ANTITRUST AUTHORITY

Competition and the Antitrust Authority. A review of the first ten years of the law

Competition, growth and the banking system

Address by the Governor of the Bank of Italy
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The Italian banking and financial system that emerged from the crisis of the thirties had a market configuration that, partly for historical reasons, was characterized by a high degree of geographical and operational segmentation. The role of the public sector in banking had expanded.

As in the other industrial countries, far-reaching regulatory and statutory changes were introduced, starting in the eighties and gathering pace in the nineties, in response to the opening up and integration of financial markets and advances in information technology; competition between banks and between banks and other intermediaries steadily intensified.

Banks reacted by carrying out concentrations aimed at increasing their size and entering new fields of activity, with a view to achieving economies of scale and scope and improving their efficiency.

Between 1995 and 1999 there were 4,360 mergers and acquisitions involving financial companies in the Group of Ten countries, Australia and Spain; the value of the transactions of which the terms are known amounted to $1.39 trillion, nearly six times the figure for the five preceding years. Mergers and acquisitions involving industrial and commercial companies also increased at a rapid pace.

Globalization has increased competition for all companies — financial, commercial and industrial. In the United States, and to a lesser extent in other countries, a new phase has begun in which innovation is once again fueling economic growth: the progress in microelectronics, computing and telecommunications is bringing productivity gains throughout the economy.

Innovation is a powerful force for growth. We must continue, in Italy as elsewhere, to prevent the distortion of competition and the formation of monopolies from hindering technological advances and their diffusion.

1. The consolidation of the Italian banking system

In Italy and Europe consolidation has been stimulated by the enlargement of the market, the opening up to foreign competition, the growth in asset management business and the introduction of the single currency. In Italy the concentration of the banking system, measured on the basis of the market share of the five largest groups, has reached 51 per cent, in line with the figure for France and higher than that for Germany. In the United States this measure rose from 11 to 27 per cent between 1990 and 1999.

In the early nineties the narrowing of margins on traditional banking business and the losses incurred on loans, coupled with high labour costs and widespread operational inefficiencies, led to a rapid decline in the profitability of Italian banks. Those located in the Mezzogiorno were affected by the deep crisis of the southern economy, not least because of the limited geographical diversification of their lending.

Consolidation has held costs down, permitted economies of scale in the production and distribution of new services, and increased risk diversification.

Between 1990 and the end of September 2000 there were 508 concentrations. In 157 cases the banks taken over maintained their corporate identities. With operating structures becoming progressively more integrated, this made it possible to take full advantage of banks’ local roots. The number of banks declined from 1,176 to 862; banking groups grew considerably in importance.

The privatization of banks and their listing on the stock exchange have made their ownership and control fully contestable. Competition in the banking market has benefited considerably.

The market share of banks controlled by the state or foundations fell from 68 per cent at the end of 1992 to 17 per cent in 1999. The total assets of the banking groups listed on the stock exchange rose from 30 per cent to more than 70 per cent of the industry total. Foreign intermediaries are substantial shareholders in Italy's leading banks and hold sizable interests in the five largest banking groups.

Consolidation and privatization have been accompanied by the entry into the market of new players, both Italian and foreign. During the nineties 165 new banks were established and the number of branches and subsidiaries of foreign banks rose from 41 to 65.

The banks involved in concentrations have broadened their product ranges much more than the rest of the banking system. In 1999 commissions and revenues from activities other than lending and deposit-taking were 45 per cent of banks' gross income; in the middle of the nineties they had accounted for less than 30 per cent.

The reorganization plans implemented in the wake of concentrations have included measures to curb staff costs. The number of employees has fallen by 20,000 or 5.5 per cent since 1995. Unit labour costs have stabilized, although they are still high by international standards. Significant improvements in productivity have been achieved. Between 1997 and 1999 gross income per employee increased in real terms at an average annual rate of 4.4 per cent; between 1990 and 1996 it had remained almost unchanged.

The profitability gap between Italy's banking system and those of the other euro-area countries has almost closed, thanks to the supply of new services, the curbing of costs and better management of credit risks. Profits rose from 2 per cent of capital and reserves in 1994-97 to 7.4 per cent in 1998 and 9.7 per cent in 1999. The data available on banks' results in the first half of this year point to an increase in operating profits compared with the corresponding period of 1999.

During the nineties the spread between deposit and lending rates fell from 7 to 3.9 percentage points.

The efficiency gains deriving from concentrations have also benefited customers; the terms on which traditional services are supplied have improved, especially for small businesses and individuals.

Empirical research into the Italian banking market at the level of regions and provinces shows that the reduction in the number of small banks as a consequence of consolidation has not reduced the supply of credit to small and medium-sized enterprises. At the provincial level, the deposit rates paid by banks resulting from mergers increased relative to the rest of the banking system in the nineties. At the regional level, the lending rates of the banks with the largest market shares generally fell and came into line with those of the other banks; this tendency was most pronounced in the regions with a larger number of banks.

2. The promotion and protection of competition

Competition brings improvements in both technical and allocative efficiency. The stability of individual intermediaries and that of the system as a whole are enhanced. Economic activity benefits.

In the eighties, in line with developments in the other leading banking systems, supervision came to be based increasingly on prudential instruments. The removal of the administrative constraints on the types of business banks could undertake and the geographical limits on their operations stimulated competition; access to highly concentrated local markets was encouraged.

Operational despecialization was fostered; the scope for banks to grow was linked more closely to their capital bases.

During the nineties statutory innovations contributed to the modernization of the financial system; the Community directives establishing the architecture of the single market in financial services were transposed into Italian law. The 1993 Banking Law expressly refers to the competitiveness of the banking system as one of the objectives of supervisory activity.

Subsequent legislation has fostered a further broadening of the range of banks’ operations and the development of new channels of distribution complementing traditional branch networks; segmentation has become less pronounced and local markets opened up further.

By promoting the widespread dissemination of information, the rules on transparency make it possible to compare the products and terms offered by different intermediaries; they allow customers to make informed choices.

The growth in competition is confirmed by price and quantity indicators and the widespread presence of banks throughout the country.

The narrowing of the spread between deposit and lending rates has accelerated in the last two years; in the Centre and South, where the spread was initially larger, the process has proceeded faster than in the North.

The difference between the short-term lending rates applied in the South and the rest of the country decreased from 3 to 2 percentage points between the end of 1986 and the end of 1991. In the middle of 2000 it was 1.8 percentage points; for medium and long-term loans it was even smaller. The spread reflects the greater riskiness of loans in the South. The differences between deposit rates in the various parts of the country have almost disappeared; asset management services are supplied on the same terms throughout the country.

Shifts in banks' shares of the deposit and loan markets have intensified; in the latter the changes recorded in 1999 were equal to 8 per cent of total outstanding loans.

On average there are 31 banks present in each province, as against 20 in 1979; overall, 80 Italians out of a hundred can choose between at least three banks in the municipality they live in, as against 58 twenty years ago.

The share of total assets held by branches and subsidiaries of foreign banks rose from 3 to 7 per cent in the nineties. In the asset management industry, companies controlled by foreign intermediaries account for a sizable proportion of the products supplied; they also play an active role in household credit, corporate finance and government securities dealing.

As the antitrust authority for the banking industry, the Bank of Italy has carried out a total of 35 inquiries, a substantial number by international standards. They were divided as follows: 17 were into concentrations, 13 into agreements and 5 into abuses of dominant position.

The key factor in assessing competition in banking markets is the size of the relevant market, measured in terms of both geographical area and products. The effectiveness of antitrust action is based on the availability of detailed information and the analysis of markets and intermediaries.

The decision to identify small geographical areas — the provinces for the deposit market and the regions for the loan market — reflects the substitutability between financial instruments found in different parts of the country and the mobility of demand.

For other financial products larger geographical areas are considered in view of the uniformity of production and marketing across the country. For some products the reference market is supranational and open to competition from foreign intermediaries.

By lowering distribution costs, technological innovation reduces the importance of the physical distance between supply and demand and tends to increase the size of the relevant markets. It is still too early, however, to measure these effects accurately. In the case of loans to smaller firms, information obtained through direct contact remains indispensable; the use of services supplied over the Internet is still limited, although it is growing.

The consolidation of the banking system must not stifle competition in local markets. As early as 1970, Guido Carli stated that the process "is being followed with attention and is not judged contrary to the general interest as long as it does not alter a structure of the banking system conducive to maintaining a high degree of competition within the industry".

Where it is found that a concentration is likely to result in the creation of a dominant position, clearance of the operation is made subject to the adoption of corrective measures. Their use has increased as a result of the growing number of concentrations and the large size of the banks involved.

The fact that the branch networks of the largest banking groups overlap in many areas is an obstacle to further big mergers from the point of view of protecting competition; for some "retail" products this may have unfavourable implications for customers.

In combating collusive agreements and abuse of dominant positions, attention first focused on the standard contracts drawn up by the banking association governing the terms and conditions of bank services for customers. The association was required to eliminate clauses that set prices or limited banks' freedom to differentiate their products.

Other investigations targeted agreements on prices and market-sharing as well as exchanges of information that reduced the natural incentives for banks to operate efficiently.

Complex investigations are needed to prove collusion because the mere occurrence of parallel behaviour does not constitute evidence of collusive intent. Consideration was given to the possible impact of industry association recommendations on competition to the extent that they place constraints on intermediaries' freedom of action or coordinate their conduct. Extensive and systematic exchanges of "sensitive" information undermine competition.

The Bank of Italy has begun a programme in its branches for the systematic monitoring of potentially collusive conduct and abuses of dominant position in local markets. Direct knowledge of specific local conditions will expand our information base and enable more rapid and effective intervention in potentially competition-reducing situations which would be difficult to identify through statistical analysis alone.

The Bank of Italy is the authority responsible for safeguarding competition in the credit sector. In its decisions it takes account of the opinions rendered by the Antitrust Authority.

Relations between the two institutions, defined in an agreement of March 1996, are fruitful and continuous. They will be developed even further in order to ensure that analysis keeps step with developments in banking and finance. It could prove useful to redefine the relevant geographical and product markets in the financial sector.

The composition and features of bank products are constantly evolving, and the most innovative products are playing an increasingly important role. New distribution channels, including electronic networks, are gaining ground. Developments in finance reinforce the multiproduct nature of banking. In the fund-raising market, individual and collective portfolio management products play an increasingly complementary role to deposits.

The Bank of Italy keeps the European Commission informed of its initiatives and participates actively in the examination of cases involving banks and the discussion and drafting of reform projects presented by the Commission.

Collaboration with Community bodies will increase with the creation of a network linking the antitrust authorities of the Member States envisaged in plans for modernizing competition rules. International cooperation is essential to ensure the effectiveness of antitrust action as economic agents and markets operate in an increasingly globalized context.

3. Competitiveness, competition and growth

Since the lira's re-entry into the Exchange Rate Mechanism at the end of 1996, the competitiveness of Italian goods has decreased by 5 percentage points.

Between 1996 and 1999 Italian exports of goods and services rose by 10 per cent, world trade by 28 per cent. Imports expanded by 24 per cent, total domestic and external demand by 9 per cent. This year, the rate of export growth has risen close to that of world demand, thanks in part to the depreciation of the euro, but it is still lower than in France and Germany. Imports have accelerated under the impulse of the recovery in economic activity.

By contrast with the other leading euro-area countries, Italy's presence in high-technology sectors has declined.

At a time of far-reaching change driven by information and communication technology, the link between a new kind of international competition and innovative activity emerges ever more clearly. The ability to innovate is an increasingly important factor in the success of firms and, indirectly, countries. Price competition has gradually become limited to mature industries. Emerging sectors, the industries of tomorrow, are characterized by the continuous introduction of new products and new production technologies. With the exception of its more traditional segments, the services sector is also undergoing a radical technological transformation.

Innovative drive was the basis of the success of the US economy in the nineties. Talk of a "new economy" has become commonplace. In the second half of the decade the rate of productivity growth, measured in terms of output per employee, nearly doubled from its level in previous decades; in 1999 it reached 3 per cent. Since 1996 US GDP has increased at an annual rate of 4 per cent, a remarkably rapid pace for an advanced economy.

American firms and the US economy as a whole have benefited from the sweeping liberalization programme begun more than twenty years ago and from the resulting increase in competition in telecommunications, transport and energy. The innovations introduced in recent decades are coming to constitute a veritable technological revolution.

The observations of a prominent economist take on new relevance. As early as 1942 Schumpeter argued that growth was driven by technological progress: "The fundamental impulse that sets and keeps the capitalist engine in motion comes from the new consumers' goods, the new methods of production or transportation, the new markets, the new forms of industrial organization that capitalist enterprise creates".

Competition is a process of "creative destruction", characterized by the role of new entrepreneurs and new firms. It is an essential condition for innovation and a dynamic economy. However, innovative activity involves rising research and development costs and risky projects. It may lead to the dominance of the largest firms and the creation of barriers to entry linked to the selfsame innovations.

Since innovative capacity is the primary competitive instrument, it is necessary to create the conditions for strengthening research. Investment aimed simply at reproducing existing models serves to maintain inadequate levels of productivity and thus leads to a narrowing of the productive base and, ultimately, to a reduction in employment.

According to OECD data, Italy's propensity to invest in R&D is much lower than that of the majority of industrial countries.

The competitiveness of Italian firms depends to a significant extent on the quality and cost of services, notably those most closely linked to industrial activity, such as transport, communications, energy, water and professional services.

Energy prices for industrial users provide an indication of the importance of these factors. Owing to the average size of users, their location and the structure and regulation of the energy market, Italy is highly disadvantaged by comparison with the other European Union countries: the disparity in electricity costs is equal to 36 per cent after tax and 41 per cent before tax, while that for gas ranges from 2 to 7 per cent. The sharp rise in the price of oil will have a larger impact on Italy, owing to the larger incidence of the energy bill.

Italy has begun to liberalize its telecommunications and electricity industries. As the Antitrust Authority has noted, there is still considerable scope for further action.

Speaking in 1954 in support of a parliamentary bill on the regulation of monopolies, Luigi Einaudi, then President of the Italian Republic, argued that: "It is legitimate to be somewhat sceptical about the prospects for the success of the attempt when one considers that much of current legislation and the witting or unwitting action of government is aimed at creating conditions in which monopolies thrive".

Decades were to pass before Parliament — Guido Carli was Treasury Minister at the time — finally enacted an antitrust law. The economic and social situation is different today from that of the fifties. And yet the public administration can still play a key role by rethinking and reorganizing its functions and operations to enhance the efficiency of the economic system.

In the coming years there will be increasing competition between legal systems in the fields of civil and administrative law and justice at the European and international levels.

Countries whose legal and tax systems best meet modern industrial economies' need for flexibility will have an advantage in location decisions, the creation of firms and the growth of existing enterprises.

Company law must grant greater autonomy to corporate bylaws, introduce forms of incorporation suited to small firms and simplify procedures along the lines contained in the bill submitted by the Government to Parliament. It is equally urgent to reform bankruptcy law so that it focuses on preserving firms as going concerns.

The costs incurred in establishing a corporation in Italy, including those arising indirectly from the lengthiness of the procedures and the complexity of the regulations, are among the highest in the world.

In the nineties Italy made great strides in safeguarding competition. Public-sector enterprises were sold off in a sweeping privatization programme. The liberalization of major public utilities began in the second half of the decade.

The entire economy has benefited considerably from the greater efficiency of the banking sector. It selects investment projects and supplies entrepreneurs with the financial resources to carry them out. In a competitive environment, lower costs are passed through to households and firms. The restructuring of the sector must equip banks to face heightened international competition. Lending rates in Italy are in line with those in the other major euro-area countries. Bank profitability has increased and is nearing the level that prevails in the rest of continental Europe.

Increased competition, research and innovation are the keys to making full use of the ample resources available in Italy. It is up to firms to make the technological leap required to ensure their competitiveness in international markets, while the social partners must seek to create the flexibility demanded by the new context.

These are the factors and conditions needed to guarantee the rapid growth of the economy and employment.