RECENT DEVELOPMENTS OF THE ITALIAN BANKING SCENE

Some relevant problems concerning roles and functions of the Italian banking system have came back to the scene in the recent past, particulary those concerning the relationship between bank and industry.

For a better understanding one has to recall what happened in the mid-seventies. After the first oil shock, a strong acceleration in the trend of production costs and a sudden increase in the cost of money had, as a consequence, a serious generalized worsening effect on the economic and financial condition of industrial firms. In many relevant cases, particularly when financial difficulties were matched by a fall in demand trends, it turned out to be a very heavy crisis.

At the time an unorthodox proposal was put forward and Was a matter for prolonged discussion. According to it, as a way out from the "financial" crisis of firms, a vast operation should have been undertaken in which banks should have become holders of risk capital: this as a result both of a partial transformation of outstanding credits and of subscription of fresh capital.

That proposal wasn't adopted on a large scale, only a new bill was passed by Parliament allowing banks and medium term credit institutions to form "consortia" aimed at the financial "recovery" of specific firms. Through these "consortia", banks and credit insstitutions were able to convert credits into risk capital, to subscribe new capital and to consolidate and reschedule unhonoured debts. All was accompanied with fiscal incentives.

These kind of consortia were not formed except in respect of critical situations and turned out be an unsuccessful instrument. The result was the reinforcement of the opinion that a banker, invited to bear risk capital in order to defend residual credits, often, far from becoming a good entrepreneur, may be induced to behave like a bad banker.

1981 witnessed two relevant events.

On the one hand effectiveness of the law enabling the formation of consortia came to an end and Parliament did not renew it. On the other hand, the Bank of Italy issued new directives aimed at redefining and circumscribing ranges and entities of participations held by banks.

The general principle of separation between bank and industry was riasserted in block letters.

The separation between bank and industry has always been a matter of major concern in the definition of the working rules of the Italian banking system, since the 1933 crisis.

Traditional arguments in favour of this guideline acquire all the more weight in face of some specific underlying conditions of the Italian economy.

First, one has to remind the decisive importance of families as a source of total savings, together with the traditional high propensity to hold savings in very liquid forms. This propensity has been in its turn favoured by the behavior of banks: Italy is one of the few countries in which current account deposits receive interests.

All this is accompanied with a permanently modest development of non banking financial intermediaries.

High reliance of Italian industry on external finance on the other hand accompanies an insufficient dimension of the stock market. From time to time this plays a relevant role as a source of risk capital but for a limited range of firms. The flow of new incomers is very limited. This is partly due to one of the main features of the structure of Italian industry where a large number of small and medium size firms are jealously held by owners who are unwilling to go public.

On the other hand for a wide range of firms a risk capital is provided by the State (through State holdings). ~~Especially~~ In particular these firms rely heavily on external finance. The State as capitalist does not always play its role timely and coherently. In the face of high budget deficits the subscription of new risk capital may be postponed or reduced in amount, meanwhile carrying on a sort of "moral" suasion on banks for further credit financing.

Finally some other general conditions can't be forgotten. When specific or generalized difficulties arise in the industrial field, social and political pressures produce high rigidities as to employment and costs for the firms involved, with the banking system once again called upon for financial assistance.

Within this framework, banks, which, as previously noted, have historically a permanent dominance in the gathering of savings, tend to play an excessive role in the financing of the economy, be it for internal attitude or for external pressures.

All this may bring about high risk instability, scarse autonomy in the decisions of financing, dangers of high immobilisations.

The memory of what happened in the thirties still dominates the minds and, as we have seen, what happened in the mid-seventies was an excellent reminder.

Recent directives issued by the bank of Italy then acquire a definite importance as a reassertion of orthodoxy.

It might be of interest at this point to recall a few other aspects of these recent directives. Limits and conditions for the holding of shares have been fixed on the basis of parameters and of predetermined objective conditions. Room for special authorizations by the Central Bank has been strictly reduced.

At the same time, on a different front, the extension to all medium term credit institutions of rules about the concentration of risks has been accompanied by the abolishment of any possibility to obtain authorizations to exceed stated limits.

The Bank of Italy seems clearly oriented towards a discipline in which rules for the system are more precisely predetermined and the scope for a case by case treatment is drastically limited. And this clearly is a further step towards better defined spheres of action and responsability.

One of the fundamentals of these rules is the division of labour between banks and medium term credit institutions in connection with the time length of credit operations.

The original drastic separation between short and medium term credit institutions has been diluted through time. Some banks have been allowed to establish proper medium term sections and all have been authorized to operate medium term financing up to 15% ~~for~~ of their deposits. The separation of functions between short and medium term credit institutions still remains fundamental. It is obvious that the arguments substaining this policy are somehow similar to those underlying the principle of separation between bank and industry.

In 1981, also as a result of the tightening of quantitative limits to the expansion of bank credit, a significant increase in medium term institutions activity took place. In a market which is dominated by a high propensity to invest short, this increase combined ~~went together~~ with a reduction in the time length of their operations.

On the one hand their weight on total assets of banks further increased.

But on the other hand, a greater amount of these bills was being held by the public. Italian banks were faced with an unprecedented process of disintermediation.

Meanwhile some private non banking institutions reached some success in door to door selling of papers of various nature, mainly investment funds (stocks and bonds and real estate certificates) in a still unregulated market. Once the long awaited regulations will be enforced, this market is expected to develop further.

All these represent major changes and new challenges for the banking system. Two different kind of responses may be expected to this challenge.

A traditional attitude to see the bank fundamentally as a current account deposit chaser may lead to react to the process of disintermediation with attempts to restore lost paradises and possibly to the request of compensations of various kind.

A quite different attitude may lead to a process of diversification of financial assets, issued by banks or other financial institutions, being sold to the public through the vast decentralized network of "Sportelli" (Counters).

Between c/a deposit and business-mindedness at present it is too early to draw conclusions about which of the two will take the lead.

If the second attitude will prevail, the Italian financial market may witness new interesting developments.