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RECENT DEVELOPMENTS IN THE ITALIAN FINANCIAL MARKETS

*Alessandro Roselli**

I shall divide my remarks into two sections: the first is devoted to a brief summary of the developments leading to greater monetary and financial integration in Europe; the second deals with the steps that have been taken in Italy, primarily at a legislative and administrative level, to create a domestic framework consistent with the new European environment.

Some of the steps that have been adopted and that are very important to the process of European integration and the modernization of Italy's financial structures may appear belated or of minor importance to a United States observer. However, one should not forget the historic political and economic division of Western Europe, the disparities and imbalances between its economies, the different structures of its financial systems and, therefore, the difficulties involved in moving toward a real overhaul of intra-Europe relations.

What goes under the generic name of "Europe 1992" is a process involving several components, some that have already been realized in part. It can be summarized under three main headings: (1) freedom of capital movements; (2) liberalization of financial services; and (3) economic and monetary union.[1]

Concerning the freedom of capital movements, during the late sixties and especially in the seventies, the deterioration of the economic situation in several European countries led to the imposition of a number of foreign exchange controls. The drive toward freedom of capital movements started in Italy and in other European Economic Community (Community) member countries in the early eighties. This liberalization movement was associated with a general improvement in the economic conditions, a widespread decline in the inflation rate, the decrease in oil prices, the gathering momentum of the financial innovation that made such controls less effective, and a general political cli-

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1. I owe this tripartition, as well as several other comments, to Dr. Tommaso Padoa-Schioppa, Deputy Director General of the Banca d'Italia. *See* Tommaso Padoa-Schioppa, *Financial and Monetary Integration in Europe: 1990, 1992 and Beyond* (Group of Thirty 1990).

mate that favored "deregulation."

Within this environment, in 1986 the Community's Single European Act, in a strong revival of European cooperation, channeled the liberalization process toward the broader goal of a Single European Market which was to be achieved by the end of 1992. In the Single European Market, all physical, technical, and fiscal barriers to the free movement of goods, services, capital, and persons will be abolished. For capital movements in particular, it was possible to speed up the process through Community Directives that provided for the full liberalization of capital within the Community after July 1, 1990. It is, however, unfortunate that this goal has not been accompanied by a parallel harmonization of the tax treatment of capital income within the Community countries. Different tax structures and rates in different countries may create distortions in capital flows and generate instability. For instance, the withholding tax rate on bank deposits in Italy is thirty percent, while in Luxembourg no withholding tax is charged on bank deposits.

Liberalization of financial services, and particularly banking services, in a Single European Market also finds its roots in the Single European Act of 1986. This liberalization is to be achieved no later than January 1, 1993. Liberalization in this sphere will be enacted with an important variation in the strategy toward integration, on the basis of the principle of "mutual recognition" of domestic regulations. Mutual recognition will permit an institution licensed in one member country to operate in any other member country without any further authorization, so long as the institution complies with its home country rules. In the banking field in particular, the Community's domestic legislation will be harmonized to a bare minimum: the very definition of banking activities provided in the Second Directive[2] is quite broad. This means that even the most liberal national legislation will fit into the Community definition; consequently, banks belonging to countries with liberal legislation, operating in other member countries that may have more restrictive legislation, will have a competitive advantage. This creates implicit competition between national legal systems, and means, in turn, a drive toward models of de-specialization, that is of diversified banking/financial group, or universal bank. This strategy, based

2. Council Directive 89/646, *published* in EC Gazz. 386 (Dec. 30, 1989).

on market forces working in a relatively deregulated environment, may be new for the United States, as the current debate on the bank reform bill demonstrates, but is also innovative in Europe. Its effects on a stability ground will be tested in the field, but there is no question that it puts increasing burdens and responsibilities on the supervisory authorities.

Concerning the economic and monetary union, the 1957 Treaty of Rome, which created the Community, paid limited attention to monetary policy and exchange rates. At that time, an environment of international monetary stability prevailed, centered upon the "gold-dollar standard." The idea of a European monetary union was first put forward in the Werner Report of 1970. But the seventies were — as I noted previously — a troubled decade that included the breakdown of the fixed exchange rate system, the oil crisis, and high monetary instability. In those years, only a limited exchange rate agreement between the German mark and some minor currencies was enacted, the so-called "snake."

This "snake" was nonetheless the embryo of the European Monetary System (EMS), which was created at the end of the seventies. The EMS consists of a credit agreement among the member states' central banks and an exchange rate mechanism (ERM). The ERM requires each Community country to keep its currency within a narrow margin against the other participating currencies in the mechanism.[3]

The ERM has worked well, exercising a "discipline effect" on the participating countries and leading them to a more positive and effective fight against inflation. However, two negative factors have gradually emerged in connection with the greater drive toward integration, particularly after the 1986 Single European Act. First, the EMS has worked asymmetrically: by making disinflation the first policy priority, it gave a leading role to the single country with the best performance in terms of price stability. This asymmetry is less acceptable when one thinks in terms of a common or coordinated monetary policy among Community countries. Second, there exists a systemic instability or, as we may say, an "inconsistency" in the combination of the following four factors: (1) full mobility of capital (which has already been enacted); (2) freedom of trade in goods and services

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3. Plus or minus 2.25% of the respective central rate.

(which will soon exist in the Community); (3) quasi-fixed exchange rates, as the EMS envisages; and (4) national autonomy of their monetary policies.

The ongoing process of economic and monetary union, however, goes well beyond the EMS and the Single European Market. Economic and monetary union will ultimately result in a single monetary policy, a new monetary institution, a single currency, and sound budgetary conditions in a framework of economic convergence of the member countries. Based on the recommendations of the Delors Report of 1989[4] — produced by an ad-hoc committee set up by the Community, consisting of the Community central banks' governors and three experts — economic and monetary union will be achieved in three stages.

Stage one is already underway and will be completed by the end of 1993. In this phase, the Single European Market will be implemented by the end of 1992. In addition, during this stage an intergovernmental conference is working on amendments to the Treaty of Rome that will establish the legal basis for the economic and monetary union. These amendments are to be signed by the end of 1991, and are to be ratified by the member countries by the end of 1993.

Stage two — a transitional stage — will start in January, 1994. By the end of 1996, the date of passage to stage three is to be set by the Community. The transitional stage should prepare the framework for the final stage. To this end, two sets of conditions will have to be met: a monetary one and an economic one.

The monetary set of conditions requires the creation of an institution to coordinate national monetary policies, with the goal of a single policy to be carried out by a European Central Bank. This bank will be federally chartered, independent of national governments, accountable to Community institutions, and aimed by statute at an overall price stability.

The economic set of conditions is based on the principle of "convergence." The principle is accepted by the member countries, but the degree of convergence required is still in dispute. The convergence indicators under discussion are primarily: (1) currency stability; (2) rate of inflation; (3) budget policies; and (4) current account of the balance of payments.

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4. Report on Economic and Monetary Union in the European Community, April 1989.

I shall now turn to my own country and consider Italy's position in the process of Community integration, focusing on the three areas of integration I mentioned at the outset of my remarks.

In January 1990 Italy decided to join the narrow band of the EMS. Before that time, the Italian lira had a margin of fluctuation of six percent, above or below the central rate, as permitted by the ERM, mainly to take into account Italy's high inflation rate, approximately twenty percent, during the late seventies and early eighties.

A few months later, in May 1990, the freedom of capital movements was fully implemented in Italy, two months before the Community deadline of July. The implementation was a historic event for Italy, since different forms of foreign exchange restrictions had been a constant feature since 1934.[5] Although the freedom of capital movements was enacted in Italy in compliance with a Community Directive, its scope also includes third countries, such as the United States. For anti-money-laundering and tax-monitoring purposes, a limit on the use of cash in foreign transactions has been maintained, while a reporting system has been introduced for statistical reasons.

These two measures must be seen in the context of a strategy, adopted by the Italian Central Bank, of stability oriented monetary and foreign exchange policy, a strategy that has resulted in a dramatic decrease in the inflation rate and a growth rate during the eighties generally above the other Community countries. This macroeconomic framework of financial stability has to be complemented by strong budgetary measures in order to reduce the excessive government deficit. This need is underlined by an inflation rate that, although substantially abated, is still running at around six percent, and that remains above that of our main European, and non-European, partners.

Concerning the liberalization of financial services, historically the Italian financial structure has — like the German one and unlike that of Britain and possibly the United States — been oriented more toward the banks than the market. Specifically, the role of the banks has been larger in financial intermediation than the role of the capital markets. Three pieces of leg-

5. Lamberto Dini, Director General of the Banca d'Italia, The Liberalization of Capital Movements in Italy: Constraints and Opportunities, Address at the Annual Meeting of the Italian Association of Foreign Securities Dealers (June 2, 1990) at 4.

islation recently enacted in Italy aim, on the whole, at modernizing the banks' structure, at giving new strength to the capital market and therefore at a more balanced structure of the financial intermediation.[6]

The first law, the "Amato-Carli law" of July 1990,[7] has three key provisions: (1) the reorganization of public-law banks and savings banks as joint-stock companies; (2) tax incentives for bank mergers; and (3) the establishment of appropriate regulations for banking groups. The goals of this law should be viewed in light of the fact that the Italian banking industry has long been characterized by a very large number of banks and few big financial institutions, which are mostly government owned. The legal structure of the public-law banks has often been that of a foundation, or a charity organization; such structures are not consistent with an internationally integrated credit market.

The Amato-Carli law will permit the incorporation of banks as joint-stock companies, thereby enabling them to raise more capital from the public by offering shares. In turn, this will increase the private component of the banks' equity capital. The law also offers creditors greater disclosure about the banks, and generally creates a legal form that is common in international markets.

The second key provision of the Amato-Carli law provides tax incentives for a two-year period. These tax incentives, as well as the new legal structure of banks, will provide a stimulus toward consolidation in the banking industry, increasing the size of banks, enhancing both geographical and functional synergies, and placing them in a better position to face international competition.

Finally, the Amato-Carli law provides for comprehensive regulations of the banking groups, and defines the banking groups permissible activities consistent with those approved at the Community level. The law also foresees a consolidated supervision, trying to balance the benefits of the group's synergies with the necessity of limited firewalls.

Another feature of the Italian banking industry has long been the absence of specific legislation separating banking and

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6. For an overview of this legislation, see Carlo A. Ciampi, Governor of the Banca d'Italia, Address at the Annual Meeting of the Italian Bankers Association (July 19, 1991).

7. Law No. 218 (July 30, 1990), Gazz. Uff. (Aug. 8, 1990).

commerce.[8] The prevention of the mix, that is potentially dangerous for reasons of conflicts of interest and concentration of power has long been based on the moral persuasion of the central bank. A resolution adopted by the Interministerial Committee on Credit and Savings[9] in March 1987 strengthened the Banca d'Italia's administrative powers to maintain this separation for newly created depository institutions. More recently, the antitrust law of October 1990,[10] which is aimed at stimulating the level of competition in the economy, has established a discipline that is very relevant to banks, since it firmly introduces the general principle of separateness between banking and commerce, setting a fifteen percent ceiling on the equity interest of nonfinancial companies in commercial banks.

The securities investment business law of January 1991[11] is part of the already mentioned effort to stress the importance of the capital market. The law creates a type of financial intermediary, securities investment firm (SIM), eligible to engage in a full range of securities activities: as underwriter, broker, dealer, and money manager. Supervisory responsibility is shared between the Banca d'Italia and the Italian equivalent to the Securities and Exchange Commission, the CONSOB depending on the purpose of supervision. Banca d'Italia is charged with controls aimed at stability, such as capital and liquidity ratios or Chinese walls between different activities, while the CONSOB has powers to ensure orderly trading and the protection of customers. The law also provides some rules for the capital market organization, making it mandatory, for listed securities, to concentrate trading in the stock exchange, and envisaging the adoption of telematic technology. Greater competition will result from the substantial deregulation of the broker's fees. The regulations issued by the Banca d'Italia and the CONSOB, and the recent enactment of an insider trading law[12] complete the framework of this legislation.

Once again, this legislation can be best understood given the historical background that was characterized by a number of in-

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8. In the sense of commercial ownership or control of banks.

9. A committee chaired by the Treasury Minister and made up of some Ministers and the Governor of the Banca d'Italia. The Committee sets financial and banking policy guidelines.

10. Law No. 287 (Oct, 10, 1990). Gazz. Uff. (Oct. 13, 1990).

11. Law No. 1 (Jan. 2, 1991), Gazz. Uff. (Apr. 1, 1991).

12. Law No. 157 (May 17, 1991), Gazz. Uff. (May. 20, 1991).

termediaries, as "agenti di cambio" and "commissionarie," with outdated and inadequate regulations. The protection of customers was less effective since, in the absence of specific regulations for capital markets, customers could only rely on the general rules of the civil code. Trading outside the official exchanges was also widespread: only thirty percent occurred at the exchanges.

The stability controls entrusted to the Banca d'Italia are consistent with the principle that the financial markets are in fact one market (a principle well assessed in the Brady Report of 1988), so that only one agency should have the ultimate supervisory responsibility over them.

The Italian authorities would have preferred to create the European Central Bank at the outset of the second, transitional stage in 1994 but recently another view prevailed and, in 1994, a European Monetary Institution will instead be created, to be then eliminated at the final stage. The European Monetary Institution, however, will have the same duties as a Federal Central Bank in a transitional phase: to gradually prepare the single monetary policy, which will replace national monetary policies.[13]

On the issue of the economic convergence, the task facing Italy is both difficult and important given the dimensions of the economy and the imbalance of the public accounts. Programs of adjustment are being activated in agreement with the Community institutions. Italian authorities share the view that some economic indicators of economic convergence must be adopted, but believe at the same time that none of them can be taken alone. In addition, the economic indicators' trend should be more relevant than their static value in areas such as, for example, government deficits. We also think that any decision about dates and methods of implementation for the final stage of the union must be taken all together, and not by a select number of member countries.

There is no question that with the process of closer integration underway, new and demanding challenges will continue to face the Community countries in general, including Italy.

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13. *See* Carlo A. Ciampi, L'impegno dell'Italia per l'Europa, Paper for the Conference on Monetary Policy and Italian Integration in the EEC held at University of Ferrara (Sept. 27, 1991), at 17-18.