section 4 concludes that, if some "political" conditions favouring more effective tendering procedures are not fulfilled, other regimes should be considered in order to obtain substantial subsidy savings.

2. Relevant issues for competitive tendering

As suggested by the recent economic literature (Klemperer, 2004), an efficient outcome of an award procedure depends on several factors, in particular on the number of participants, on the absence of barriers to entry and on the existence of widespread knowledge about the best production technologies. The implementation of a competitive tendering process in the bus industry is even more complex, as not only economic but also technical aspects of the services must be taken into account[2]. First, the local

[1] See also Alexandersson, Folster, Hultén (1998); Kennedy (1998); Ramella (2001); Toner (2001); London Transport (2002); Alexandersson, Pyddoke (2003); Boitani, Cambini (2004a).

[2] Notice that, since local transport services are unprofitable at the present Italian level of fares and costs, the price that comes out of a competitive tendering normally consists of the remuneration that the winning

authority has to define the type of contract to be offered to the winning bidders. Following the analysis of Isotope (1997), there are two different types of on-going risks that a supplier of transport services has to face: the *production risk*, associated with the production cost of the services' provision; and the r*evenue (or commercial) risk*, associated with the sale of transport services. The allocation of these risks defines a set of different types of contracts that could be tendered:

- *Gross Cost Contract*: the transport firm bears only the production risk while the revenue risk is born by the tendering authority. The firm receives a unit transfer related to an anticipated unit cost. Revenues accrue only to the tendering authority.
- *Net Cost Contract*: both risks are born by the transport firm. It receives a transfer determined in the tendering process, equal to the difference between anticipated total costs and traffic revenues.

There is a variety of incentive contracts between local authorities and the transport firm - such as gross cost contracts with revenue incentive, or net cost contracts with shared revenue risk - in which the revenue risk is split between actors. Different types of contract entail different incentives to minimize costs and/or to control revenues. Whatever type of contract has to be clearly specified ex ante when designing the tendering procedure.

The size of the service-area is the second element that local governments should define in a tendering procedure. Ex ante costs and benefits of different alternatives are as follows (Cambini, Filippini, 2003):

- *Route-by-route tendering* guarantees an efficient production of transport services, as the number of potential bidders can be expected to be high and competition can thus be expected to be fierce. However, route-by-route tendering could increase the planning-costs of urban transport, since the local authority must coordinate a large set of services provided by different operators in order to have a well integrated network. This tendering procedure could more successfully be used to assign inter-city routes than urban ones.
- *Network tendering*: implies that all services in an urban or even regional area are bunched together and tendered out. Although this method maintains the integrity of the network, it presents some disadvantages. The complexity of the services to be provided increases the organizational costs of the tendering procedure. Moreover, if one applies this procedure to allocate transport services in a large city or a metropolitan area, the potential number of bidders would be low. The lower the number of bidders the lower the potential benefits from the auction.
- *Sub-set tendering*: the service-area to be tendered is divided into sub-set. Each sub-set is made of a bunch of routes to be served by the winning bidder. By reducing the area to be served one can expect that the number of potential bidders increases, hence that the competitive pressure also increases. In addition, the possibility of tendering small units, without loss of integration, permits the local authority to compare operators' performance simultaneously (yardstick competition). The main difficulty with route bunching is defining the single units to be awarded and their size in order to exploit the economies of scale or density and to coordinate and correctly plan the services in the whole area.

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bidder *requires* to run the services and not a price to *pay* to get the rights to run the services. For a discussion on this issue see also Isotope (1997), Toner (2001) and Boitani, Cambini (2002).

Summing up, on the one hand, the definition of a small service area to be assigned, for instance a bus line, can guarantee a high level of competition because many operators will be able to participate in the tendering process. On the other hand, a small service area cannot guarantee the optimal scale of production[3].

There are other relevant aspects in the design of a tendering procedure. First, local Authorities should decide either to accurately design ex ante the assigned area (i.e. to implement a *rigid tender*) or to leave some degrees of freedom to the franchisee in designing the services, in terms of fares, frequencies of buses, bus routes, quality of buses, etc. (*non rigid tender*). In order to avoid a quality reduction in the provision of transport services, local authorities usually set penalties in case of unjustified reduction in quality provision. Third, the introduction of quality features in a tender procedure generates difficulties in evaluating the overall level of each bid. In this context, the selection criteria (i.e. the scoring system) must take into account both the economic and technical issues of service provision. While the economic elements can easily be quantified, problems of evaluation emerge in assessing quality. The possibility of assigning arbitrary weights to different elements of the bid could alter significantly the final result of the award process.

Finally, it is extremely important how the ownership of buses, deposits and other equipment is allocated among competitors. The use of infrastructure represents a consistent barrier to entry that could prevent new operators from entering the market. If the tendering authority owns the infrastructure, then these barriers can be eliminated. Otherwise, the tendering authority must oblige the incumbent to transfer the entire infrastructure to the potential new operator, but it has to define how to evaluate the financial value of these capital goods. This last task is extremely complex due to the information asymmetry between the incumbent and the local authority.

3. The Italian competitive bidding experience in the local bus industry: an overview

In the last two decades of the twentieth century the Italian local public transport sector has been characterized by increasing costs, sky-rocketing deficits and a declining market share. Especially labour costs, which represent 2/3 of the total operating costs, have increased over years, while traffic revenues have remained stationary due to a combination of low fares (due to distributive concerns) and a consistent shift from public to private transport. Although fares have increased substantially since 1992, in 2004 traffic revenues covered on average only 30% of total operating costs while the remaining costs were covered by public subsidies. A few economic indicators of the local bus industry in selected European countries can be found in Table 1. It can be seen that the Italian local bus industry has the second-highest unit cost (behind Germany), the highest unit labour cost and the second lowest labour productivity (behind Belgium). Although traffic revenues per km in Italy are not the lowest in Europe, the Italian local bus industry turns out to be the most heavily subsidised.

[3] See for example Cambini, Filippini (2003) and Cambini, Piacenza, Vannoni (2006).

Table 1: Performance indicators of the local bus industry (average values 2002-2004).

	Italy	*UK*	*Germany*	*France*	*Sweden*	*The Netherlands*	*Belgium*	**Average (excluding Italy)**	**Average (including Italy)**
Public subsidies per km (€)	2,2	0,6	1,5	1,9	0,9	1,5	2,0	*1,4*	*1,51*
Traffic revenues per km (€)	1,08	1,49	2,39	1,14	1,07	0,98	1,00	*1,34*	*1,30*
Operating osts per km (€)	3,5	1,8	4,0	2,9	1,9	2,4	3,0	*2,7*	*2,78*
Revenue/cost ratio %	30,7	84,2	60,5	39,2	55,4	40,0	33,1	*52,1*	*49*
Standard ticket fare (€)	0,84	1,53	1,89	1,26	1,95	1,60	1,40	*1,60*	*1,50*
1hour ticket in capital cities (€)	0,80	1,13	0,97	1,32	1,76	1,44	1,33	*1,33*	*1,25*
Monthly pass (€)	30,00	41,33	51,19	45,80	44,02	47,20	32,54	*43,68*	*41.72*
Labour cost per km (€)	2,3	0,8	2,1	1,6	1,1	1,7	2,0	*1,6*	*1,66*
Average product (Vehicle-km) per employee	17060	20592	17761	20506	23423	18275	10018	*19763*	*18233*

Source: Earchimede (2005).

In some Italian regions competitive tendering procedures were planned in order to improve the poor cost performance of local bus companies and reduce public subsidies. Table 2 summarises the available information on the Italian tendering procedures, as of December 2005. In particular, Table 2 contains information on the contractual form, duration of the contracts, the size of the service area and the size of the area tendered, as a percentage of the total.

Only four regions have tendered out more than 50% of total bus-km of the service-area (Valle d'Aosta, Friuli Venezia Giulia, Lombardia and Toscana), while in Emilia Romagna only 34% of the total area was actually tendered out, but competitive tendering is still taking place in the residual area (Table 2). In Lombardia all the service-area has been tendered out, except for the metropolitan area of Milan, that accounts for about bus-km 120 mln. In some southern regions (Sicily, Apulia, Sardinia and Calabria) competitive tendering of local bus service did not even start, whilst in other southern and central regions (Campania, Basilicata, Marche, Umbria) competitive tendering is slowly starting. In some northern regions, like Piemonte and Veneto, competitive tendering didn't take place, except for a few isolated experiences. In all these areas, the normative uncertainty mentioned above and a good deal of political opportunism lead many local authorities to prefer the *in house provision*.

Table 2: Quantitative Analysis of the competitive tendering procedures in Italy (1998-2005).

Regions	*Contractual Form*	*Contract duration*	*Total Bus-km in regions (a)*	*Bus-km in competition through bidding (b)*	*% (b)/(a)*	*Bus-km auctioned (c)*	*% Total Bus-km (c)/(a)*	*% Vehicles-km in competition (c)/(b)*
Valle d'Aosta	Net cost	6+3 years	6.545.500	6.545.500	100%	6.545.500	100%	100%
Liguria	Net cost	6 +3 years	69.000.000	53.962.700	78%	14.962.700	22%	28%
Piemonte	Net cost	6 years	120.000.000	2.748.065	0,02%	2.748.065	0,02%	100%
Lombardia	Net cost	7 years	275.379.176	145.884.290	53%	139.307.896	50%	95%
Veneto	n.a.	n.a.	131.549.005	252.000*	0,19%	n.a.	n.a.	n.a.
Friuli Venezia Giulia	Net cost	10 years	41.596.000	41.596.000	100%	41.596.000	100%	100%
Emilia Romagna	Gross and Net cost	From 2 to 8 years	108.000.000	112.006.557	103%	37.181.176	34%	33%
Toscana	Net cost	5 years	117.000.000	120.965.842	103%	120.965.842	100%	100%
Umbria	Net cost	6 years	30.274.724	30.274.724	100%	n.a.	n.a.	n.a.
Marche	n.a.	n.a.	51.800.000	43.000.000	83%	n.a.	n.a.	n.a.
Lazio	Gross cost	3 years	n.a.	22.500.000	*Additional services*	22.500.000	n.a.	100%
Campania	n.a.	n.a.	158.000.000	2.490.642	1,57%	2.490.642	1,57%	100%
Puglia	n.a.	n.a.	n.a.	33.072.549	n.a.	9.681.678	n.a.	29%
Basilicata	Net cost	5 years	n.a.	28.000.000	n.a.	1.900.000	n.a.	6,79%

*It refers to the urban area of Vicenza. No one had participated in the bidding procedure. The service is still offered by the incumbent.

As for the contractual features of tendered services, it seems that net cost contracts are predominant, whilst the contract duration varies in different regions. Regarding the definition of the service-area, one can observe that a homogeneous criterion to define the size of the bus service area does not exist. In particular, the regional authorities normally choose the size of the service area by using the province or municipal jurisdictional boundaries, aggregating sometimes urban and inter-cities transport services, disregarding potential economies of scale and density. The design of competitive tendering procedures so far does not seem to give correct incentives to mergers of transport operators or at least to efficiently aggregate bunches of routes in nearby areas. Indeed, the Italian local transport market is still composed of a great number of small or even very small operators, contrary to what is going on in many EU countries, like Sweden and the UK.

Tendering procedures in Italy do not generally regard single lines but large or small networks. In some cases, especially in small and medium-sized Italian provinces, urban and inter-city routes are bundled for tender, in order to let the winning firm cross-subsidize the unprofitable urban services with the more profitable intercity services and thus reduce the subsidy to be given to the winning bidder[4].

In all the above-mentioned experiences, local governments maintain the ownership of infrastructures and buses. Tipically, these capital goods are given for free to the winning bidder but have to be returned to the local authority when the franchise expires. Finally, the competitive tendering was won almost everywhere by the incumbent operator, sometimes in joint venture with other local transport operators, with very limited savings with respect to the reserve price: 4% reduction on average in Val d'Aosta, and

[4] The winner of the competitive tendering procedure is typically the company ready to offer a pre-defined transport service asking for the least amount of public subsidies.

3% in Friuli, while in other regions, like Lombardia, the reduction was even lower (1% on average) (Table 3). A special case is Tuscany. Here, the bidding procedures were designed with the objective of increasing the supply of transport services, and so the total bus-kilometers to be provided by the winning bidder. If the additional services offered in the tender by the winning bidders are taken into account, the average reduction in Tuscany reaches 4,3%.

Table 3: Selected results of competitive bidding in Italy.

Regions	**Average reduction for winning bids**	**Ex post presence of Incumbent**
Valle d'Aosta	4%	100%
Friuli Venezia Giulia	3%	100%
Liguria	n.d	75%*
Lombardia	1%	- urban areas: 90%* - suburban areas: 95,5%
Emilia Romagna	0,5%**	100%
Toscana	0,01%	100%

*The bidding procedures in Como and Albenga, both won by new entrants, were revoked by the Regional Administrative Tribunal (TAR).
** Only for the area for which official data are available
Source: Boitani, Cambini (2004a); Cambini, Galleano (2005)

The tendering procedures in Lazio deserve further explanations. These procedures actually refer to the case of Rome only, since no tendering procedures took place in other towns or provinces within that region. The early competitive tendering procedures organised in Rome were limited to *additional transport services*, consisting of new lines for the 2000 Jubilee (J routes) and of 15 additional million bus-km divided in two sets (8 and 7,5 million bus-km, respectively). A complete picture of the competitive tendering in Rome can be drawn from Table 4. These new routes integrate bus-km 115 million provided, with a non-tendered concession, by the incumbent operator, the publicly owned Trambus. A joint venture - lead by Sita (owned by the national railways operator, Ferrovie dello Stato), with some local operators (Arpa - Chieti, Apm – Perugia) and the French company Transdev - was able to win all of the three early franchises.

In the first and second tenders the incumbent operator, Trambus, was not allowed to make an offer in order to favour the entry of new transport operators. As can be seen in Table 4, this decreased the competitive pressure in the bid, leading to a reduction of approximately 8% of the reserve price. In the third tender, however, Trambus's bid was admitted but the offer of the new entrant was better. In this last case, the reduction was 25%, the highest reduction ever seen in Italy for whatever transport tendering procedure.

The fourth tender contained a bundle of the previous additional services, plus some additional ones, for a total of 26,5 mln bus-km per year. Trambus was not admitted to the tender won by a new consortium of transport operators called "Tevere S.p.A", once again led by Sita. The French operator Transdev didn't take part in the consortium. The reserve price was € 2,37 per bus-km (gross cost), which was the actual transfer given in 2005 (after allowing for RPI-indexation) to the previous operator and the winning bid was € 2,36 per bus-km: a tiny 0,42% reduction.

Table 4: Competitive tendering in Rome (additional services).

Service area	*Bus-km per year (million)*	*Annual value (Euro million)*	*Compensation per bus-km (Euro)*	*Contract duration*	*Contract form*	*Reduction*	*Winning operator*
Set 1: Jubilee lines (1999)	7	13.05	2,14	3 years	*Gross cost*	8,0%	*New entrant* in ATI: Sita, Atm Perugia, CIPAR
Set 2: additional services (2000)	8	17.04	2,13	3 years	*Gross cost*	8,23%	*ATI*: Sita, Apm, Arpa, Transdev, Star ,Cotri
Set 3: additional services (2000)	7.5	14.98	1,74	3 years	*Gross cost*	25%	*ATI*: Sita, Apm, Arpa, Transdev, Star ,Cotri
Set 4: additional services (2005)	26.5	62.54	2,36	3 years	*Gross cost*	0,42%	*ATI*: Sita, Apm, Arpa, Star, Cotri

Source: Boitani, Cambini (2002); Atac (unpublished data).

Figure 1 shows the compensation paid per bus-km varies widely across tendered areas. Such a variance is partly due to the fact that some contracts are gross cost (Lazio and some in Emila Romagna) whilst most of them are net cost (hence compensations are equal to subsidies). The variance may also be due to the service-mix effect and to many other differences in the type of service provided. However an average compensation of € 1,78 per bus-km in tendered services is more than 19% lower than the average compensation for both tendered and non tendered services (€ 2,2) reported in Table 1.

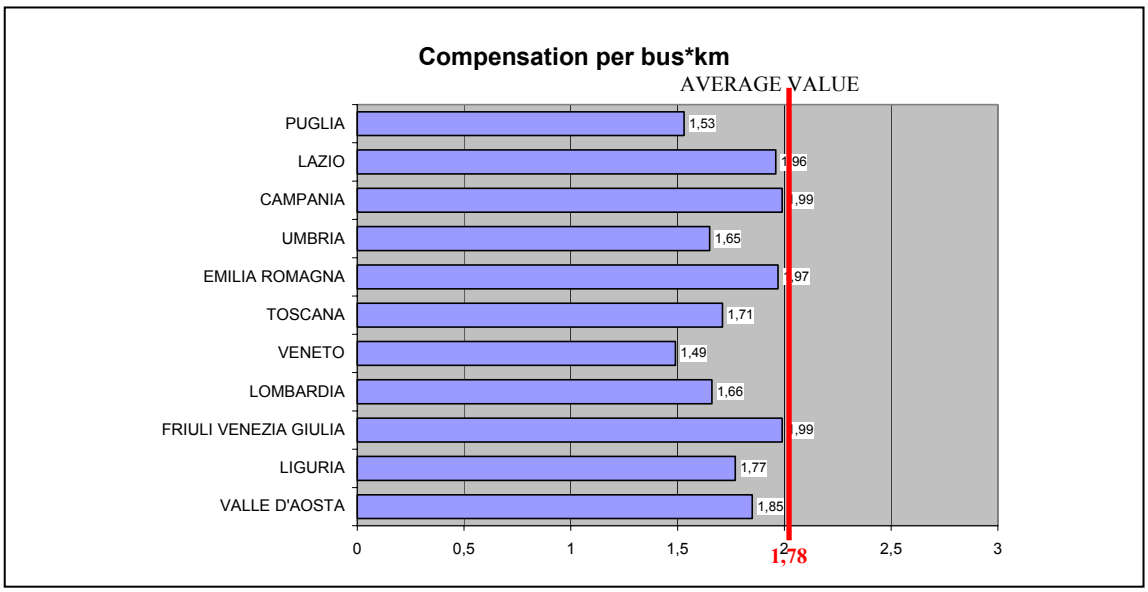

Figure 1: Average compensation per bus*km (urban + inter cities services)
Source: Cambini, Galleano (2005)

The compensations per bus-km in selected tendered areas of different regions are depicted in Figures 2 and 3. It turns out that the average compensation for urban services is higher than the one for intercity services due to the higher cost of urban transport (lower speed and higher traffic congestion). Comparing the data for some regions we can observe that the average compensation value in Lombardia for urban services is equal to € 1,91 per km, while it is equal to € 1,44 per km for inter-city services. The average for urban and inter-city services is equal to € 1,77 per bus-km, while in Toscana it is equal to € 1,71 and in Emilia Romagna € 1,97. Note that the value in Emilia is higher than the other ones because of the fact that in some areas of Emilia gross cost contract are in place, while in the other regions (except Lazio) only net cost contract are used.

As for strictly urban services, Figure 2 shows a high variance in compensations, ranging from € 1,43 in Varese to € 2,60 in Crema. Whilst the high compensation in Sondrio may be explained by taking into account the high share of mountain-routes in the service-area, the same explanation does not fit for the case of Crema. The altimetry of the service-area may also serve as an explanation for the high compensations paid in Aosta 2 and Aosta 3 (which both encompass services in the mountain valleys of that area). However, the case of Naples stands out without any satisfactory explanation (Figure 3).

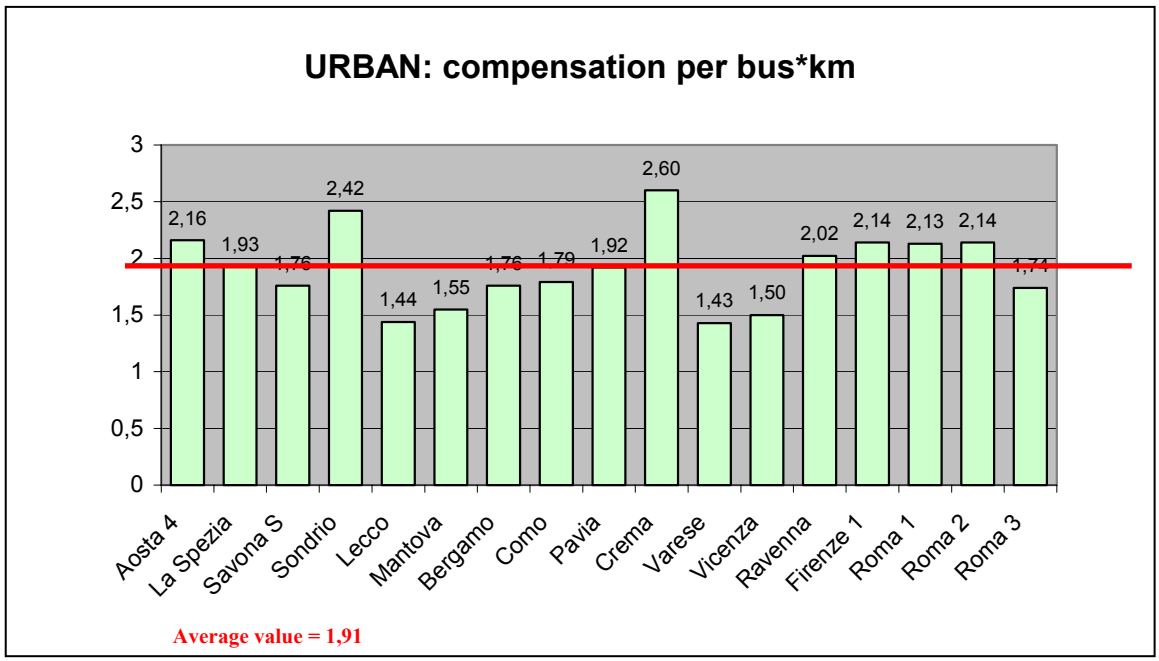

Figure 2: Compensation for urban services in selected towns and cities.
Note: Rome 1,2,3, gross cost contracts.
Source: Cambini, Galleano (2005).

It is fair to say that no definite pattern emerges from the available data. Competition through franchise bidding hasn't lead yet to a convergence of the cost of local bus services towards some common value. The actual compensations paid by local authorities to the franchisees seem to be determined more by the past level of costs than by the levelling effect of competition.

When commenting on these results it should be considered that regional regulations require that, if an old operator is substituted by a new entrant, all the employees of the incumbent automatically become employees of the new franchisee on the same terms and conditions. Such "social clauses" may be justified because of the absence of any unemployment benefit for laid off workers in the Italian local transport industry. Nonetheless, it is difficult for a potential entrant to make a truly competitive bid when more than 60% of its cost (i.e. labour cost) is bound to be exactly the same as that of the incumbent and productivity is also bound to beclose to the one of the incumbent. The Italian Competition Commission denounced the anti-competitive nature of these "social clauses" and the results of the early tenders in Rome - where no "social clause" was imposed as the new entrants did not bite in the services of the incumbent – showed that competitive tendering tends to be more effective when less constraints are imposed on the participants.

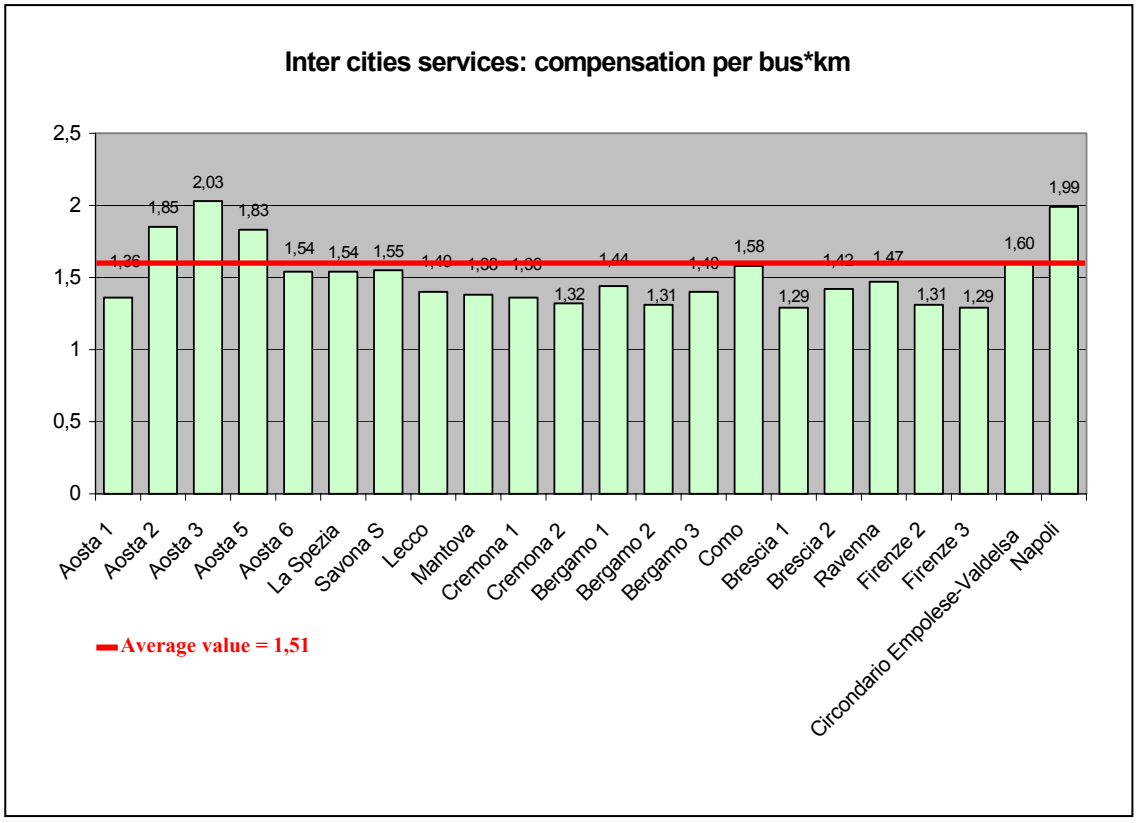

Figura 3: Compensation for inter-cities services in selected areas.
Source: Cambini, Galleano (2005).

It should also be observed that, in many cases, local governments failed to define precisely the service to be provided by the franchisee and retained large discretion as to the re-definition of the service to be provided[5]. The expected uncertainties may have discouraged some potential bidders and, due to the limited number of bidders, it is not surprising that the outcomes of competition are rather weak. Incumbent operators – mainly owned by local governments – not only had better information on the actual

[5] This seems to be a feature shared with the unsatisfactory French experience mentioned above (Yvrande-Billon, 2005).

state of the network and of the fleet but also had a lower "political risk" (Williamson, 1976) as they could be confident that their shareholders would not let them go bankrupt in any unforeseen and unfavourable state of the world. Moreover, it has been observed (Boitani, Cambini, 2004a) that many tenders were "tailor-made" for the incumbents, i.e. that many local authorities designed the auctions in such a way as to put their own enterprises in an advantageous position.

As a consequence of the above mentioned features of the awarding procedures, no foreign competitor dared to enter the market, except the French company Transdev, which joined other Italian operators in the early tenders in Rome. Recently Transdev decided not to participate in the new bidding procedure for services in Rome and bought a controlling share of Genova's bus company. The British company Arriva chose to take over a private operator (Sab-Bergamo) in order to get hold of the market and institutional information of an Italian incumbent and, by doing so, to reduce its future bidding risks. Another consequence of the fact that the winners of the tendering procedures were almost everywhere the old local public operators is that no new Italian "player" grew up in the market so as to be able to take full advantage of scale and scope economies and to compete in Italy and abroad.

4. Conclusions

The definition of appropriate regulatory policies for unprofitable public utilities is a difficult task. As argued by Segal (1998), the incentive for unprofitable monopolistic firms, like a local public transport operator, to reduce its cost and increase revenue is low, particularly when the regulator has a reputation for bail out. In other words, if the regulator is benevolent, the firm tends to under-invest (i.e. reduce its effort) in order to become unprofitable and extract higher public subsidies. This is, in a nutshell, the *soft budget constraint disease*, the welfare losses of which are typically higher than the dead-weight cost of monopoly.

Since Demsetz (1968) competitive tendering is viewed as a tool that local governments can use to benefit from the incentives towards efficiency entailed by *ex ante* competition. However Williamson (1976) and Goldberg (1976) warned that franchise bidding may be difficult to implement in practice and that potential gains from competition may be overcome by the burden of transaction costs that characterise inevitably incomplete contracts (Crocker, Masten, 1996). Many European local public transport services are now subject to competitive tendering. Some experiences (Sweden, Finland, UK) show that competitive tendering leads to lower costs and better service-quality. The French experience turns out to be less positive.

The Italian tendering experience in the bus industry is limited and does not allow to reach a definite conclusion; however in the previous sections it was argued that the results might have been far more encouraging if the tenders were organised in another way. We agree with Yvrande-Billon (2005, p. 20) when she points out that a disappointing experience "does not mean that this mechanism of coordination could not yield positive results and has to be abandoned" and that "competitive tendering cannot be beneficial if certain conditions are not respected".

With regard to the Italian experience the conditions to be fulfilled to have truly beneficial competitive tendering may be summarised as follows. The first and hardest condition is the willingness of local authorities to see their own firms thrown out of the

market if less efficient than potential entrants. This in turns depends on the willingness to give up political rents accruing from the ownership of local public enterprises. The national government may strengthen the "propensity to competition" of local authorities by setting appropriate financial sticks and carrots (Boitani, Tocci, 2005). The second condition is the extension of unemployment benefits to local transport workers, in order to drop those "social clauses" that are burdening all the Italian awarding procedures (Scarpa, Boitani, *et al*., 2005). The third condition is guaranteeing fair tenders, which implies that local authorities are not in charge of the procedure whenever their own company is allowed to make a bid. In such a case an independent agency should take up the task (Scarpa, Boitani, *et al*., 2005). This agency might also help local authorities in the definition of many technical aspects of the service, thus reducing post-contractual uncertainty and making bidding less risky. However the very existence of such an agency might not be popular with the local authorities, as some power would be taken away from them and transferred to the agency.

If it were too hard to fulfil these conditions it seems reasonable to revert – at least as an *interim* measure - to a different route to strengthen the incentives of unprofitable local public buses, that is introducing a mechanism aimed at reducing the real value of subsidies over time: for short a *subsidy cap* (SC)[6]. Such a mechanism is indeed one of the provisions of the Italian 1997 reform, according to which public subsidies should not exceed 65% of operating costs and should decline over time in force of a cap explicitly aimed at increasing the *X*-efficiency of the industry. Despite the law, only few Italian local governments appear to have reverted to the SC. The same mechanism was introduced in Norway in a "menu" where also yardstick competition and competitive tendering were listed as alternatives to replace individual cost-plus negotiations. As documented by Dalen and Gómez-Lobo (2003) SC contracts rapidly outnumbered cost-plus contracts and yardstick competition contracts and were able to deliver a yearly percentage cost reduction greater than the one delivered by tardistick competition and cost plus contracts.

Performance based contracts advocated by Hensher and Houghton (2004) as an alternative to tendering in order to maximise some measure of the social surplus are more sophisticated than SC but also require well informed regulators and are difficult to implement. If the top ranking objective is subsidy savings, a SC contract may be regarded as a reasonable second best.

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[6] The efficiency properties of a subsidy cap contract for local buses are examined in Boitani, Cambini (2004b).

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