# Financial Regimes and Systems Revisited: The Case of Italian Banking

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**ABSTRACT**

This paper proposes a new theoretical approach to finance and banking that aims at bridging the gap between, on the one hand, political scientists mainly interested in institutions and policies and, on the other hand, economists interested in the structure and functioning of financial systems.

For the past twenty years scholars have been trying to understand the deep changes at work in financial systems, and have been trying in particular to answer the following three core questions: (i) what are the origins of these changes? (ii) Are financial systems converging towards a single model? And (iii) what room of maneuver is left to governments? Broadly speaking, answers to these questions have fallen into two schools of thought: one which is arguing the irresistible convergence towards market-based financial systems, brought by globalization; and the other who is emphasizing the "resilience" of national financial systems, rooted in institutional and political factors.

Most neo-classical financial and banking economists, as well as some International Political Economy (IPE) scholars, argue that the trend towards market-based financial systems (in which banks would have a residual role) is irresistible[1], due to structural factors within the financial systems themselves.

As evidence of this convergence, Vitols (1997) argues that the differences between the three ideal-types of financial systems identified by Zysman (1983) - securities markets-based systems, such as in Great-Britain and the United States; bank-based systems, such as in Germany; and state-based, administered credit systems, such as in France, appear to be fading away. While administered credit systems are unraveling everywhere (Vitols, 1997), market and bank-based systems seem to be taking on similar features. In Germany, indeed, the close relationship between companies and their banks has been weakened by the increased ability and willingness of large corporations to avail themselves of the services of competing banks, especially in foreign markets (Lutz, 1998). Finally, both economic and sociological theories of organization assert that globalization is leading to a convergence towards a single model of the firm[2].

Story and Walter's book on European financial systems also cites evidence showing that the construction of an integrated financial market in Europe (a development that accompanies and reinforces the "globalization process" itself) reveals a "battle of *systems*" but conceals a strong converging trend to similar financial *regimes*[3]. Reforms of the financial system, policies regulating the banking sector, both at the national and

[1] The seminal IPE works in this sense are those of Cerny, 1989, 93 and 1997; Loriaux, 1991 and 1999; Cohen, 1993; Coleman, 1993

[2] See Fligstein, 1996, for a critical account of this literature.

[3] Here is the difference between financial system and regimes, according to Story and Walter: the financial system is the ensemble of relationships between financial institutions, whereas a financial regime is the ensemble of rules that enable these relationships to take place. "In equilibrium, the process of financial intermediation evolves within a financial system that is regulated according to a hierarchy of norms, effectively implemented" (Story & Walter, 1997, p.106). This is a tricky distinction, since even the authors exhibit some confusion in their analysis of the European situation. Subtitled "A battle of systems", their book is indeed much more focused on financial regimes…

European level show indeed a very strong tendency to converge towards a similar regime that paves the way for an integrated financial system (see the Lamfalussy report released last May for a description of the "ideal" integrated financial system according to the European "wise men"). Convergence in macro and micro-economic policy is also, as noted above, the thesis of Forsyth and Notermans in their historical account of regimes.

But why is convergence taking place? Several causal mechanisms are put forward by the literature: increased competition, impact of free capital flows, … Underlying all these explanations is the assumption that financial regulation plays a residual role and that globalization increasingly constraints policymakers and circumscribes the policy capacity of governments, leading to undermining the "structural bases of the national state" (Cerny, 1989). Through macro-economic and fiscal pressures (in particular exit threats from firms) on governments, financial markets "impose" the regulatory changes they see as most appropriate (Loriaux, 1991; Rodrik, 1997).

The second school of thought is what I call the "national capitalism" school. Indeed, it is composed of scholars who have, since the early 1980s, undertaken the study of "national capitalist systems" – i.e. national systems of production, competition and consumption. One can cite the seminal works of Michel Albert (1990), Robert Boyer and Daniel Drache (1996) Colin Crouch and Wolgang Streeck (1997) and Ronald Dore (2000). Other scholars, whom I have arbitrarily attached to this school of thought, are political scientists who have written case studies on financial and banking reforms in Europe (on Germany: Deeg, 1992 and 1999; Vitols, 1999 and Lutz, 1997; on France, Loriaux, 1991 and 1999, Schmidt, 1996 and Cerny, 1989 and 1997; on Spain, Perez, 1997). Most of them argue that national capitalisms resist uniformization and are not converging towards a single, market-based, model. In a sense, we can speak of a convergence towards… distinctiveness vis-à-vis stock-market based economies, as others point out (See, in particular, Labye and Renversez, 2000).

As evidence, these scholars point to the persistence of non-market forms of financial intermediation and of a sizeable non-profit banking sector in bank-based systems (Deeg, 1992 and Vitols, 1999 for the German case). Labye and Renversez make a more subtle point, acknowledging that "market intermediation" increases in Germany or in France, but emphasizing that this form of intermediation "cohabits" with more traditional, credit-based intermediation (Labye and Renversez, 2000).

Why is convergence towards market-based financial systems not happening, according to these scholars? Here again, several causal mechanisms are put forward. However, most scholars point to political institutions as their main intervening variable for explaining resilience.

First, some social scientists argue that states retain autonomous regulatory power, which they can use to prevent the "marketization" of their economy. This is the main argument used by IPE scholars who wrote on the transformation of French economic-policy-making in the 1980s (Hayward, 1986; Schmidt, 1989 and 1996) These scholars argued that rather than indicating a quantitative decrease of the French state influence over the economy, regulatory reforms of the 1980s showed a qualitative transformation of its modus operandi towards business and the economy as a whole. Similarly, and more recently, Sigurt Vitols has shown that there are areas, within the financial and banking sectors, where states maintain significant regulatory discretion, citing corporate governance or households savings as important examples (Vitols, 1997).

A second, and perhaps more interesting theoretically speaking, argument takes political institutions as an intervening (and not dependent) variable; national economies do not converge towards a market-based system because those groups within the economy who are most prone to suffer from deregulation and market expansion (i.e., in the case of bank-based systems, non-profit banks) are successful in pressuring the state for maintening subsidies, guarantees or other kinds of protection. This argument is based on a dual vision of the economy (sheltered versus exposed sector, non-profit banking being the protected sector), which perdures if political institutions favor the protected sector (or if, notwithstanding the particular characteristics of political institutions, the protected sector is successful in imposing its interests to the policy-makers). This is the main argument at the basis of Dani Rodrick's seminal work on globalization (Rodrick, 1997). This is also the main argument behind Sofia Perez' exploration of Spanish banking policy

in the 1980s: state elites and banking elites are entangled into a historical web of relationships which prevents banking from being de-regulated, even within the context of of macro-economic reforms (Perez, 1997). According to Deeg, state protection is the main cause behind the enduring strength of the German Landesbanken and Sparkassen (Deeg, 1992 and 1999).

Verdier makes a further step into the argument, showing that state centralization is the key intervening factor explaining the resilience of non-profit banking sector (Verdier, forthcoming). According to Verdier, there is an emerging dichotomy between the two "historical prototypes" (Germany and Great Britain), with universal and specialized banking prevailing in, respectively, decentralized and centralized countries. Verdier also advances a more "economic" argument: "The initial effect of deregulation was to release a repressed desire for diversification (…) Deregulation did not sanction universal banking, but merely reset the clock to the pre-regulatory era." So specialization/fragmentation dynamics are also at play within the banking sector, which are or not accentuated by political institutions.

A third explanation for resilience is given by economic sociologists. Neil Fligstein emphasizes the strong interaction between state and market building: "together, the existing interests served by a set of rules and the unique rules produced by modern capitalist society make national capitalisms resilient" (Fligstein, 1997, p.7) So, in a sense, the reason national capitalisms persist is the unique development of market institutions in each society, which is due to the relative power of capitalists, workers, politicians and state bureaucrats. Actors form specific institutional projects in order to form stable markets. This is, in essence, the "embeddedness" argument. As other cited authors argue, finance and banking are embedded within national systems, with their specific political, institutional, economic and social features, which prevents them from converging towards another, market-based, model (Vitols, 1997, Perez, 1997, Deeg, 1999).

These rivalling arguments, belonging to different disciplines and taking on different perspectives, do not pefectly respond to each other. This non-parallelism does not make the dialogue easy – and makes the testing of alternative hypotheses extremely difficult. The present paper proposes a new, alternative theoretical approach that aims at going beyond this opposition. Its goal is not to answer the questions addressed by the literature – about the sources and directions of change - but, rather, at changing the perspective from which these issues are approached. The basic assumption is that national configurations of banking occur at the crossroads of systemic and regime changes. The challenge is to be able to measure these various strands of change.

The main question to be addressed by the paper is, then, the following: how are financial *regimes* and *systems* interconnected? The paper answers this question by proposing a theoretical approach based on the three following hypotheses: (i) both regulatory institutions and market forces shape decisions and expectations of financial intermediaries; (ii) this interaction occurs at both macro and micro level; (iii) One can observe patterns that go beyond national single cases.

The paper builds on research on the automobile industry carried out by the Permanent Group of Research and Study on Automobile Industry and Workers, and summed up in Boyer, 1998, Freyssinet et al., 2000 and Boyer and Freyssinet, 2000. In particular, Boyer and Freyssinet link "growth modes" at a macro-level with firms' profit strategies and productive models. Growth modes are combinations of a main source of national revenue (consumption, investment, export) and of a mode of revenue distribution throughout the economy (concurrential, planned, coordinated…). These growth modes could be tied to the macroeconomic regimes identified by Forsyth and Noterman. At the micro level, on the other hand, banks adopt profit strategies which reflect both their own profit goals and the constraints and incentives generated by the growth mode. Finally, a productive model is chosen so as to fulfill the profit strategy; a 'productive model' is a "largely unintentional process of external and internal consistency of changes" (Boyer and Freyssinet, 2000). Within this theoretical framework, economic actors' behavior goes beyond market mechanisms and is circumscribed within politically-defined boundaries; and politics is more than a zero sum-game between competing actors.

The theory is applied to the Italian banking system, and its evolution over the past twenty years. The mixed methodology adopted responds to the multiple levels of causality postulated at the theoretical level. It is both hard and soft, qualitative and quantitative. More precisely, it consists of three strands of data: macro-

quantitative (data on banks balance sheets and results), macro-qualitative (data from interviews with regulators and actors of the policy-making process, document analysis), and micro (one case study).

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