THE JOURNAL OF EUROPEAN ECONOMIC HISTORY
BANCA DI ROMA

HISTORICAL RESEARCH OFFICE
BANCA D'ITALIA

Conference on

International banking and financial systems: evolution and stability

Introductory remarks by Vincenzo Desario
Director General of the Bank of Italy

Palazzo Koch, 8-9 March 2001

Ladies and Gentlemen, I should like to open this conference by expressing my thanks and a general welcome to the speakers and participants. A special word of appreciation goes to the efforts of the Journal of European Economic History and Banca di Roma who, together with the Bank of Italy's Historical Research Office, have organized the meeting.

Tomorrow's session will discuss the present and future of the banking and financial systems, with particular reference to concentration.

Today's discussion will focus on history, in the traditional manner of international debate. Scholars from different countries meet to reflect on how essentially similar problems were addressed in the past, in different institutional, legal and economic circumstances.

Suffice it to recall the events organized in recent years to mark the foundation of a number of central banks. The Bank of Italy's centenary offered an opportunity to present the Bank's Historical Series, an ongoing history of Italy's monetary and financial past. The Bank of England's tercentenary saw the publication of important comparative studies of central banking; central banks and the evolution of their role were examined to mark the Bank of Portugal's one hundred and fifty years; the two hundredth anniversary of the Bank of France offered a convention to debate "European monetary identity"; and the Belgian central bank's first one hundred and fifty years provided an opportunity to discuss the problem of growth in historical terms.

As the process of analyzing and comparing experiences moves forward, the outline of a European monetary and financial history becomes increasingly clear.

I should now like to share some brief reflections, based partly on experience, on the topics tabled for discussion, and on risk in particular.

Almost a century ago, in 1909, the United States National Monetary Commission chaired by Senator Aldrich met several times in Paris and laid the foundations for the establishment of the Federal Reserve. The key factor in creating support for the establishment of a United States central bank was the financial and banking crisis of 1907, when the absence of a lender of last resort had been felt.

Aldrich and his colleagues heard experts from various European countries. The Bank of Italy's economist and future Deputy Director General, Tito Canovai, was called on to describe the Italian scenario. His extensive report ranged from the crisis at the end of the nineteenth century and highlighted the importance of the reform of the issuing banks undertaken as part of the Italian readjustment programme. Canovai concluded by stating that "Italy's banking system is a kind of experimental laboratory for banking diseases, which happily has recently been closed on account of the complete cure of the diseases".[1]

Canovai was, however, aware that having reformed the issuing system, other challenges still remained.

The problem of banking crises afflicted Italy and numerous other countries in the 1920s and 1930s. In 1933 IRI was established to solve the problems posed by the major mixed banks' locked-in assets. During the preparations for a radical overhaul of the financial system, the conviction remained that banking stability could be achieved in the future: IRI's annual report for 1934 stated that: "We found the courage to effect a [.....] total cleansing of banking's diseased organism".[2]

The 1936 Banking Law, which reformed and supplemented that of 1926, introduced effective protection for depositors and imposed a strict separation between banking and industry.

---

[1] Vice-Canè, *La Commissione monetaria americana e l'Italia bancaria,* in "La Tribuna", 28 September 1909.

[2] In G. Guarino and G. Toniolo (edited), *La Banca d'Italia e il sistema bancario. 1919-1936,* Laterza, Roma-Bari 1993, p. 857.

The same period saw other countries grapple, or grapple again, with the problem of the protection of savings: Spain in 1931, the United States in 1933, and Germany in 1934.

After the Second World War, in Italy the principle of the protection of savings was embodied in the highest level of legislation, the Constitution of the Republic.

In the late forties and early fifties there was a reorganization of the Italian banking system; new categories of bank were created with the aim of supporting economic growth.

In the seventies serious bouts of instability occurred in many countries, on both sides of the Atlantic. It was recognized that there was a need to act promptly to counter the improper conduct of some bankers. The foundations were laid for fruitful international cooperation among banking supervisors.

The events, often highly dramatic, of the eighties and nineties led to a reassessment of the problems associated with systemic risk and the mechanisms of contagion. Objective parameters were developed with which to evaluate the soundness of banks.

Major progress has been made at both the national and the international level to bolster stability. However, we cannot assume that the problem of financial crises is entirely behind us.

The metaphor used in the past is instructive in this respect: the parallel drawn between banking crises and human sicknesses, between doctors and the "rehabilitators" of banks (legislators, supervisors, economists and managers).

In the medical field the focus of attention has shifted in recent decades from treatment to prevention, from illness, considered on its own, to the conditions needed to ensure health. Supervisory authorities have taken the same direction, and now devote no small part of their activities to forestalling crises, to strengthening the requirements that promote the health of both individual banks and banking systems as a whole.

Moving along a path that was neither simple nor straight, it came to be recognized that, since financial activity was an entrepreneurial activity, risk in its various forms was inherent to it and could not be eliminated. It came to be seen that the necessary condition for financial stability was the knowing management of risk; recognizing, measuring and managing risk is essential for the proper working of the banking industry and financial markets.

In the search for the optimal allocation of resources, the question whether bank-based systems are superior to those that are market oriented is still open. But in both cases risk remains the distinguishing feature of economic and financial activity.

Economies based on free enterprise leave plenty of scope for the energy, ingenuity and creativity of economic agents. If appropriate laws and institutions promote the proper working of the market, free enterprise can generate new products and processes capable of making a, sometimes major, contribution to economic growth.

In Europe, the opinion of both academics and the public with regard to financial intermediaries has oscillated between appreciation of their contribution to economic growth and diffidence. The latter stems from both fear of crises and dislike of potentially excessive concentrations of power.

In countries and historical periods marked by diffidence, or even complete rejection of the market, the entrepreneurial and creative role of bankers was curtailed, sometimes annulled. Risk was considerably reduced, but so was the vitality of the economy and its ability to adapt.

The various forms of mixed or social market economy did not negate the banker's autonomous function. Public intervention, although it was later to cause malfunctioning and degeneration, undeniably contributed to the reconstruction of many economies in the aftermath of the Second World War and the prodigious growth of the fifties and sixties.

In the countries marked by liberalism, or at any rate by a certain respect for economic agents' freedom of choice, correctives were introduced to limit both outbreaks of banking instability and the excessive concentration of economic power: lending of last resort, banking supervision, antitrust legislation, deposit insurance, disclosure requirements and oversight of the payment system.

Since the eighties capital and internal controls have been the cornerstones of the management of risk. This has ensured the autonomy of the entrepreneurial function and enhanced competition within the market. There are no restrictions on the allocation of resources and each bank is free to choose its preferred combinations of risks and returns, provided it complies with the capital adequacy constraints in force.

The Italian financial system has responded well to the innovative stimuli; today it is fully integrated into the European and international markets. The reorganization of the last few years has been driven by an appropriate mix of market pressure and propulsive action by the authorities.

The structure of the system has undergone a profound change. Since 1987 mergers have reduced the number of banks from 1,200 to 864, while the number of branches has risen from 15,020 to 28,176. From 1.7 per cent in 1995, the return on equity rose to 9.3 per cent in 1999 and the first half of 2000 saw this indicator improve further, to 12 per cent. After rising to 10.1 per cent in 1996, the ratio of bad debts to loans fell, reaching 7.8 per cent in 1999; the downward trend continued in the first six months of 2000, with the ratio dropping to 6.9 per cent.

Competition in the banking industry increased significantly in the eighties and even more in the nineties. The main price indicators confirm the positive developments in the market. The 1993 Banking Law established competitiveness as one of the fundamental objectives of supervision.

The law on transparency enacted in 1992 has considerably strengthened the protection of the final users of financial services; relations between banks and their customers have been improved by the law on consumer credit and the self-regulatory code of conduct adopted by the Italian Bankers' Association in 1996.

There is room for further improvement in this respect, to be promoted by fair and transparent contractual conditions, the development in corporate cultures of the concept of assisting customers, and adequate protection of contractual commitments that have been entered into freely.

The results achieved must be consolidated. Further progress is possible. The success of the supervisory approach based on capital ratios must not lead to complacency, vigilance must be maintained. In addition to the complex problems of implementing the new Basel capital accord, there are other questions that need to be addressed: international contagion, the regulation of new products and activities, the effects of concentrations, the relationships between different supervisory authorities and the position of off-shore centres.

Concentrations, both domestic and cross-border, need to be carefully evaluated in the light of fundamental objectives and technical issues. They do not always produce the results envisaged, they are not the only way to achieve efficiency and competitiveness.

The latest mergers carried out in Italy still have to realize their full potential. Different corporate cultures, professional skills, operating procedures and organizational structures need to be effectively integrated. The presence of Italian banks in foreign markets needs to be augmented.

Technological innovation, rapid and relentless, requires the constant attention of supervisory authorities.

It is necessary to counter the threats to the stability of the financial system inherent in infiltration by organized crime.

More generally, there is a growing need for a new monetary order, not least in order to respond to the recurrent financial crises in important components of the system.

In the age of globalization, the primarily national basis of banking and financial supervision has been maintained, increasingly supplemented by international cooperation.

The range of instruments and institutional fora that can be activated today to prevent, treat and cure banking and financial crises is much wider than it was even twenty years ago.

The fight to keep the banking and financial system in good health and defend it against the ever-present threats of disorder has entered a new dimension.

I conclude with best wishes for the success of the conference and invite Cesare Geronzi, Chairman of Banca di Roma, to take the floor.